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Global Tax Alert

News from Transfer Pricing

UK Tax Authority issues new guidance on transfer pricing of cash pooling arrangements

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The UK Tax Authority, HM Revenue & Customs (HMRC), has issued new guidance in its International Manual which focuses on the transfer pricing issues created by cash pooling arrangements. The guidance acknowledges that cash pooling arrangements are generally not set up for tax planning purposes but notes that they give rise to a number of "complex" transfer pricing issues. These include:

- How cash pool participants should be rewarded for deposits to the cash pool (including where these are in substance long term)
- How the cash pool participants should be charged for borrowings from the cash pool (including where these are in substance long term)
- How the cash pool header should be remunerated
- How the benefits of the pooling arrangements should be shared between the cash pool participants

The guidance notes that, due to the variety of different legal and contractual arrangements in place, each pooling arrangement should be assessed separately on the basis of a full functional and risk analysis. Adequate documentation should be provided to justify the pricing within the pool, the return to the cash pool header and the treatment of any pooling benefits.

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There are extensive references to the new Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines, including the need to consider the "substance" of the arrangements as well as their legal form and (where the cash pool header obtains a risk-based return) whether the cash pool header is adequately capitalized and has the necessary expertise to control the relevant risks. The guidance recognizes that a cash pool header can be exposed to a level of risk (including credit risk and liquidity risk) which justifies a risk-based return, as opposed to being purely a service provider, but notes that whether a risk-based return is appropriate will depend on the facts of each arrangement.

A number of areas are flagged as areas which tax authorities may consider when reviewing whether the transfer pricing arrangements within any particular cash pool are acceptable, including:

- The need for the cash pool depositors to receive a return reflecting their risks of lending to the other cash pool participants and/or the cash pool header (based on the credit ratings of the borrowing entities).
- The need to consider whether deposits and borrowings are genuinely short term or, if in essence long term, whether these are incorrectly priced. The guidance states that borrowing by a cash pool participant which is structurally long term should not be part of a cash pooling arrangement but should be treated as a long term structural loan and priced accordingly. There may also be withholding tax exposures in such cases.
- Whether the cash pool header is appropriately remunerated, including for any risks it is bearing/managing.
- Whether the benefits of the pooling arrangements are appropriately allocated, including to avoid any "unacceptable accumulations" in a cash pool header.

Tax authorities are increasingly focusing on transfer pricing considerations for all types of intra-group financial transactions. HMRC's latest guidance on cash pooling arrangements is an indication of the heightened attention being paid to such transactions. This is set to intensify with the OECD known to be working on guidance on transfer pricing of all types of financial transactions.

Businesses with cash pooling arrangements in place, as well as those considering such arrangements, should therefore ensure they have carried out an appropriate transfer pricing analysis and have detailed documentation to support their positions.

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