Decoding Transfer Pricing with GT UAE

TP considerations for Cash Pooling Arrangements

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Cash pooling arrangements are commonly employed in the UAE region, particularly among large corporate groups. Therefore, it is crucial to establish a robust transfer pricing (TP) policy and ensure thorough justification and documentation of these transactions. This strategic approach helps prevent potential challenges, audits, and litigation in the future.

With respect to cash pooling arrangements, while determining the arm's length price, Taxpayers could encounter issues which leads to complexity and uncertainty. In this article we have provided an overview of the cash pooling arrangements and key points to be taken into consideration based on the guidance provided in the UAE Transfer Pricing Guide issued by FTA in October 2023 and the OECD TP Guidelines on Financial Transactions.

What is Cash Pooling arrangement?

In accordance with the UAE TP Guidelines, cash pooling is defined as a financial management strategy employed by group of related entities of subsidiaries to enhance the group's cash flow and effectively manage liquidity across the group. This arrangement entails the aggregation of cash balances from various accounts into a central pool, usually maintained by a parent company or a designated treasury entity.

In a cash pool arrangement, there are typically two main types of participants:

Cash Pool Leader

The central entity responsible for managing the cash pool oversees daily operations, including transferring funds between accounts and managing the group's overall liquidity. This entity handles the central account and supervises cash pooling activities. The cash pool leader can be either the parent company or a designated subsidiary within the group.

Participating Members

These are the subsidiaries or business units that participate in the cash pool. They can either be depositors (entities with surplus cash) or borrowers (entities with cash deficits).

Cash pooling arrangements are complicated contracts that can involve both related party and third-party transactions (i.e., loans, availing of banking facilities, etc.). These arrangements are essential for optimizing liquidity management within a group of companies.

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The benefits of cash pools

Cash Pooling arrangement mainly can help reduce transaction costs of moving money between bank accounts and overall cost efficiencies. Furthermore, here are other material benefits of cash pooling arrangements:

1. Liquidity Management

Maintain sufficient liquidity to fulfill the group's financial commitments while reducing idle cash balances

2. Interest Optimization

By pooling cash balances, the group can lower borrowing expenses and enhance interest earnings through effective fund utilization

3. Simplification of cash management

Cash pooling streamlines cash management and cuts down on administrative tasks by centralizing balances and transactions

4. Funding and borrowing efficiency

It facilitates more efficient internal funding and borrowing, potentially lowering external borrowing costs and securing better terms with a major bank due to the group's size and significance.

5. Cash flow forecasting

Cash pooling offers a clearer and unified view of the group's cash position, supporting cash flow forecasting and financial planning

6. Risk management

Centralizing cash balances can help address liquidity challenges of individual entities and enhance overall risk management within the corporate group

7. Central visibility

For companies in the cash pool, the parent company gains full visibility of cash locations and funding needs. This is crucial during acquisitions or when integrating new entities and management teams, especially in decentralized groups

8. Foreign exchange exposures

Foreign exchange exposures can be managed collectively by netting and aggregating currencies across the group

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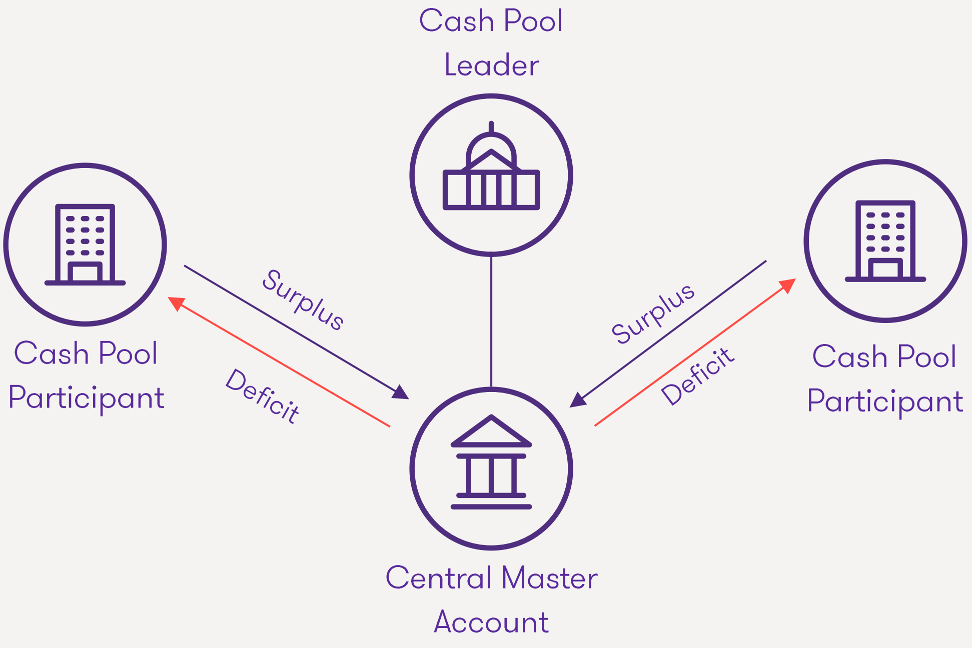
Types of Cash Pooling

There are mainly two types of Cash Pooling arrangements, as follows:

Physical Cash Pooling

In a typical physical cash pooling arrangement, the daily balances of all participating members' bank accounts are consolidated into a central account managed by the cash pool leader. If any member's account is in deficit, funds are transferred from the central account to bring it to a target balance, usually zero. After adjusting all members' accounts, the cash pool leader will either borrow from the bank to cover any net deficit or deposit any surplus funds as needed.



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Types of Cash Pooling

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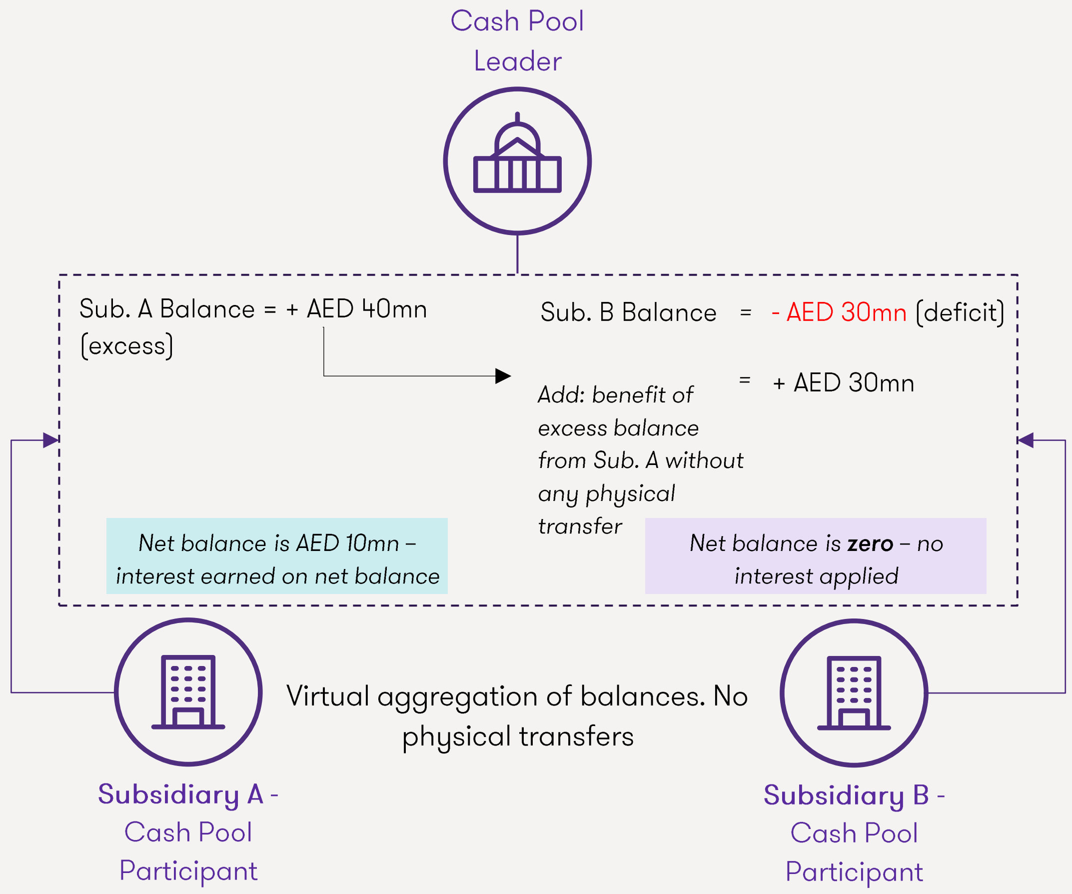
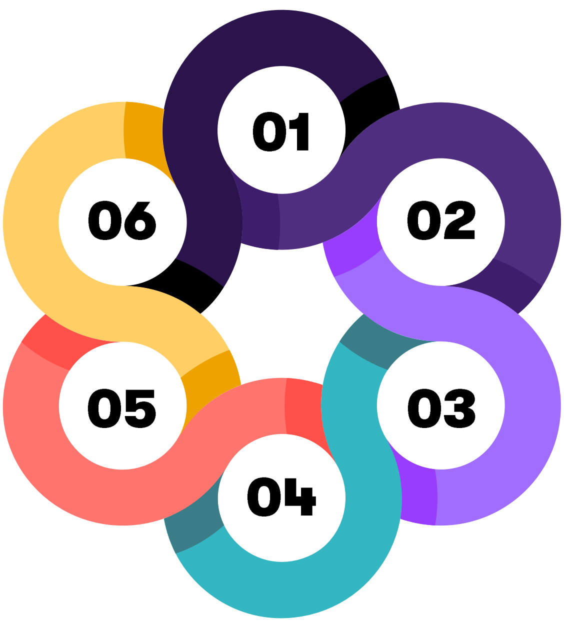
Notional Cash Pooling

A notional cash pooling arrangement is a cash management strategy where the balances of multiple bank accounts within a corporate group are aggregated virtually for interest calculation purposes, without the actual transfer of funds between accounts. Notional cash pooling arrangements are generally entered with banks by the cash pool leader with sub-accounts for cash pool participants. Illustration below:



Complexities in Adhering to the Arm's Length Principle

Determining whether the arm's length principle is followed in cash pooling arrangements is a complex task, with several factors adding to the complexity:



Multiple currencies may be used

Balances may fluctuate daily

External funding or investing surplus funds can impact the financial outcomes and risks for the cash pool leader

The cash pool leader may also engage in other activities within the pool

Calculating the return for the cash pool leader can be difficult in a treasury company with varied activities

Since money is fungible, distinguishing between "long-term" and "short-term" balances can be challenging

These complexities necessitate regular reviews of group transfer pricing policies related to cash pool operations. Therefore, a detailed analysis and proper delineation of the cash pooling arrangement adopted by a group of companies are required to comply with Transfer Pricing rules and regulations.

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Determining an Arm's Length Transfer Pricing Policy

From a transfer pricing perspective, determining an appropriate policy involves several steps:

Step 01

Accurately Delineating of Transaction

based on actual operations, a Taxpayer should identify whether they are running a cash pool, treasury company, or another business. Through "accurate delineation", transfer pricing focuses on pricing the "the real arrangement" rather than a written contract that may not reflect the true contributions. This requires a functional analysis to determine which entities perform key functions, bear the important risks and own the relevant assets relating to the inter-company transactions.

Step 02

Remuneration of the Cash Pool Leader (CPL)

When operating a cash pool, the business must determine an arm's length remuneration for the CPL. The appropriate remuneration depends on the functions performed, assets used, and risks assumed. A CPL performing only coordination or agency functions should receive limited remuneration. However, if the CPL assumes significant risks (e.g., liquidity, credit, currency, hedging risks) and has the financial capacity to bear them, the remuneration may include part or all of the spread between borrowing and lending positions.

Step 03

Allocating Benefits to Cash Pool Participants (CPPs)

The compensation for cash pool members will be determined by applying arm's length interest rates to the debit and credit positions within the pool. This determination will allocate the synergy benefits arising from the cash pool arrangement amongst the pool members and it will generally be done once the remuneration of the cash pool leader has been calculated. One key benefit for CPPs is reduced interest expense on borrowings by paying interest only on the net amount borrowed, considering deposits from other group companies. Calculating the group benefit can be complex due to fluctuating balances, different currencies, and mismatched deposits and borrowings. Sometimes, the benefit comes from accessing long-term financing not available to standalone entities. The primary goal is to ensure that all cash pool participants benefit more from the arrangement than they would without it.

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Next Steps

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- Identify whether your group has a cash pooling arrangement and the type of cash pooling arrangement occurring among group entities
- Conduct a thorough analysis of the cash pooling arrangement, identify relevant characteristics for accurate delineating of transactions
- Determining an appropriate policy by identifying the benefits for all participants of the cash pool arrangement, and arm's length remuneration for the Cash Pool Leader
- Maintain detailed TP documentation, detailed cash pooling agreement and benchmarking analysis to justify the remuneration applied and the benefits allocated as per arm's length principle.

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Contact our Transfer Pricing team

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For more details regarding this topic or other Tax issues, reach out to our team of experts on the latest Tax developments within the UAE and the Middle East region.

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