TAX RISK IN CASH POOLING AGREEMENTS IN POLISH ENTERPRISES

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Cash pooling is a service addressed to enterprise groups, which enables effective management of cash pooled on a bank account. In Poland, there is no normative definition of the cash pooling agreement, what is a source of the tax risk of qualifying such an agreement as a loan agreement. The consequence of the recognition of cash pooling as a loan agreement is an increase of the tax burden resulting from the application of the thin capitalisation rules (TCR). In 2013, such interpretation was presented by the Polish tax authorities. The aim of the article is to identify the tax risk in Poland in income tax issuing from the application of the TCR. Referring to the construction of the cash pooling agreement and the features of indirect financing and making appropriate analysis of tax law the author has shown that this interpretation is wrong.

Key words: cash pooling, enterprise groups, loan, thin capitalisation rules.
JEL codes: G32, H25.

1. Introduction

Cash pooling is a service addressed to enterprise groups enabling an effective management of cash collected on a bank account. In a simplified way one may say this is a joint account of the enterprise group, which enables compensation of transitional surplus funds of one company with deficits of another company of the same enterprise group. Despite apparent financial benefits entailed by cash pooling, this is a service encumbered by the tax risk in Poland.

The tax problems of cash pooling agreements in Poland has been analysed by many researchers. In 2004, H. Zawial-Kubiak revealed that parties and values of the transaction in the cash pooling agreements is controversial. These doubts can potentially lead to the reclassification of cash pooling agreements on multiple and multilateral loans between group of enterprises (Zawial-Kubiak, 2004). M. Zwyrtek analyzing the tax consequences of cash pooling agreement stated that it is similar to a loan agreement but does not exhaust its essential features (Zwyrtek, 2006). According to B. Orliński the negative consequences of the use of cash pooling agreement in Poland are mainly linked to the tax risk. There are no legal regulations referring to cash consolidation which is the main reason of different interpretations made by tax authorities (Orliński, 2013).
W. Naruć stated that lack of the normative definition of this service in Poland causes that Polish tax authorities determining tax effects of cash pooling for the participants (group of enterprises) arbitrarily interpret its nature (Naruć, 2013). One of such interpretations is treating the real cash pooling as a loan contract. This, in turn, causes definite implications on the grounds of thin capitalisation rules due to the fact that there are related parties within the framework of cash pooling agreement. The application of the TCR in cash pooling agreements may result in negative consequences for entrepreneurs. This could mean that the costs of interest payable resulting from cash pooling agreement cannot be treated as tax costs. This, in turn has an impact on the growth of the tax base and growth of corporate income tax.

The aim of the article is to:
- identify the tax risk in Poland in income tax issuing from the application in relation to real cash pooling agreements of the thin capitalisation rule (TCR) provisions;
- point out the arguments that thin capitalisation rules should not be applied in this case. This stems from the two aspects. First, the real cash pooling contract does not constitute all the features characteristic for loan. Second, cash flows between the agreement participants are most often exercised through an independent party which the bank is.

Conclusions of this analysis should be taken into consideration by entrepreneurs in business decisions regarding the profitability of cash pooling agreements and related tax risk. These conclusions can also be used as an effective argument in a potential dispute with the tax authority in court since individual interpretations issued by the Ministry of Finance are subject to an appeal.

The adopted in the article research method is the comparative law method and the dogmatic law method based on definite interpretation rules.

2. Methods

The research conducted by the author was based on two sources. The first one is individual tax interpretations issued by the Ministry of Finance in Poland. Thus, the Finance Minister seeks to ensure the uniform application of tax law by tax authorities. These interpretations are issued at the request of the taxpayer and published at the website of Finance Ministry. Their content should take into account the judicial decisions of the administrative courts in Poland as well as the European Court of Justice. The author made an analysis of 40 individual tax interpretations issued at the period of January 2013 March 2014. The analysis of interpretations allowed indicate the direction of the judgement of the Polish Finance Ministry and how it changed during two years.

The second sources of the research were tax regulations concerning cash pooling agreements which are: Act of 23 April 1964, Civil Code, Act of 15 February 1992 on corporate income tax, Act of 29 August 1997, Banking Law. This part of the research allow to contest the current judicial trend in individual interpretations.

The adopted in the article research method is the comparative law method and the dogmatic law method based on definite interpretation rules.
3. Literature review

Cash pooling is an effective instrument of liquidity management. Through the possibility to cover temporary cash deficits, an enterprise may maintain lower cash positions (Burżacka, 2010). Research on cash pooling allow us to conclude that it can be used not only in an enterprise but also in local government units (Galiński, 2013). An advantage of participation in the system of cash pooling is minimisation of costs of crediting entities from the enterprise group as those are actually credited with cash surpluses of other companies of the group. Cash pooling effectiveness, therefore, consists in netting interest on the basis of zero-balanced means on many different bank accounts of related enterprises (Table 1) (Sierpińska, 2007). Cash inflows occur in enterprises that are engaged in sales, while expenditures of cash are related to payments realized in manufacturing plants and in holding company, which is responsible for repayment of loans, taxes, insurance and payment of dividends (Czajkowska, 2014). Besides, the enterprise group making use of cash pooling also gains economies of scale connected with a better bargaining position towards the bank in relation to the position which has individual companies of the enterprise group. J. Grzywacz and M. Lipski pay attention that owing to use of cash pooling there take place (Grzywacz, 2008):

- reduction of the foreign exchange risk owing to statement of all liquid positions of the enterprise group in one currency what provides better information on the foreign exchange positions and the possibility to effectively target them in the scale of entire enterprise group;
- possibility to receive and present the information on bank accounts of a given unit;
- no need to make decisions concerning borrowing or placement of liquid assets.

Table 1. Interest rate effects applied to cash pooling

<table>
<thead>
<tr>
<th>Enterprise group companies</th>
<th>Bank balance (m.u.)</th>
<th>Interest rate (%)</th>
<th>Amount of interest (m.u.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No application of cash pooling</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Company A</td>
<td>1000</td>
<td>2</td>
<td>20</td>
</tr>
<tr>
<td>Company B</td>
<td>2000</td>
<td>2</td>
<td>40</td>
</tr>
<tr>
<td>Company C</td>
<td>– 500</td>
<td>5</td>
<td>– 25</td>
</tr>
<tr>
<td>Interest rate effect</td>
<td></td>
<td></td>
<td>35</td>
</tr>
<tr>
<td>Application of cash pooling</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Company A</td>
<td>1000</td>
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<td>Company B</td>
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</tr>
<tr>
<td>Company C</td>
<td>– 500</td>
<td>5</td>
<td></td>
</tr>
<tr>
<td>Interest rate effect</td>
<td>2500</td>
<td>2</td>
<td>50</td>
</tr>
</tbody>
</table>

The presented benefits issuing primarily from reduction of costs of the enterprise group operation as well as individual companies affect growth of competitive-
ness of the entities participating in the cash pooling system, what is emphasised by M. Dąbrowska (Dąbrowska, 2010). Cash pooling allows not only to obtain an optimal result on financial operations, but also helps in cash management, reporting and planning. Using cash pooling enterprises can group and plan centrally receipts that are depended on the location or type of activity as well as negotiate and establish the limits and conditions of a loan together for all enterprises (Borowiec, 2013).

In the literature and in the economic practice, there take place two basic types of cash pooling – zero-balancing cash pooling (or physical cash pooling, real cash pooling) and notional cash pooling (or virtual cash pooling) (Sierpińska, 2007; Burżacka, 2010; Kluzek, 2010). In practice, there may also take place a hybrid form of cash pooling (Sierpińska, 2007).

The zero-balancing cash pooling agreement as an actual form of intragroup financing anticipates a physical flow of cash on the master account of the enterprise group from individual accounts and then allocation of those funds between accounts of the companies requiring co-financing. Transfer of funds usually takes place at the end of the day that the amounts could return on their owners’ accounts on the next day in the morning (Fig. 1). In the economic practice, the zero-balancing cash pooling may take various forms: a balance netting system, target pooling, conditional pooling, reverse pooling or pooling in multilevel models (Szumielewicz, 2011).

In the notional cash pooling, there is no real cash flow between accounts of the enterprise group’s companies (Jensen, 2011). There is only fixed the preferential interest rate on cash shortfalls and surpluses, in result of which the entity with a balance deficit pays lower interest rates compared to the standard interest rates on credit on the current account, while the entity with a positive balance has an opportunity to gain a higher interest rate compared to the earning resulting from short-term financial investments offered in the market (Kwapień, 2011). The essential benefit of participa-
tion in the system of notional cash pooling is, therefore, optimisation of interest payments consisting in an increase of revenue on account of interest received and reduction of costs on account of interest paid.

4. Legal grounds for cash pooling contract conclusion in Poland

In Poland, we lack legal regulations which would precisely define the cash pooling agreement, setting forth, at the same time, the rights and obligations of parties thereof. Both in the Civil Code and in the Banking Law there is lack of normative definition of the institution of cash pooling. This is an innominate contract, and the basis for its conclusion is the principle of the freedom of contracts stemming from Art. 3511 of the Civil Code (Act of 1964, Art. 3511). A certain residual reference to cash pooling, but only notional, can be found in Art. 93a of the act named the Banking Law (Act of 1997, Art. 93a) where the legislator regulates the principles of setting the consolidated interest rate on the accounts kept for the companies constituting a tax group of enterprises (It is a group of enterprises taxed as one entity). In turn, there is lack in the Polish legal system whatever regulation concerning the real cash pooling. Therefore, the most often the legal basis for cash pooling used by banks is subrogation, i.e. assumption of the rights of the creditor through clearing of someone else’s debt or assignment of receivables. Due to substantial definitional differences between cash pooling and loan, consolidation agreements cannot be treated as a series of loans. The structure of cash pooling as a way of managing available funds of the participants undoubtedly includes certain elements of crediting one entity by other ones. However, it hardly can be considered that the structure of cash pooling exhausts all the elements objectively material for the loan agreement. Cash pooling is an agreement where there is lack of obligation to transfer of a definite amount of money to the entity described in the agreement. The cash pooling participant holding available funds does not know if those funds will be used, in what amount and for the benefit of which participant. Therefore, there is not specified the other party of the transaction as well as object thereof.

The structure of the very cash pooling agreement may differ depending on the enterprise group’s needs. Most frequently such an agreement assumes commission, most often, to a bank to exercise management of enterprise group’s accounts, though, in practice, a manager may be also another subject (e. g. a parent company). Besides, bank may execute other activities related to management of enterprise group’s finance; for example, monitor the demand for participant’s funds. In that agreement there are also defined the principles of total balance interest rate, the principles of distribution of interest, prospective rules for investing cash surpluses occurring for the end of the day. A cash pooling agreement is signed between the participant and the bank. From the point of view of every participant, transaction within the cash pooling are made exclusively with the pool leader (only with the use – in order to ensure economies of scale – of other participants’ funds) (Zawal-Kubiak 2004). It is so as for the benefit of the pool leader there are transferred surplus funds and interest in the
situation of financing deficits thereby. In turn, the participant executing a transfer of cash for the benefit of the pool leader is rewarded thereby in the form of interest. The participant, apart from their own transaction with the pool manager, is not aware what is the nature of financing other participants of the system – in what amount and who receives financing from the pool manager.

Summing up the presented considerations we can say that the basic features of the presented interpretation of the cash pooling agreement are (Figure 2):

- identification of only one transaction, i.e. between the participant and the pool leader;
- lack of a direct transaction between other participants of the cash pooling system;
- bank’s agency with transfers as an organiser of the entire service.

![Diagram of Bank's agency in the zero-balancing cash pooling](image)

**Fig. 2. Bank’s agency in the zero-balancing cash pooling**

In view of the lack of explicit legal regulations relating directly to cash pooling agreements, application of real cash pooling agreements is in Polish practice encumbered by a substantial tax risk of discretionary interpretation of tax effects of the concluded agreement. The tax effects of cash pooling agreements are decided by their two basic features: participation in an agreement of the related entities and the recourse nature of transfers (Szlęzak-Matuszewicz, 2013). The basic area of risk is consideration of the cash pooling agreement as a loan agreement as this may be a basis for consideration that the regulations on thin capitalisation will find their application in the case of cash pooling agreements.

The substance of solution issuing from the thin capitalisation rules, adopted by the Polish legislator, concerns injunction related to withholding tax on a part of interest on loans (credits) drawn from the directly related entities (this is a partner who holds no less than 25% of shares of the borrower, or partners holding jointly no less than 25% of that company’s shares.) or sister companies (this is a sister company providing loan if the same partner holds no less than by 25% of shares in the borrow-
er’s and lender’s capital.) in the situation when indebtedness towards certain related entities (These are partners directly related, holding at least 25% of its shares as well as partners related indirectly if they hold at least 25% of shares in those partners’ capital and the sister company if it provides a loan.) exceeds for the day of interest re-

Therefore, the fundamental issue is determination whether within the framework of agreement there takes place conclusion of a loan contract and whether within the framework of mutual transfers there appear related entities. As it was shown earlier, classification of consolidation agreements as a series of loans is not proper because there are not specified the loan’s subjective elements. However, one should remember that the Polish Corporate Income Tax Act contains its own definition of a loan created for the purpose of application of the thin capitalisation rule provisions, which is considerably broader as compared with the definition adopted in the Civil Code (Jurkiewicz, 2009). Loan for TCR purpose means every agreement where the lender is obligated to transfer to ownership of the borrower a specified amount of money, and the borrower is obligated to repay that amount of money; this loan also means issuance of debt securities, irregular deposit or interest-bearing investment (Act of 1992, Art. 16 para. 7b). Fact that definition of loan that exists in tax regulations is broader than in Civil Code has become a basis for statement by the Polish tax authorities that in relation to the cash pooling agreement there need to be determined the same effects as for loan contracts, although the position of Polish tax authorities in this matter is not uniform.

Over years, the direction of published interpretations (rulings by relevant national tax authorities) has evolved. An analysis of the contents of individual interpretations pronounced in this respect allows outlining the two trends. The first trend – favourable for taxpayers – took place till mid-2013 when tax authorities were agreeing with the taxpayers’ position considering that cash pooling did not constitute a loan within the meaning of the regulations on corporate income tax. For example, one of the tax authorities stated that “a cash pooling agreement is not a form of the traditional loan granted to one another by related entities, but has the nature of current compensation of balances by way of multilateral and multiple consolidation services of the reverse nature.” (Interpretation of 2012). This approach is also represented by some Administrative Courts in Poland. For example, in the judgement of 11 February 2014 (WSA of 2014), it was stated that cash pooling agreement should not be treated as a loan agreement because participants do not know the borrowers and the amount of a loan. Moreover, there is lack of freedom in managing the means by participants in cash pooling agreement while it is necessary in a loan agreement. Due to this fact, according to the Court, there is no basis for classifying relations between participants of cash pooling agreement as a loan which means that the interests paid by participants of the system should not be subject to thin capitalisation rule.

The second – unfavourable for taxpayers – trend, which became visible in the mid-2013, assumes that cash pooling meets the legal definition of loan provided in

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Art. 16 para. 7b of the Corporate Income Tax Act (CITA) and therefore the thin capitalisation rules should be applied here.

However, it seems that consideration of cash pooling as a loan agreement should yet not prejudge the application of thin capitalisation rules in this case as those rules are applied only when the loan is granted by an eligible entity from the enterprise group. Hence, there arises a reasonable question: Who does in cash pooling arrangements provide potential loan? Indirectly they will be companies of the agreement whose funds have been paid onto account of the pool leader who, next, transfers cash to the benefit of companies with negative balances. But the direct lender is the entity which physically transfers cash. It may be a bank or a company playing the role of pool leader. If, therefore, that entity is the related entity in the light of TCR, interest limitation may be applied. And if a lender is a bank, despite the equaling of a cash pooling service with a loan, the thin capitalisation rules shall be applied in view of lack of direct transaction between the related entities (provided that the bank is not such an entity).

Notwithstanding, it seems right to determine the tax results in relation to a direct borrower. Adoption of such a thesis underlies cost-effectiveness of indirect financing. In favour of such an approach speaks also the fact that cash pooling participants sign the agreement only with the bank, and not with individual companies participating in the system. While determining the tax results, one cannot neglect the role of bank which is, as to the principle, remunerated for the services provided. In the light of the recently pronounced tax interpretations, the role of bank is completely disregarded, and the tax effects are determined in relation to intermediate lenders. The consideration of the system members as the lender leads to a number of problems of the technical nature, as it is not possible an explicit determination whose funds served as a specific loan. Thus it is difficult to determine in practice the level of interest to be excluded from revenue earning costs.

The application of the interpretation represented by tax authorities and the use of thin capitalisation rules may be eliminated owing to the favourable structure of the provisions of Polish TCR and the nature of cash pooling agreements. One should remember that the moment of interest setting in cash pooling agreements is later related to debt repayment. In practice, even if the level of indebtedness exceeds three times of the borrower’s equity, debt repayment before the interest payment date will eliminate the need to apply the thin capitalisation rules because the interest limitation must be applied exclusively on the interest payment date (Szleżak-Matusewicz, 2013). Validity of such an optimising measure is confirmed by tax authorities in the published tax interpretations (Interpretation of 2013, 2010, 2009, 2008). Unfortunately, this measure is only effective when indebtedness results only from cash pooling agreements. If the entrepreneur is indebted in relation to the eligible shareholders for other titles than cash pooling (for instance, trade payables, loans), setting a part of interest issuing from the cash pooling agreement in tax deductible costs may be limited by the application of the thin capitalisation rules. There is also possible a reverse situation – the application of the thin capitalisation rules in case of existence of cash pooling in-
debtedness may have an negative impact on setting interest on loans for other than cash pooling titles.

5. Conclusion

1. Absence of the normative definition causes that those agreements are subject to a discriminative interpretation by tax authorities. One of them is assumption that the cash pooling agreement is in its structure approximate to the loan agreement, hence all consequences, including limitations stemming from thin capitalisation, related to a loan are also applied in case of cash pooling.

2. According to the authoress, such an approach cannot be accepted in view of the fact that the direct lender in the system of cash pooling is a bank and not another company of the system, and the agreement is signed with the bank and not with other companies.

3. Lack of understanding of the essence of cash pooling arrangements causes a number of problems of the technical nature. Even if companies wanted to apply the thin capitalisation rules, it is difficult to identify the intermediate lender and, thus, the level of indebtedness towards that entity.

4. The interpretation problems on the grounds of income taxes should be resolved by the introduction of the normative definition of cash pooling as it took place in case of leasing in Poland. Determination of the tax effects on the grounds of tax normative act would have certainly eliminated the tax risk what would undoubtedly have affected the development of this instrument of liquidity management.

References


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LĖŠŲ SUJUNGIMO SUTARČIŲ MOKESTINĖ RIZIKA LENKIJOS ĮMONĖSE

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