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Global Transfer Pricing

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Danish Tribunal Rules on Cash Pooling Arrangement

TP ALERT 2014-002
5 March 2014

The Danish National Tax Tribunal recently issued its first decision on cash pooling arrangements and transfer pricing.

The main conclusions from the decision on the current status of cash pools are:

- Deposits in a cash pool are not comparable to bank deposits, and credit risk should be taken into account in setting the arm's length interest rate;
- When no or inadequate transfer pricing documentation is provided, the tax authorities are entitled to make a discretionary assessment, which shifts the burden of proof from the tax authorities to the taxpayer;
- When a cash pool participant has both borrowings and deposits in a cash pool, the interest rate should be calculated on the net position; and
- Services rendered in connection with a cash pool arrangement should be charged as a mark-up on the interest rate rather than on a cost plus basis.

Outline of the case

The case (which remains anonymous at the tribunal level) involved a Danish subsidiary of a Canadian-based multinational company engaged in the production, development, renovation, and maintenance of trains and aircraft. The Danish subsidiary participated in an intragroup cash pool (a zero balancing cash pool, in which all surplus liquidity is physically transferred each day to the cash pool administrator's account) whereby the cash pool operator/top account holder was placed in Switzerland. The cash pooling arrangement was based on a daily overnight interbank rate plus a spread. The spread was -0.5 percent on the Danish subsidiary's deposits and +1.15 percent on loans from the cash pool administrator. All deposits and loans between the group companies and the cash pool administrator were unsecured.

The Danish subsidiary had a cash surplus because of prepayments from customers, which was deposited in the cash pool. In some periods, the Danish subsidiary had placed all its excess liquidity in the cash pool under a short-term binding deposit (up to six months); hence, on occasion the subsidiary needed to borrow from the cash pool for day-to-day cash needs.

The Danish subsidiary had not submitted any transfer pricing documentation as required under section 3B, subsection 5 of the Danish Tax Control Act. This allowed the Danish tax authorities to perform a discretionary assessment of the controlled transactions, including the cash pool transactions.

The Danish tax authorities viewed the deposit as not comparable to a deposit with a bank, because banks are highly creditworthy, whereas the financing company in Switzerland was considered less creditworthy, given that its business consisted of unsecured lending and borrowing.

The group had not prepared a separate credit rating for the cash pool administrator. Accordingly, the Danish tax authorities assessed the cash pool administrator's credit rating to be the same as the group's credit rating, which was Ba2/BB, and thereby disregarded the difference in the spreads on the deposits and loans to and from the cash pool administrator.

The Danish tax authorities took the approach of comparing the cash pool with a credit facility, and accordingly netted the deposits and borrowings by the Danish subsidiary. This resulted in a net deposit for the Danish subsidiary. Consequently, the Danish tax authorities denied deductibility for the interest paid by the Danish subsidiary for its borrowings in the cash pool. The Danish tax authorities denied that they disregarded the transactions undertaken by netting the cash pool transactions, but maintained that they were bundling transactions and adjusting the terms and prices of the existing transactions.

The Danish tax authorities calculated a spread for the deposit based on the Ba2/BB rating of the cash pool administrator. The spread was calculated based on a benchmark analysis and resulted in a spread of 118 bps. Consequently, the interest rate was adjusted to a basic rate plus the spread of 118 bps. Furthermore, the tax authorities assessed a financial service fee of 25 bps payable to the cash pool administrator for administrating the cash pool agreement. The service fee was assessed based on the gross balance of all deposits and loans.

Decision of Danish National Tax Tribunal

The Danish National Tax Tribunal upheld the tax authorities' decision, but lowered the spread from + 118 bps to + 115 bps on the loan from the cash pool.

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