Home and away, part 2

IN HIS CONCLUDING ARTICLE ON FITTING A REGIONAL TREASURY CENTRE INTO A GLOBAL STRUCTURE, **WILL SPINNEY** CONSIDERS THE PROS AND CONS OF VARIOUS LOCATIONS AND WHETHER THE CENTRE SHOULD BE RUN AS A PROFIT OR COST CENTRE.

The first part of this feature, in the summer issue of Cash Management, considered the place of regional treasury centres in the centralised and decentralised treasury models, the analysis of the business case, and staffing. Here, we look at the location aspect and sum up with a consideration of whether to operate a regional treasury as a profit or cost centre.

The box on page 20 offers a checklist of considerations to be addressed in selecting a location. Note that, depending on the country and the vehicle, the treasury centre may not be allowed to perform all of the functions discussed in the first part of this article and may be restricted to certain activities.

Many countries offer tax-advantaged vehicles for companies wishing to establish treasury centres in their region. Some of the traditional European vehicles, such as the Belgian Co-ordination Centre, are closed to new entrants, having been placed under pressure from the European Commission to harmonise regulations. With or without specialised vehicles, there are nevertheless a number of places around the world that are attractive locations for a treasury centre, meeting many, if not all, of the criteria discussed in part one of this article. The rest of this article offers a very brief summary of some of the most popular locations.

EUROPEAN LOCATIONS Even without specialised vehicles, Western Europe generally offers the business environment necessary for establishing a treasury centre. Banking facilities are advanced and there is access to some of the world's largest FX, stock and capital markets. It also has the benefit of being able to cover all three major time zones – Asia, Europe and the Americas – during working hours.

Some of the more popular European locations for treasury centres include the following:

- **Ireland** Even though the IFSC (International Financial Service Centre) is no longer open to new entrants, the Irish government has lowered the corporate tax rate to 12.5% on trading activities (the rate is 25% for passive income). Ireland also offers an extensive tax treaty network and no withholding tax on interest payments to companies resident in the EU or with which it has a tax treaty, no formal transfer pricing rules, no thin capitalisation rules and no CFC rules. One of the requirements, however, is that to substantiate the trading activity status, there needs to be substance present in Ireland in the form of employees. As a result, while Ireland has become one of the most popular locations for treasury centres in Europe, it is now an expensive choice.
- **Hungary** Among the new EU members Hungary is

emerging as a favourable location for a treasury centre. Politically stable and with dynamic economic growth, Hungary offers some of the lowest corporate income tax rates in Central Europe; currently, the statutory rate is 16%. The Hungarian government particularly encourages financing and intellectual property licensing operations through attractive tax exemptions.

■ **The Netherlands** With its well-developed banking industry and a special tax scheme for treasury and group financing activities, the Netherlands offers a favourable business environment for treasury centres. Attractions include zero outbound withholding tax on interest payments, a good tax treaty network and the opportunity to conclude an advance tax ruling/advance pricing agreement for companies with substance in the Netherlands.

■ **Switzerland** In addition to its reputation for political stability and favourable business environment, Switzerland offers a number of attractive tax regimes which reduce the already low Swiss tax burden. For properly structured entities, the Swiss finance branch structure exempts income allocated to Switzerland from taxation at the head office level and offers many other tax advantages. In order to qualify as a Swiss finance branch, however, the organisation must be largely equity-financed.

■ **The UK** While the UK offers no specific advantages for treasury centres it is one of the best locations for access to the financial markets, has one of the most extensive tax treaty networks and offers a relatively benign tax environment for non-resident companies.

ASIA PACIFIC LOCATIONS The Asia Pacific region also has a number of suitable locations for treasury centres.

■ **Mainland China** Shanghai has introduced legislation to position itself as a regional business centre. The legislation provides for the formation of a holding company (sometimes called an investment company) or a management company. A holding company (in line with China's requirements for a regional headquarters – RHQ) needs a registered capital of $30m, but a management company requires only $2m. Under the Shanghai legislation a holding/management company can provide services to the group, including:

- investment and operational strategy;
- sales and marketing services;
- financial management (within the existing framework of foreign exchange control and borrowing restrictions);
- technical support and research and development;
- information services; and
- training and management for personnel.

Companies established under the new legislation may also benefit from the preferential tax treatment available to enterprises located in Pudong. Beijing offers similar benefits to companies that wish to establish a regional headquarters in the capital.

■ **Hong Kong** Rather like London, Hong Kong provides one of the most popular locations for a regional treasury centre, with its favourable business environment and active markets, especially for managing business in mainland China. The corporate tax rate of 17.5% is among the lowest in Asia. There are no foreign exchange controls or other ancillary taxes such as capital gains taxes. Banking is advanced, offering e-banking and sophisticated cash management vehicles.

■ **Singapore** Singapore has been encouraging financial institutions undertaking high value-added back-office processing services by offering a concessionary tax rate of 5% to income derived by a qualifying processing services company (QPC). The processing services must be in support of the following financial services: treasury and securities, asset management, private banking, wholesale and retail banking. On the corporate side, the tax rate has been reduced to 20%. Singapore has become one of the most important centres for South-East Asia and many corporate regional treasuries are established there.

AMERICAS LOCATIONS North America is not known for its benign tax regimes, although its financial markets and banking centres make it attractive to certain companies as an offshore banking centre. As a result, Miami has become a primary offshore banking region for Latin America.

PROFIT CENTRE OR COST CENTRE? We have discussed many structures that can make treasury more effective and realise benefits to the group through centralisation. In all instances there are both monetary and qualitative benefits that arise from using these vehicles, and the question is to whom these "benefits" belong. Is group treasury acting as a profit centre, a cost centre or something in between?

In many cases companies elect to have the treasury act as a cost centre, undertaking activity as efficiently as possible, with the group level benefiting from the qualitative benefits such as better cash forecasting and improved risk management.

If treasury is a cost centre the objective is to minimise banking costs and fees, and to offset positions to reduce overall transaction costs for the company as a whole. This model has a higher chance of ensuring that the operating units co-operate, as treasury costs are absorbed by treasury and the units are not charged specifically for treasury services.

At the other end of the spectrum, treasury acts as a profit centre and charges the operating units directly for its services. This can encourage treasury to maximise the potential to earn profits through certain approved trading activities in addition to performing activities on behalf of the group. This has implications in terms of the skill level required at the treasury centre. There may also be resistance from the subsidiaries to relinquishing their role and control of functions taken over by treasury if they do not perceive a tangible benefit.

Many companies adopt a mid-way position, using a profit-sharing or value-added model. While treasury does not take positions in the market, it adopts a managed approach to hedging and other activity in order to add value. It may be considered to be self-funding and any benefits in excess are shared between the treasury and operating units or returned entirely to the units after costs have been covered.

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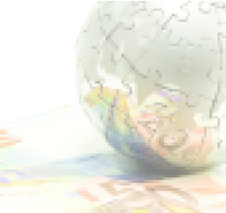
See overleaf for a treasury location centre checklist.



Treasury location centre checklist

POLITICAL AND ECONOMIC CONSIDERATIONS

- The treasury centre needs to be located in a politically stable and economically strong location, ideally with laws and special incentives for headquarters' operations and treasury centres.
- In particular, the location should be in a country where changes in government and/or regulations are not likely to occur on a frequent basis, as compliance might become expensive and quickly negate the benefits of the treasury centre.

EXCHANGE CONTROLS AND BANKING REGULATIONS

- The ideal location will have no exchange controls to prevent the free flow of funds through the centre (although there may be central bank reporting of some activities).
- Banking regulations should not be restrictive in terms of cash management vehicles that companies can use.
- There should be a healthy competitive banking environment.

STAFFING

- Good staff should be easily available, well educated, with financial and language skills.
- Some locations impose minimum staffing levels on companies and these can be onerous, particularly in countries where trained staff are scarce and salaries high.
- There can be high penalties on companies seeking to reduce staff and these aspects need to be considered for the future.
- Expatriates may be needed, and relocation and other costs should be factored in, as well as the availability of work permits.

PREMISES

- The treasury centre may look for a location where it can take advantage of some existing corporate infrastructure, in terms of premises, administration services and mainframe computer installation.

TAXATION

- The tax ramifications should be considered after decisions have been made concerning the optimal structure and needs of the group.
- The ideal tax situation would be: low local corporate taxes on profits and capital; low payroll tax rates; utilisation of any exchange losses or interest expense to be offset against profits; ability to carry forward losses to future years; no (or minimal) withholding taxes on interest, dividends and royalties; good set of double-taxation treaties with other countries where the group operates and where the treasury centre is domiciled; low or no value-added taxes (particularly on banking services); and no additional or onerous banking taxes, such as stamp taxes or levies such as lifting charges.

Note: there are always trade-offs between what is best for business and treasury, and what might be considered best from a tax perspective. However, even in the most liberal regimes, companies will have to bear some level of tax burden.

LEGAL

- There should be minimum documentation for startup and maintenance.
- Fast response times are required from authorities.
- There should be minimum annual requirements for audit, reporting, statutory filings, etc.
- Dissolution (if necessary) should be allowed at minimum cost.

TREASURY MANAGEMENT ENVIRONMENT

- Is there a well-developed banking environment with sophisticated electronic banking and cash management tools?
- Is there a stable but innovative banking system?
- Is there access to major stock markets?
- Is there a liberalised capital market?
- Is there an active foreign exchange market?
- There should be minimal differences between resident and non-resident status.

INFRASTRUCTURE

- Does it have good airport and travel facilities?
- Are there good communications systems for telephones, data transmission, fax and mail?
- Is there access to leading-edge technology and support?

OVERALL COSTS

- Some locations impose a high minimum capital requirement or staffing levels.
- There is a cost in acquiring properly trained staff and premises.
- Systems costs are sustained to ensure smooth operation.