PORTUGESE CASH POOLING

TO COMPLEMENT THE ACT'S WORK ON CROSS-BORDER EURO POOLING, THIS MONTH, **DAVID ESCRIBESE** OF FORTIS BANK SHARES HIS EXPERTISE ON DOMESTIC POOLING IN PORTUGAL. THIS ARTICLE IS ADAPTED FOR *THE TREASURER* FROM AN EXTRACT OF AN ARTICLE WHICH ORIGINALLY APPEARED IN *ASSET*, THE JOURNAL OF THE SPANISH ASSOCIATION OF CORPORATE TREASURERS. FURTHER INFORMATION ON CASH MANAGEMENT IN PORTUGAL CAN BE OBTAINED FROM *THE TREASURER'S HANDBOOK 2002*, P227-230.

For multi-nationals looking to expand their business interests into Portugal, it is often regarded as beneficial for Portuguese operations to share management structures with any presence the company may have in its nearest neighbour, Spain. Geographic proximity, cultural similarities, a common currency and the comparative cost advantages of Portugal over Spain all contribute to the case for a single Iberian business unit.

However, in terms of setting up arrangements for a shared cash management arrangement, Portuguese tax implications may oblige treasurers already familiar with the Spanish context to reconsider their approach when including Portugal in cash concentration schemes.

The most widespread cash concentration solution employed in Spain is a zero-balancing approach (see *The Treasurer's Handbook 2002*, p245). This is where credit and debit balances are physically swept from separate accounts to a single central account, leaving nil balances in all but this one account. This occurs on a regular, sometimes daily, basis, with agreed rates of interest paid to and by pool members on balances included in the pool. In Portugal, however, the treasurer is faced with two main issues in a zero-balancing solution.

PAYING THE STAMP. *Imposto do selo* is a Portuguese stamp duty that is applied to both loan balances and interest payments. In 2002, stamp duty was levied at a rate of 0.04% on loan balances over a monthly average of the amount outstanding. The rate on interest payments was 4%. Stamp duty regulations contain a table with the rates applicable to a range of other transactions.

The physical movements of cash amounts between the accounts of subsidiary companies under a zero-balancing arrangement will generate inter-company loans between the sub-account holders who are in credit and the central account holder. Inter-company lending, which replaces bank overdraft for subsidiaries with debit balances, will still represent loan balances. Therefore, the number of loan relationships within the group is proliferated and the increased inter-company loan amounts may be regarded as subject to stamp duty on loan balances.

The opposing benefit would be a saving of stamp duty on interest received on credit balances across the group (as credit balances offset borrowings), but the tax authorities may seek to challenge such savings as stamp duty avoidance. This creates considerable uncertainty, which is exacerbated by the fact that stamp duty rules in Portugal are subject to ongoing revision.

WITHHOLDING TAX. A further tax issue is that credit interest paid by one company to another within the pool or to a company by a bank is subject to a local Portuguese witholding tax. The tax is levied at 20%

PORTUGUESE PAYMENT AND CLEARING SYSTEMS – A SUMMARY

PORTUGUESE PAYMENT METHODS. Means of payment commonly used in Portugal are:

- **Cheque.** This is the most used domestic mean of payment. Other exchange instruments. Bills of exchange, promissory notes and the like.
- **Domestic electronic transfers.** Processed through different clearing systems, depending on the amounts, (over or under €100.000). It is essential to indicate the NIB (the inter-Bank account number) for the identification of the account in the banking system.
- **Direct debit.** This means of payment was implemented in 2000 but it still is not widely used and has enjoyed limited acceptance in the market.
- **International transfers.** Realised through international banks or Trans European real time gross settlement (Target) for euro transfers.
- **Multibanco.** Domestic system of cash dispensers and point of sale terminals in outlets and stores. During 2001, more than 70 million payments were processed through this system.
- **E-banking.** Almost all banks have their own solutions offered via the internet. External providers such as XRT also compete in the Portuguese market.

PORTUGUESE CLEARING SYSTEMS.
- **SPGT**. ***Sistema de Pagamento de Gandes Transacçoes***. System linked to Target. Transfers, cheques or bills of exchange over €100,000 are compulsorily cleared through this system. Currently, an average of 60,000 transactions a month is cleared through SPGT.
- **TEIs (*Transfèrencias Electrónicas Interbancárias*)**. System created for payments of less than €100,000, which processes an average of 2.2 million transactions/month. A trend of growth is detected in the last statistics.
- **Electronic settlement.** Cheques and Bills of Exchange below €100,000 are cleared through this system, with an average volume of 20 million cheques per month and 800,000 Bills of Exchange in 2001. The volume of cheques has suffered a slight downturn over the past three years.

TABLE 1
WITHHOLDING TAX RATES.

Credit interests paid by a Portuguese bank to companies resident in:	Withholding tax rate	Forms
AUSTRIA	10	Form4 RFI
BELGIUM	15	Form 4 RFI
FINLAND	15	Form 4 RFI
FRANCE	12	Form 4 RFI
GERMANY	15	Form 4 RFI
IRELAND	15	Form 4 RFI
ITALY	15	Form 4 RFI
LUXEMBOURG	20	Form 4 RFI
NETHERLANDS	20	Form 4 RFI
PORTUGAL	20	
SPAIN	15	Form 4 RFI
UNITED KINGDOM	10	Form 4 RFI

TABLE 2
EXAMPLE OF CENTRAL COLLECTION ACCOUNT.

	Subc/a1	Subc/a2	Main account
Minimum amount	+100	+10	
Target	0	5	
Balance	55	0	-10
Transaction	+5	+20	-
Balance after transaction	+60	+20	-10
Automated collection		-15	+15
Balance after automated collection	+60	5	5

for loans between two Portuguese resident companies. Again, there is a potential risk that withholding could be applied not only on interest paid by the central account to those pool members with credit (as for interest payments received by the subsidiary from a bank), but also on that paid to the central account holder by subsidiaries. Withholding tax paid by residents is available for offset against corporate tax liabilities in Portugal, but administration of this can be onerous.

Where one of the accounts included in a pool is that of a non-resident company, the rate of withholding on interest paid to that entity will be the rate determined in the applicable double taxation treaty (DTT). The rate applied to Spanish companies is 15% and for UK companies 10%. *Table 1* shows withholding tax rates on credit interest earned by businesses resident in several European countries and the documentation needed to take advantage of the of the treaty rate.

OTHER TAX DETAILS. Debit interest paid by a resident in Portugal caused by loans for commercial purposes is deductible. While there is no specific transfer pricing legislation, the Portuguese tax authorities do not allow a deduction for interest paid by related parties if it can be demonstrated that rates are excessive compared with those that would be negotiated between counter-parties at arms' length. Thin capitalisation rules also apply. Financial transactions and lending are not subject to VAT in Portugal.

OTHER OPTIONS. The lack of clarity in the taxation of zero-balancing, especially surrounding the imposition of stamp duty on loan balances, has led some companies to look at other cash management solutions.

NOTIONAL POOLING. Under this technique, all accounts involved in a pool retain their balances and a monthly interest settlement is performed, with interest applied to each account. This system creates the position whereby the bank calculates interest taking into account the net total of gross debit and gross credit balances of the group accounts. This leads to savings, as the bank takes its spread only on the net balance of the group – be it credit or debit. For the sake of transparency, the spread saved is usually divided between all participating accounts, based on revised rates of interest reflecting the group savings achieved.

In the notional pooling structure, banks may often require an adjustment to the interest rates offered to take into account the cost of regulatory capital under its solvency (capital adequacy) requirement. For notional pooling schemes, the debit balances offset attract capital requirements and as the usual spread is not earned on these balances, banks will seek to recover the funding costs of capital through overall margins on the pool. The advantages of pooling include the following:

- the issue with stamp duty on inter-company loan balances is eliminated;
- as there are no physical funds transfers, fees applied by the banks for the maintenance of the structure are generally cheaper; and
- subsidiaries' credit lines are not centralised, which offers greater autonomy to subsidiaries while allowing a group treasury to negotiate centrally with banks and obtain a single cash position.

It should be noted, however, that the argument brought forward by the tax authorities that cash concentration schemes constitute stamp duty avoidance on interest would apply equally to notional pools. The issue of withholding tax on interest payments also remains.

AUTOMATED COLLECTION. As a result of the taxation issues associated with pure cash concentration systems, companies exporting goods to Portugal may opt for a simpler solution. Exporters that have clients in Portugal can open non-resident accounts in that country and collect payments on these accounts. Collection can be effected by cheque, transfer or by bills of exchange. A lock-box system for collections by cheques can be implemented. Once collection is complete, balances can be automatically repatriated at regular intervals to a central account in Spain or elsewhere and the account in Portugal periodically zero-balanced. With an electronic banking tool, exporters can also control the amount, source and reference of payments from the account.

This type of system offers cost reductions and procedural automation for exporters to Portugal while, for Portuguese customers, it can reduce procurement costs by eliminating international transfers. This can be important for cementing relationships with overseas suppliers. *Table 2* shows an example of how the system might work.

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