Real tax compliance provisions for (notional) cash pooling

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Background

Cash pooling arrangements are used by multinational organizations to centralize their cash management. The purpose is for an entity with surplus cash to allow affiliated entities in another jurisdiction to access that cash on a cost-efficient basis. While cash pooling arrangements can take a variety of forms, they are primarily split between:

- physical cash pooling arrangements; and
- notional cash pooling arrangements.

Physical cash pooling involves actual transfers of the excess cash from each individual entity's bank accounts to a centralized account that is under control of a "financing" affiliate. The cash is then redeployed to the different entities within the group as needed. The transfers of cash in both directions are typically structured as intercompany loans.

Notional cash pooling avoids the need for actual transfers and intercompany loans by using an arm's length bank to track the credit and debit balances of the participating entities. Typically, each participant with a positive account balance earns deposit interest from the arm's length bank and participants with negative account balances incur overdraft interest. The group companies that are in an overdraft position would benefit from a more favourable overdraft charge imposed under the notional cash pooling arrangement than if each company had borrowed monies directly from the arm's length bank.

The Canada Revenue Agency at both the 2024 and the 2025 International Fiscal Association Canadian Tax Conferences provided updated compliance guidance on the provision of notional cash pooling arrangements.

a. Requirement for interest income to be accrued by Canadian depositor

If a Canadian-resident corporation is in a net deposit position (*i.e.*, it contributes cash) to the arm's length bank, then the Canada Revenue Agency confirmed that the anti-avoidance tax provisions that pertain to a "back-to-back" loan could apply in such

circumstance. Under the back-to-back loan provisions, the Canadian depositor could be considered to have made a direct loan to the affiliated entities that have borrowed cash from the bank.

In order for the Canadian depositor to avoid adverse tax exposure under the back-to-back loan rules, one of three provisions must apply: (a) the cash deposit by the Canadian depositor corporation must be repaid within one year after the end of the tax year in which the deposit into the cash pool was first made by the Canadian depositor and that repayment must not be characterized as part of a series of loans and repayments; (b) the Canadian depositor corporation remits Canadian withholding tax on the amount of the deposit, and that withholding tax would be at the same rate that applies to a dividend distribution; or (c) the Canadian corporation makes a "pertinent loan or indebtedness" (PLOI) tax election, and the Canadian corporation then accrues interest revenue at the prescribed rate.

Issues:

i. Do the cash pooling arrangements qualify as a series of loans and repayments?

The deposits and withdrawals of the Canadian corporation would need to be fully analyzed to determine if such deposits by the Canadian corporation would be considered to have been completely repaid by the financing bank, or whether there is simply an ongoing stream of monies into and out of the cash pool account held on behalf of the Canadian depositor corporation. The Canada Revenue Agency has suggested that automatic cash sweeps managed for a cash pooling arrangement could be part of a series of loans and repayments.

ii. How to calculate the withholding tax amount required to be paid

If the cash is not repatriated by the Canadian depositor corporation within the requisite safe harbour period, the deposit is deemed under the *Income Tax Act* to be characterized as a dividend paid to the affiliated group company that has recorded an overdraft from the financing bank. The dividend would be subject to Canadian withholding tax and this tax would be refunded once the Canadian corporation is no longer a depositor in the cash pool. The key consideration is to determine the specific rate of Canadian withholding tax that should be applied on this deemed dividend. The default position would be a 25 per cent withholding tax rate on the deposit, since this 25 per cent rate is the statutory maximum under the *Income Tax Act*. Alternatively, an attempt could be undertaken to trace the deposits advanced by the Canadian company to the particular overdraft balance of affiliated companies, such that a treaty withholding tax rate of less than 25 per cent could rationally be applied to the various deposits into the cash pool by the Canadian depositor corporation. However, it may be a challenge to properly complete the tracing exercise.

iii. Does PLOI election simplify tax compliance

A PLOI election would permit the Canadian depositor corporation to elect to receive interest on the deposit at the greater of either the prescribed rate imposed under the *Income Tax Act* and the actual interest received by the Canadian corporation from the financing bank. Currently the prescribed interest rate for the

Q3 of 2025 is 6.62 per cent. The PLOI exception requires the taxpayer and its non-resident parent corporation to file a joint election form.

A notional cash pooling arrangement would typically involve a larger number of participants and a high volume of fluctuations in the accounts, possibly resulting in many transactions that would need to be identified on the PLOI election form. The Canada Revenue Agency has indicated that it will develop a simplified PLOI election form, but that form has not yet been released.

b. Reporting requirements by Canadian debtor in notional cash pool

If the Canadian corporation becomes a debtor (i.e., it is in an overdraft position) in the cash pooling arrangement, then it may be necessary for the Canadian corporation to file an RC312 Tax Information Return on the basis that the arrangement is characterized as a "notifiable transaction". Conversely, if the Canadian corporation is only a depositor into the cash pool and it is reasonably expected to remain a depositor, then the cash pooling arrangement would not be a notifiable transaction.

Issues:

i. Evaluate compliance requirements for a notifiable transaction

The Canadian debtor corporation must evaluate whether it is definitively required to file the RC312 Information Return with the Canada Revenue Agency. In particular, the cash pooling arrangement could be considered a notifiable transaction where the Canadian debtor company is expected to report its tax position under one of these three situations: that the debt amount owing by the Canadian company is not subject to the thin capitalization calculation imposed on the Canadian debtor corporation; that the interest on that debt is not subject to withholding tax (*i.e*., on the basis that there should be no Canadian withholding tax imposed on interest paid on the advance); or that the Canadian withholding tax rate attributable to the debt balance with the financing intermediary is lower than the rate that would apply if amounts were directly loaned by an affiliated group company to the Canadian debtor.

ii. Evaluate applicable rate of Canadian withholding tax

The final issue to consider is that, even where the Canadian corporation is not intending to participate in a cash pooling arrangement to obtain a lower withholding tax rate, it is not always clear what the proper Canadian withholding tax rate should be. For example, in a notional cash pooling arrangement where the Canadian entity is one of several debtors, there may be entities in multiple other jurisdictions with different withholding tax rates that would be imposed on the interest attributable to a creditor position. It is not clear which non-resident entity or entities would be considered the creditor of the Canadian entity and what proportion of the debt is attributable to each creditor. While an election can be filed by the Canadian depositor corporation under the so-called "back-to-back" loan rules to designating one of the group companies as the recipient of the interest payments made by the Canadian entity, the designated entity must be the entity with highest applicable withholding tax rate that would apply if interest payments were to be paid to it by the Canadian entity.

Key takeaways

Cash pooling arrangements are a common way to reduce financing costs. However, managing the tax issues is critical. Businesses with Canadian participants engaging in a notional cash pooling arrangement must consider the following issues.

1. If the Canadian Company is a depositor into the cash pooling arrangement:

- Can the Company mitigate the application of the “back-to-back” loan rules?
- Is a PLOI election advisable?
- Which withholding tax rate (or rates) apply?

2. If the Canadian company is a net borrower under the cash pooling arrangement:

- Does the arrangement constitute a notifiable transaction?
- What documentation is required to support the arrangement?
- Which withholding tax rate (or rates) apply?

In all cases, the notional cash pooling arrangement will need to be monitored on an ongoing basis to ensure compliance with the respective Canadian tax provisions and reporting.

We have experience in advising on the Canadian tax requirements for cash pooling financing structures. Contact us for help in managing your tax needs.

By

Daniel Lang

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Tax, Business Tax

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BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749