Financial Flows and Treasury Management Firms

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- What is a Treasury Management Firm?
- They are central to the organisation of global financial flows within an MNC.
- Because of recent judgements by the European court of Justice relating to two Treasury Management Firms operating at the IFSC in Ireland, the nature of such firms have become central to the legally recognised location of a firm within the EU
- They have become central to issues relating to tax competition between different member States.
- Such issues are of great interest to non EU countries because of their implications for the use of tax havens and international tax competition.

- The development and location of treasury management firms is a function of different tax rates and tax systems and recognition that low tax rates are compatible with EU and other treaties.
- A recent opinion issued by the European Court of Justice (ECJ) in a case involving the taxation of profits under UK anti avoidance legislation (C F C) of two Cadbury Schweppes treasury management subsidiaries operating in the IFSC in Dublin, concluded that:-
- "as long as there is genuine and actual pursuit of an activity by the controlled subsidiary in the Member State in which it was established, the reason for which the parent company decided to establish the subsidiary in that host State cannot call into question the rights which that company derives from the Treaty" (par. 49), and

- "the fact that Cadbury decided to establish its subsidiaries in Ireland solely so that those subsidiaries are subject to the very favourable tax regime applicable in the International Financial Services Centre does not, in itself, constitute an abuse of the right of establishment" (par. 50).
- The opinion also states that while it may be "regrettable that [tax] competition operates between the member states in this field without restriction. This is, however, a political matter" (par 55).
- Thus a key requirement for the successful use of low tax regimes would appear to be a "genuine and actual pursuit of an activity" and the question arises what constitutes 'genuine activity'.

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- The Irish Government supported Cadbury-Schweppes
- The UK Government was supported by the Danish, German, French, Portuguese, Finish, and Swedish governments (par. 68).
- While a majority of EU states are also in favour of harmonising the corporate tax base (Commission, 2006) Ireland is opposed to such moves

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- The rest of this paper is organised as follows:-
- Consideration of what “genuine and actual pursuit of an activity” means.
- An examination of operational characteristics and financial flows of 41 Treasury management firms operating at the IFSC in Ireland using panel type data

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- The answer to the first issue revolves around the question of what activities or characteristics are required by a firm to determine the location of the true residence or what is the centre of main interest?
- In a second important ECJ ruling relating to another IFSC based firm, Eurofood, it was decided that that the place of incorporation was the centre of main interest, provided some “business in the territory of the member state where its registered office is situated”

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- Note:
- Eurofood had no fixed assets
- No employees. Although pre-tax profits amounted to $48 million in the period 1997-2002
- Net assets are shown as £198 million net, but $80 million was held in a bank of America account in the UK
- The firms solicitors was the location of the registered office.
- The Bank of America managed daily operations in accordance with the terms of an administration agreement
- One director was an employee of the Bank of America, another a solicitor employed by the firm of solicitors used by the firm, two directors were employees of the parent company, Parmalat
- Directors were not paid by Eurofood for their services
- Of 14 meetings of the Board in total not all meetings were held in Ireland, Board members did not attend all meetings, and where they did attend, this was on some occasions ‘by phone’.
- For the last two meetings the two Italian directors could not be present as they were in custody

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- Eurofood had in effect many of the features of a ‘letterbox’ company.
- Although the ECJ did rule that the country of registration could not be the centre of main interest in the case of a ‘letterbox’ company not carrying out any business in the territory of the Member State in which its registered office is situated” it did not consider that the minimal presence of Eurofood in Ireland warranted the classification of ‘letterbox’ company.

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- The rest of this paper examines the operating and financial flows of other Treasury management firms

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- Table (1)
- Some Features of Treasury management firms

Total size of sample	41
Auditor is one of the big four	40
Auditor is PWC	17
Solicitors office is Registered office	8
Books are kept at bank	15
Books and registered office is a bank	12
Year established > 1995	24
Incorporated as a limited company in Ireland	32
No Employees	24

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Table (2)
Employees, Profits and revenues of Treasury Management Firms
$ million[1]

Year	Revenues	Pre-tax Profits	Pre-tax Profits[2]	Pre-tax Profits/ Revenues[2]	Pre-tax Profits/ Revenues[3] (Median %)	Total Employed	Employees per firm[3] (median)	Tax Rate[2] (median %)
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
1998 (22)	1174.230	511.939	513.582	43.4	0.89	65	1	10
1999 (31)	1469.399	657.546	657.829	44.8	0.89	86	0	9
2000 (36)	1523.398	-4891.453	634.130	41.6	0.85	121	0	8
2001 (38)	1224.060	-2778.408	446.277	36.4	0.52	161	0	13
2002 (38)	1068.750	387.806	501.245	46.9	0.74	156	0	17
2003 (25)	631.190	430.167	543.257	86.0	0.81	88	0	17

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Table (3)
Assets of Treasury Management Firms
$ million[1]

Year	Gross Assets[2]	Gross Assets Median values	Intra group assets[3]	Intra group Median values	Cash	Cash Median values	Bank Borrowing	Bank Borrowing Median values
1998 (21)	24407.307	531.943	16597.706 52%	428.123	972.560 3.1%	5.044	1.277	0
1999 (31)	37186.692	452.268	17,750,542 51%	326.237	656.638 1.8%	0. 877	2.305	0
2000 (36)	38088.788	385.656	21362.298 56%	202.944	964.485 2.5%	0.614	3.981	0
2001 (38)	24228.301	376.212	17453.952 72%	173.482	375.820 1.5%	0. 114	8.699	0
2002 (38)	24490.215	344.506	17118.943 70%	167.160	463.656 1.9%	0. 357	16.614	0
2003 (24)	16187.772	340.264	12270.141 76%	185.817	1597.669 9.9%	0.692	35.222	0

Notes
1. Calculated for those firms for which all the variables shown in Table (3) were present
2. Defined as fixed plus current assets
3. Intra group debtors

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Table (4)
Average Ratios Treating each Firm as a Separate Observation

Year	Intra-Group debt/Gross Assets		Intra-Group assets/Gross Assets		Cash/Gross assets	
	Mean	Median	Mean	Median	Mean	Median
1998 (20)	0.31	0.21	0.70	0.79	0.06	0.002
1999 (31)	0.33	0.001	0.74	0.92	0.03	0.003
2000 (36)	0.29	0.03	0.69	0.93	0.03	0.002
2001 (38)	0.30	0.002	0.75	0.96	0.02	0.004
2002 (38)	0.28	0.05	0.72	0.96	0.07	0.002
2003 (23)	0.26	0.08	0.71	0.89	0.13	0.006

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Table (5)
Total Intra-group flows $ million

Year	N (1)	Dividend Payments (2)	New Capital subscribed (3)	Change in Intra Group assets[1] (4)	Change in Intra-Group Liabilities[2] (5)	Change in net intra-group balances[3] (6)
1998	21	1188.375	2567.903			
1999	29	6749.985	10475.403	-696.732	2043,887	-1214.216
2000	35	1486.472	1373.148	2190.777	4763.376	-2572.599
2001	38	269.292	-1120.156	-2159.665	-3526.593	1366.937
2002	38	919.660	-1137.162	174.275	1376.297	-1202.022
2003	25	95.832	1458.811	476.254	10.363	465.891

(1). A fall in intra group assets or liabilities is shown with a negative sign.
(2). A fall in intra group assets or liabilities is shown with a negative sign.

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- Dividend payments in any given year were not correlated with pre-tax profits for the same year (Pearson product moment correlation of 0.21).
- But there was a strong correlation between capital inflows and dividend payments within the same financial year (Pearson correlation = 0.865).
- A simple linear regression of the form Div = f(capital flows) was statistically significant with an adjusted R2 of .747, but no statistically significant relationship was found if the relationship Div = f(pre tax profits) was estimated.
- This is explained by the large capital inflows and subsequent outflows by the Tyco subsidiary (Brangate). Omitting these flows from the Tyco subsidiary (Brangate) resulted in no lower correlation between capital subscribed and dividends.

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Table (6)
Some Comparisons with aggregate figures (Euro billion)

	Aggregate assets	% accounted for by firms in the study	Aggregate dividends	% accounted for by firms in the study
1998	228.735	12.5	8.310	16.7
1999	355.567	10.5	9.196	73.7
2000	472.278	7.5	11.736	12.7
2001	616.338	3.9	15.037	1.8
2002	676.623	3.6	15.156	6.0
2003	801.000	2.0	13.238	0.7
2004	930.654		21.738	

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- Table (6) shows that companies in the study accounted for a small per cent of total assets, but a larger per cent of total dividend payments for some years.
- Firms in the study appeared to account for 73% of aggregate dividends paid outside Ireland for 1999 due to dividends payments by Brangate (Tyco subsidiary)
- If treated as a ‘dividend’ GDP would be reduced by approximately 8% for 1999. The overall balance of payments would not be affected as the dividend was financed by an inflow which would be reflected in the capital account.

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- In summary
- Although a common feature of MNCs, discussion of treasury management subsidiaries is omitted from management literature dealing with MNC organisational structure.
- Two recent European Court of Justice cases dealing with Treasury Management companies located at the IFSC in Dublin are significant in terms of providing a legal basis for the operation of companies with little operational substance in low tax rate regimes.
- Study found financial flows to be large, and are highly variable from period to period.
- While these firms are profitable they mostly have zero employees.
- The continued existence of such companies is opposed by many EU and non EU countries as being at variance with legislation to counteract tax avoidance. More generally low tax centres such as the IFSC in Dublin are incompatible with moves towards a harmonised corporate tax base within the EU.