International TaxWatch

EUROPE

THE AGN SURVEY OF HOLDING COMPANY JURISDICTIONS FOR 2003

AGN International is an association of separate and independent accounting and consulting firms represented in 80 countries in the world with 500 office locations and 10,000 partners and staff.

Each year the European Tax Task Force of AGN International carry out a survey of holding company jurisdictions in the European Region. The objective of the survey is to compare and contrast the conditions for the exemption of dividends and capital gains in the various holding company jurisdictions and to try and identify the most useful and flexible jurisdiction to place a holding company. The jurisdictions chosen were Austria, Belgium, Cyprus, Denmark, Germany, Luxembourg, Malta, Netherlands, Spain, Switzerland and United Kingdom.

Dividends

Percentage exempt: Most jurisdictions chosen apply a dividend exemption system. Belgium and Germany (only for dividends of foreign subsidiary) deduct 95% of the dividend income from taxable profit. The UK taxes dividends at 30% but gives a tax credit for the underlying corporate and withholding taxes paid by all subsidiaries and sub-subsidiaries in the group. Malta taxes the dividend income at 35% but reimburses the tax paid to non-resident shareholders of the Maltese company.

Participation: The holding company generally needs to hold at least 10% of its subsidiary or the investment needs to amount to a certain significant monetary amount for the exemption to apply. Austria and Denmark require a 25% participation, Switzerland 20%, Netherlands and Spain 5% and Cyprus and Germany where owning one share would suffice.

Period: Most jurisdictions require the investment to have been held for at least 12 months except Austria that requires 24 months. Cyprus, Germany, Malta, Netherlands and UK do not require any minimum period at all. However, the Netherlands does not grant the exemption to portfolio investments i.e. investments held for resale. Investments bought and sold within a short space of time are considered portfolio investments in the Netherlands.

Application of Participation Exemption: Belgium, Germany, Luxembourg, Spain and Switzerland allow the participation exemption on dividends received by branches, partnerships and permanent establishments from EU- and Double-Tax-Treaty countries.

Capital Gains

Capital gains resulting from the sale of shares in qualifying subsidiaries are not taxed in all countries if the shareholders fulfil the minimum holding period and the minimum holding percentage. The only exception is Malta where the gain is taxed at 35% but the tax is reimbursed to non-resident shareholders. Belgium and Germany exempt capital gains on shares if the dividend exemption applied. In general, the shareholder needs to hold his participation for a minimum 12 months. However Denmark requires 36 months and Austria 24 months. Netherlands and Spain require a minimum participation of only 5% and Austria 25%

Other Tests on Subsidiaries

To grant the participation exemption on dividends and capital gains countries tax authorities also look at whether the subsidiary is a trading company with active income or only a financial company with passive income. Belgium, Cyprus, Denmark and Spain do not grant the exemption to companies whose income is mainly passive. The others also exempt dividends and capital gains of mainly passive income subsidiaries. Belgium, Cyprus, Luxembourg, Netherlands also look to see if the subsidiary is subject to tax of more than 15% in its jurisdiction, Spain requires a tax rate of more than 35% and no tax is paid in the UK if the underlying subsidiaries have already paid more than 30% corporate tax.

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Interest Expense Deduction and Other Deductions

Interest expense deduction: Austria, Cyprus, Malta, Netherlands, Switzerland and the UK allow an interest expense deduction without any limit. In the other jurisdictions the deduction of interest is restricted by a debt-equity-ratio. The debt-equity ratio in Germany and Spain is 3:1, Denmark 4:1, Luxembourg 6:1 and Belgium 7:1. Spain and Belgium levy a withholding tax on interest of 15% and the UK 20%.

Other deductions: Furthermore, write-down to fair value of a participation and the amortization of goodwill are not possible in every country. Belgium, Cyprus, Denmark, Germany and UK do not allow a write-off of investment costs or goodwill. In the UK, this strict exclusion has been abolished for companies bought before April 1, 2002. Luxembourg, Netherlands, Spain and Switzerland allow the write-down to fair value of participation as well as the amortization of goodwill over periods of 5 to 20 years.

Company, Shareholder and Directors

In all of the countries the company types differ as well as the minimum investments by the shareholders and the time it takes to create the company. To create a company in Cyprus takes 3 days and in the UK it takes 1 day. In Cyprus, Malta, Spain and the UK the minimum capital required to create a company is very low compared to other jurisdictions. In the most countries you can create a company that requires only one shareholder and one director (individual or company) for establishment. Only Switzerland requires the majority of the board to be Swiss. However for tax purposes it is always advisable to have the majority of the board resident in the country of registration of the company.

Local Taxation, Dividend Withhold Tax and Disclosure

Capital Contribution Tax: In addition to the corporate income tax Austria, Belgium, Luxembourg, Netherlands, Spain and Switzerland levy a capital duty of between 0,5%-1%.

Corporate Tax: The actual corporate income tax rates of the chosen jurisdictions (except Cyprus) range between 25% for Switzerland and 35% for Malta. In Cyprus corporate tax is just 10%.

Dividends Withholding Tax: In most of the jurisdictions a withholding tax on dividends is levied in addition to the corporate income tax. The rate for this withholding tax depends on the domicile of the dividend recipient. If this domicile is located in an off-shore country, the participation should be placed in a Cyprus, Malta or UK company as they do not levy a withholding tax. Denmark has a withholding tax rate of 28% and Switzerland of 35%. If the shareholder is located in a DTT-country, the normal withholding tax would be between 5-15%.

Parent-Subsidiary Directive: Nearly all EU countries apply the 25% holding for 12 months rule to grant the 0% withholding on dividends paid. Luxembourg, Netherlands and UK have reduced the holding percentage and UK has removed the holding period requirement completely. Only Austria insists on a holding period of 12 months.

Disclosure: All countries except of Belgium, Cyprus and Denmark require publication on who holds the shares of a domestic company. In Germany and Austria this information must be supplied to the tax authorities and in all other countries it has to be transmitted to the banks to identify the beneficial owner. Beyond this, these jurisdictions require filing of statutes and financial statements each year. Banking secrecy is guaranteed in all countries except of Denmark and Spain.

Conclusion

Obviously, in choosing the most appropriate holding company jurisdiction you must have regard to your own particular domestic tax laws and commercial considerations. From a European tax point of view and particularly with regard to a low tax burden and a short-term realization of dividends from a holding company a non-resident taxpayer should have a holding company in Malta. Irrespective of the foreign domicile of the subsidiary (affiliate company) of a Maltese company there is a tax burden of 0% for non-resident taxpayers due to the fact that foreign shareholders receive a refund of the Maltese corporate tax charged. Furthermore, for dividends and capital gains the tax exemption will be granted even if the subsidiary has 100% passive income.

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The UK also does not have a passive income test but dividends are taxed at 30% corporate tax and a tax credit is given for underlying taxes paid by the subsidiaries. If the subsidiary pays no tax the UK will collect up to 30% tax on this income.

Cyprus can be recommended from the tax point of view. Here, only 10% corporate income tax has to be paid and no dividends withholding tax is applied. Nevertheless Cyprus requires at least a partially active activity as the tax exemption will not be granted for dividends and capital gains on companies that have passive income of more than 50%.

UNITED STATES

MAJOR DEVELOPMENT STORY

The central theme of the U.S. Jobs and Growth Tax Relief Reconciliation Act of 2003 ("new tax law") is the reduction in the maximum dividend tax rate on individuals from 38.6% to 15%, effective for qualified dividends paid or accrued after 2002 and before 2009. Though the rate reduction is temporary, the U.S. Congress may be pressured to make this law permanent if the U.S. deficit is brought under control by 2008. In contrast to the lower tax rate on qualified dividend income, interest income and non-qualified dividend income are taxed at a maximum tax rate of 35%.

Under the new tax law, U.S. individual taxpayers that invest along-side non-U.S. taxpayers in new or existing foreign corporate ventures either directly or indirectly (i.e., through a U.S. partnership or other pass-through entity) may prefer to structure their foreign investment to allow for repatriations of "qualified dividends". This new preference for "dividends" characterization is present when a U.S. individual investor neither prefers interest income (taxed at a higher rate of 35%) nor capital gain income (long-term capital gain income is taxed at 15%, the rate applicable to qualified dividends) if he or she has no capital losses with which to offset capital gain income.

According to the new tax law, "qualified dividends" means dividends received from a U.S. corporation or from a "qualified foreign corporation", which includes any foreign corporation that is either 1) incorporated in a possession of the U.S. (i.e., Guam, American Samoa, Northern Mariana Islands, Virgin Islands, and Puerto Rico), or 2) is eligible for benefits of a comprehensive income tax treaty with the U.S. which includes an exchange of information agreement. In a recently published notice, the U.S. ruled that all of its existing treaties with the exception of four (Barbados, Bermuda, The Netherlands Antilles, and the U.S.S.R.) are comprehensive income tax treaties that include exchange of information agreements. To be eligible for the benefits of a comprehensive income tax treaty, a foreign corporation must be considered a qualifying resident and satisfy the limitation of benefit (LOB) article of the relevant treaty.

Certain foreign corporations can never be a "qualified foreign corporation" including a Foreign Personal Holding Company (FPHC), a Passive Foreign Investment Company (PFIC), and a Foreign Investment Company (FIC) (these U.S.-designated entities are not discussed in this article).

A foreign corporation that is not considered a "qualified foreign corporation" because it is not eligible for the benefits of a "comprehensive income tax treaty" (e.g., it is incorporated in Cayman Island, Bermuda, Barbados, or other low-tax jurisdiction or it fails the LOB of a U.S. treaty) is nevertheless treated as "qualified foreign corporation" if its dividend-paying shares are readily tradable on an established securities market in the U.S. In a recent published notice, the U.S. ruled that company shares are considered readily tradable if 1) they are listed on a national exchange registered under §6 of Securities Exchange Act of 1934, which includes the NYSE, the American Stock Exchange, the Boston Stock Exchange, the Chicago Stock Exchange, the Pacific Exchange, the Philadelphia Stock Exchange, and the Cincinnati Stock Exchange, or 2) it is traded on the Nasdaq Stock Market. For example, Tyco International is a U.S. multinational that has undergone an inversion transaction by which it migrated its legal domicile from the U.S. to Bermuda. Because its shares are readily tradable on the NYSE it is considered a qualified foreign corporation, entitling its U.S.

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shareholders for the 15% tax rate on dividends paid by Tyco. This new preference for qualified divided income can introduce structuring conflicts between U.S. investors and non-U.S. investors when structuring new offshore investments. For example, if a U.S. and an Australian individual investor own a valuable intangible that is licensed to several jurisdictions having no (or reduced) royalty withholding tax, the Australian investor may prefer to set up an active intangible holding company in Bermuda to benefit from Bermuda's favourable tax regime assuming he or she would ultimately repatriate corporate earnings to Australia and would suffer no Australian CFC consequences if corporate earnings accumulate in Bermuda before being paid as dividends.

In contrast to the Australian investor's Bermuda preference, the U.S. investor's preference would be to set up an intangible holding company in a jurisdiction that would result in having shares of a qualified foreign corporation (assuming the company's income would not be passive income of a CFC, FPHC, or PFIC under U.S. rules). One such jurisdiction, for example, is Ireland whose corporate tax rate of 12.5% applies to trading income of a corporation. Even after the payment of Irish corporate tax of 12.5%, the U.S. investor is still better of by a 7.5% spread if the Irish Intangible holding company is considered a qualified foreign corporation since its dividends would be taxed at 15% instead of 35%, the rate of tax that would apply to dividends paid by a Bermuda company (35% - 15% - 12.5% = 7.5%).

In summary, U.S. individuals now have a new potential "divided income" characterization preference when structuring their cross-border investments. Whether this potential characterization preference would alter investment decisions and structuring depends on the individual's particular tax situation and ability to influence non-U.S. investors in structuring the offshore investment to allow for repatriations of "qualified dividends". Moreover, the use of hybrids that produce debt characterization in a foreign jurisdiction but equity characterization in the U.S. may become more common in cross-border structuring involving U.S. individual investors.

GERMANY

REFORM OF THE SHAREHOLDER-DEBT-FINANCING RULES

On December 12, 2002, the European Court of Justice (ECJ) held that the German rules on thin capitalisation as laid down in sec. 8a German Corporate Tax Act were not in line with the European law. In the specific case, a German subsidiary of a Dutch shareholder was not allowed to deduct interest on shareholder loans beyond the then applicable safe-haven (now: 1.5:1). Rather, the interest payments in excess were treated as a constructive dividend, whereas in case of a German resident shareholder, the full interest deduction would have been granted.

According to the ECJ, the restrictions imposed on all foreign shareholders lead to a substantial disadvantage for non-German European shareholders. Therefore, the concept of free movement of capital throughout the European Union was violated.

As a consequence, sec. 8a German Corporate Tax Act is not enforced any more in relation to European shareholders. Thus, for European shareholders, currently no safe haven applies at all, allowing for a full deduction of interest on all shareholder loans.

In order to close this gap in the system, a new bill is in the process of being enacted. It is scheduled to enter into force with effect as of January 1, 2004, and provides for the following key rules:

The aforesaid safe haven of 1.5:1 shall generally apply to loans granted by both foreign and domestic shareholders holding at least 25% of the shares in the corporate (substantial shareholders), unless a third party test can be claimed. A remuneration amount of 50,000 p.a. is protected in order to encourage small and medium sized enterprises.

In addition, 75% of any rentals paid by the company for the use of shareholder owned real estate and 25% of any remuneration paid for the use of other assets are deemed to be a constructive dividend, unless arm's-length-terms can be proved in a third party test. Again, up to an amount of $50,000 p.a. the aforesaid payments shall not qualify as constructive dividends.

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According to the aforesaid bill, a foreign investor may charge up to $50,000 interest p.a. with a guaranteed deduction at the level of the German subsidiary. Lease charges to the German subsidiary of up to $200,000 ($67,000 in case of real estate lease) may be deducted for tax purposes. Further charges require a third-party test to verify arm's length terms.

The new rules will certainly require checking the financing structure of German operations of foreign investors. However, the new rules should grant a higher level of certainty for foreign investors.

HONG KONG

MAINLAND AND HONG KONG CLOSER ECONOMIC PARTNERSHIP ARRANGEMENT

Hong Kong became a Special Administrative Region ("SAR") of China in 1997 when its sovereignty reverted to the Peoples' Republic of China. Over the past six years, the Government of Hong Kong was able to maintain the same judicial system, low tax regime and way of liberal life as before under the principle of 'one country two systems'. Following the global economic downturn in recent years, Hong Kong's economy has unavoidably declined. Confidence is returning now the Central Government of China resolved to give strong support to Hong Kong to regain the confidence of local people and foreign investors in Hong Kong.

A Closer Economic Partnership Arrangement ("CEPA") was entered into between the Chinese Central Government and the Government of the HKSAR on 29 June 2003. A number of privileges and conveniences to enter the Chinese Mainland market are given to the Hong Kong manufacturers and service suppliers effective next year in priority to other foreign competitors who may access to the China market later under the WTO agreement.

The objectives of the Arrangement are to strengthen trade and investment co-operations between Mainland China and the HKSAR and to promote joint development of the 2 sides in reducing trade barriers, achieving trade liberalization and facilitating trade and investments. Broad areas relating to trade in goods and trade in services are covered in the agreement. With effect from 1 January 2004, Mainland China will apply zero tariff to 273 Mainland product codes of imported goods of Hong Kong origin and further release to zero tariff for other products of Hong Kong origin will be given latest by 1 January 2006. Goods of Hong Kong origin include products undertaken substantial transformation in Hong Kong. If the products are manufactured or processed in Hong Kong and not less than 30% of the FOB value of the products exported to the Mainland are the value of materials, components, labour and development costs exclusively incurred in Hong Kong, the exporting goods would be acceptable as of Hong Kong origin.

The 273 items of products which are now subject to tariff at rates from 35% to 1.5% will be free from any tariff in China with effect from 1 January 2004.

In the area of trade in services, 17 service sectors will benefit for free market access to or removal of specific restrictions in the Mainland market. These sectors are accounting, advertising, audiovisual services, banking, construction and real estate, convention services, distribution services, freight forwarding, insurance, legal services, logistics, management consulting, medical and dental services, securities services, storage and warehousing, transportation and tourism.

Service supplier refers to any natural person, partnership, joint venture, trust, association or corporation. The criteria for service supplier to qualify for CEPA application are:

i) It should have been incorporated pursuant to the Hong Kong Companies Ordinance or registered with a valid business registration certificate and in actual operation for 3 years or more.

ii) It should be engaged in substantive business operations in Hong Kong with its nature and scope of services including that intended to provide in the Mainland.

iii) It should have paid profits tax in Hong Kong.

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iv) It should have owned or rented premises in Hong Kong.

v) Its employed staff in Hong Kong should be Hong Kong residents by more than 50%.

Registered overseas companies in Hong Kong and companies established for specific services to their overseas companies are excluded as Hong Kong service suppliers. Overseas investors however can take advantage of the Arrangement by acquiring or investing in CEPA qualified company or by partnership with such company. If the overseas investors acquire the equity of the Hong Kong service company by more than 50%, the Hong Kong company can be regarded as a Hong Kong service supplier qualified for CEPA application after 1 year from the date of acquisition.

As a result of the slowdown in economy and the outbreak of the SARS, the Hong Kong Government will probably suffer a greater deficit this year than in the past 3 years. The Government has been for years looking for ways to broaden the tax base but is still undecided as to the type of new taxes that would be revenue effective and acceptable to the people of Hong Kong. Although the standard income tax rate will be increased from 15% to15.5% and the corporation profits tax rate from 16% to 17.5% for the fiscal year 2003/04, the increase in revenue therefrom will give very little help to ease the big deficit. It is the recovery of economic growth in Hong Kong that is more important for increasing the revenue. In this connection, the conclusion of the CEPA Agreement with Mainland China is a big success of the Government as the anticipated booming in economy and investments in Hong Kong will more positively bring in a substantial revenue to the Treasury.

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SINGAPORE

SINGAPORE AS A CENTRE FOR HOLDING COMPANIES

Singapore has always been attractive as a place to set up a holding company for a group. Some of the advantages are:

- Strategic location
- Pro-business government
- Excellent infrastructure
- Conducive Income tax regime
- No exchange controls

This article looks at the Singapore income tax regime and some recent changes which enhance Singapore as a jurisdiction conducive for international holding companies.

Income Chargeable to Income Tax

Both resident and non-resident companies are liable to income tax in respect of:

i. Profits derived from or accrued in Singapore, and

ii. Profits derived elsewhere but received in Singapore.

There are no capital gains taxes in Singapore. Gains arising from disposal of investments will only be taxable if the Comptroller of Income Tax treats the gains as ordinary income.

The word 'resident' when applied to a company means a company "... the control and management of whose business is exercised in Singapore", and although many other factors are

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considered, this is generally taken as meaning where the directors meet and exercise 'de facto' control of the company.

Income derived from outside Singapore will also be taxed in the following circumstances:

a. The income is remitted or transmitted to Singapore;

b. the income is applied in or towards satisfaction of a debt incurred in respect of a trade or business carried on in Singapore; and

c. the income is applied towards the purchase of any movable property which is brought into Singapore.

However, from 1 June 2003 foreign income in the form of dividends, branch profits and services income will be exempt from Singapore income tax even if the income is remitted to Singapore. The exemption will be applicable to all taxpayers, but will apply only to income earned from jurisdictions with headline tax rates of at least 15 %;

Rates of Tax

The current corporate tax rate is 22% but this will be reduced to 20% within the next two years. The tax rate on the first $100,000 of chargeable income effectively attracts a lower rate of tax due to the exemptions.

- 75% on the first S$10,000
- 50% on the next S$90,000

The exemption is not applicable to Singapore dividend income.

Distribution of Dividends

Prior to 1 January 2003, Singapore adopted the imputation system which meant that, among other things, the income tax paid by a resident company on its profits could be passed on to the company's shareholders by dividend payments because of Section 44 of the Singapore Income Tax Act.

With effect from 1 January 2003 the imputation system (i.e. the passing of income tax paid by a company to its shareholders mentioned above) was replaced by the one-tier corporate system.

Under the one-tier system, the corporate tax paid by a company is final. The after tax profits that are distributed as Singapore dividends are exempt from tax in the hands of the recipients.

A 5-year transitional period for the imputation system from 1 January 2003 to 31 December 2007 will be allowed. During this period, shareholders (who receive franked dividends) will still be able to receive dividends with credits attached.

Recipients of Singapore Dividends

As mentioned earlier, recipients of Singapore dividends distributed under the one-tier system will be exempt from Singapore income tax.

If the recipient is resident in a country with which Singapore has concluded a double taxation agreement ("DTA"), the terms of the DTA should be reviewed to claim relief. In most of the agreements, the recipient will probably be able to claim credit for the tax paid by the company on its profits in Singapore out of which the dividend is paid.

Recipients of dividends can place the amounts in local banks and interest received would be totally exempt from Singapore income tax for:

a. non-resident companies and individuals; and

b. resident individuals on interest in excess of amounts of $100,000 up to 31 December 2004 and on all interest from 1 January 2005.

Conclusion

It is obvious that the tax regime in Singapore is conducive for the setting up of a Singapore holding company because:

1. Offshore income, excluding interest, will not be taxed in Singapore with effect from 1 June 2003 even if remitted to Singapore as long as the income has suffered headline tax of 15% in the foreign country;
2. The ability to claim tax relief under the DTA's Singapore has (currently with fifty countries);
4. The competitive rate of corporate tax as compared with the rates of countries other than tax havens.
3. No Singapore income taxes will be levied on recipients of Singapore dividends distributed under the one-tier tax system.

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ended in 1980. For Australia, it is intended that the treaty applies from 1 April 2004 for fringe benefits tax and from 1 July 2004 for income tax and withholding tax purposes. For the UK, it is intended that the treaty applies from 1 April 2004 for corporate tax purposes and from 1 July 2004 for income tax and withholding tax purposes. The most significant changes are reductions in certain withholding taxes. These changes are in line with the reductions in withholding taxes under the Australia-US treaty, which commenced operation on 1 July 2003.

Royalty withholding taxes are reduced from 10% to 5%. While the interest withholding tax rate remains unchanged at 10%, certain exemptions from withholding have been created for government bodies and financial institutions.

Generally, the dividend withholding tax rate remains at 15%, however a corporate shareholder with 10% of the voting power is able to access a reduction in the withholding rate to 5%. Further, a corporate shareholder with more than 80% of the voting power is will not be subject to dividend withholding tax. It is noted that Australia does not seek to impose withholding tax on fully-franked dividends.

The treaty now incorporates the operation of the capital gains tax provisions. As such, gains arising from the sale of real estate, or property used in a branch operation, are taxable in the country in which the property is located. Further, disposals of interests in entities domiciled in one country which hold significant parcels of real estate in the other country may be subject to tax in the other country where the gains principally relate to the real estate.

The treaty also now extends to the operation of Australia's fringe benefits tax provisions. The right to impose fringe benefits tax is determined by reference to the right to tax the benefit if provided as employment income.

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