CHAPTER 7

THE NETHERLANDS

7.1 INTRODUCTION

The Netherlands is ranked 26 out of 181 economies in terms of ease of doing business.[1] The Dutch economy has changed significantly in the last 20 years mainly due to its perspectives on international business and open market policies.[2] The Netherlands has been very successful in attracting international business, mainly in the form of IHCs from all over the world, including within the European Union. This is largely due to the tax regime it applies to IHCs, which contains tax instruments that ease the tax burden for IHCs.[3] IHCs located in the Netherlands hold investments in operating companies in the Netherlands, within the European Union and all over the world.

These attributes make the Netherlands an ideal country to study in order to determine how the South African tax regime could be designed in order to provide a suitable tax environment for the location of IHCs. The ability to route investment from all over the world through the IHCs located in a country is the attribute that the South African government seeks to achieve by making South Africa a financial centre for Africa.

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[1] See World Bank *Doing Business 2009 – Country Profile for Netherlands* http://www.doingbusiness.org/Documents/CountryProfiles/NLD.pdf accessed on 25 May 2009.
[2] Koninkrijk der Nederlanden *Doing Business in the Netherlands* available at http://www.netherlands-embassy.org/printerfriendly.asp?articleref=AR00002251EN accessed on 25 May 2009.
[3] See ABAB Accountants, Tax Consultants and Lawyers Doing Business in the Netherlands available at http://www.abab.nl/downloads/DOINGBUSINESSEN.pdf accessed on 25 May 2009.

7.2 BACKGROUND

The Netherlands is situated west of Germany and north of Belgium along the North Sea coast. It has a total area of 41 526km^2 and a population estimated (in 2008) at 16.6 million. This makes the Netherlands the most densely populated country in Europe.[4]

The Netherlands is one of the most stable European countries. It is a full member of the European Union (commonly referred to as the EU) and one of the original co-founders of the former European Economic Community (the EU's predecessor). The official language is Dutch but English, German and French are widely spoken in the business community.[5] The monetary unit of the Netherlands is the Euro.[6] The Netherlands political system is a parliamentary system with a constitutional monarchy.

The Netherlands is a country within the Kingdom of the Netherlands, which further consists of the Netherlands Antilles (the Dutch Caribbean Islands of Bonaire, Curaçao, Saba, St. Martin and St. Eustatius, with the exception of Aruba) and Aruba (which is geographically part of the Netherlands Antilles, but has a special legal status within the Kingdom).[7] Each of the parts of the Kingdom has its own tax legislation.[8] This chapter addresses the tax legislation of the Netherlands as a country within the Kingdom.

For centuries, the Netherlands has encouraged an entrepreneurial spirit, an international perspective to business and open market policies. These historical factors, along with the country's secure political and economic climate, make it a near perfect environment for

[4] *Tax Planning Through The Netherlands* http://www.icsl.com/pages/jurisdic/nether.html accessed on 02 June 2009.
[5] See *Tax Planning Through The Netherlands, supra.*
[6] Prior to 1999 the monetary unit was the Dutch Guilder (or Florin), which was divisible into 100 cents. The Guilder was freely convertible and was one of Europe's strongest and most stable currencies.
[7] Lambooij and Portengen *Netherlands – Holding Companies* (2008) par 1.1 http://online2.ibfd.org/collections/hold/html/hold_nl.html accessed on 19 August 2008.
[8] "The relationship between the three parts of the Kingdom (the Netherlands (European territory), the Netherlands Antilles (with the exception of Aruba) is regulated by the Tax Arrangement of the Kingdom of the Netherlands, which has the same function as a bilateral tax treaty. Currently, there are far-reaching discussions with the parts that together form the Netherlands Antilles on their future. It is likely that Bonaire, Saba, St Martin and St Eustatius will become part of the Netherlands in the form of a municipality or a special type of entity in the course of the coming years. It is at present unclear what the consequences will be for the applicable tax legislation." Lambooij and Portengen par 1.1.

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international tax planning for investors from all over the world. This environment is further enhanced by the Netherlands's network of double tax agreements with virtually every significant financial territory in the world, as well as the benefits that can be gained from basing intermediary holding companies in the Netherlands and within the Netherlands Antilles.[9] The Netherlands has one of the largest tax treaty networks in the world. This makes the Netherlands attractive for tax planning by companies from all over the world.[10]

Historically, the Netherlands played a key role in international tax planning.[11] Currently it is still a major player in international corporate structuring. It offers a wide range of facilities that allow both non-resident corporate and individual clients a broad range of tax advantages.[12]

> For decades The Netherlands have been the pilot country in facilitating tax driven structures as a result whereof many foreign enterprises hold their investments abroad through Dutch 'tax planning' companies. Not only are there several supporting technical arguments to do so, like the beneficial and flexible tax and legal regime, but it also has to do with emotions. Simply stated, the Netherlands are stable and reliable and therefore a safe place to do business and apart from that, it is a country worth visiting.[13]

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[9] http://www.dboffshore.com/offshore/html/location/netherlands.shtml accessed on 08 June 2008.
[10] http://www.anglo-legal.com/index.php?id=86 accessed on 08 June 2008. See also Kriek and Drijer "Cypriot Companies go Dutch for Tax Planning" (2007) *International Tax Review* http://proquest.umi.com/pqdweb?did=1379442051&Fmt=3&clientId=27625&RQT=309&VName=PQD accessed on 17 October 2009.
[11] Boon R "The Holding Regime in the Netherlands" (1992) *The International Tax Journal* (Vol. 18 Issue 4) 48-73; Bayliff and Teves "Using the Netherlands as an Operational Base" (1985) *International Financial Law Review* (Vol. 4) 31-35; Turkenburg "The Netherlands Woos Foreign Investors" (1993) *International Tax Review* 31-32. Boudewijn "Using a Dutch Intermediary Company to Help Manage and Control an Organization's Worldwide Tax Liabilities" (1994) *The International Tax Journal* http://proquest.umi.com/pqdweb?did=7645136&Fmt=2&clientId=27625&RQT=309&VName=PQD accessed on 17 November 2009.Brood "Dutch Credit for Foreign Withholding (1995) *International Tax Review* (Vol. 6) 20-22; De Jong "The Netherlands" (1995) *International Tax Review* 30-38; Jenner and De Koning "Dutch Law Offers Mixed Blessings(1996) *International Tax Review* (Vol. 7) 21-24; Van der Donk "Dutch Boost for Multinationals" (1996) *International Tax Review* (Vol. 7) 31-33;
[12] See Van der Laan and Papen "About Netherlands Finance Centres and More" (1996) *International Tax Review* 210.
[13] http://www.taxci.nl/read/using_netherlands_tax_planning, accessed on 08 June 2008.

According to the Royal Dutch Embassy in Washington DC, United States "the Netherlands has an abundance of sales agents, importers and distributors experienced in international trade. People are internationally oriented and largely multilingual, moreover education level is high. In addition, the cultural climate is convenient, innovativeness is stimulated and people are open-minded."[14]

7.3 THE DUTCH CORPORATE TAX SYSTEM

7.3.1 General

The Netherlands tax system is based on a number of laws some of which date back many years.[15] In the Netherlands, corporate income tax is levied on both resident and non-resident companies. Resident companies are taxable on their worldwide income and non-resident companies, primarily branch offices of foreign companies doing business in the Netherlands, are taxable only on income derived from a source within the Netherlands. Resident companies are companies incorporated under the Dutch Civil Law[16] and foreign incorporated companies that are effectively managed in the Netherlands.[17]

7.3.2 Corporate Income Tax

Dutch companies are subject to a corporate income tax at the rate of 26.9% (20% on the first EUR 41 000) for the 2008 tax year.[18] The standard tax year is the calendar year. However, a company is allowed to use its financial year as its tax year. As opposed to common practice, the Netherlands is one of the few countries where, in calculating taxable income, no distinction is made between ordinary income and capital gains.

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[14] See Koninkrijk der Nederlanden *Doing Business in the Netherlands* available at http://www.netherlands-embassy.org/printerfriendly.asp?articleref=AR00002251EN accessed on 25 May 2009.
[15] Spenke and Lier *Taxation in the Netherlands* (1992) 1.
[16] Resident companies include subsidiaries of foreign companies and European companies (*Societas Europaea* or SEs) established in the Netherlands even if their management and statutory seats are located abroad.
[17] See Ernst & Young, *Worldwide Corporate Tax Guide* (2006) 635.
[18] The standard corporate tax rates have been systematically reduced over the years. For 2006 the standard corporate tax rate was 29.6% (with 25.5% applying to the first EUR 22 689) and for 2007 it was reduced to 27.4% (with 20% applying to the first EUR 41 000); see Ernst & Young 635.

Taxable profits are calculated in Euro, although a corporation can elect to determine its taxable profits in its functional currency. [19]

Non-resident corporates and individuals are subject to corporate or individual income tax, respectively, at the normal rates applicable to Dutch residents. This liability arises if the shareholder has a substantial interest in the Netherlands holding company and such interest cannot be allocated to the assets of the enterprise.[20]

7.3.3 Capital Gains Tax

As indicated above,[21] in the Netherlands no distinction is made between capital gains and other income. Capital gains, like other income, are taxed at the corporate tax rate. In this regard Lambooij and Peelen state that "[c]onsequently, dividends received and capital gains realized on the shares of a Netherlands holding company, as well as interest on loans to such a company, [are] subject to the Netherlands individual and corporate income tax at the normal rates."[22]

7.3.4 Dividend Tax

The standard dividend tax rate in the Netherlands is 25%. Where the participation exemption applies, dividends paid by resident companies to other resident companies are usually tax-free.[23]

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[19] Lambooij and Peelen "The Netherlands Holding Company – Past and Present" *Bulletin for International Taxation* (2006) 4.1. According to the Dutch system profits are determined on the principles of sound business practice and in a consistent manner. See also http://www.minfin.nl/en/subjects,taxation/corporate-income-tax/Tax-base-and-tax-rates.html accessed on 20 August 2008.

[20] See Lambooij and Peelen *Bulletin for International Taxation* 7. A shareholder has substantial interest if he or she directly or indirectly owns at least 5% of the shares, a specific class of shares or rights over shares.

[21] See par 7.3.2.

[22] Lambooij and Peelen *Bulletin for International Taxation* 7.

[23] See Müller *The Netherlands in International Tax Planning* (2005) 10. See the discussion on participation exemption in par 7.5.1.

7.3.5 Controlled Foreign Company Provisions

The Netherlands does not have controlled foreign company legislation. Instead it has limited measures to prevent residents from accumulating passive income in non-resident entities.[24] The participation exemption provides relief from this anti-avoidance measure. In this regard Sandler[25] states as follows:

> A corporate taxpayer that holds an interest of at least 25 per cent in a non-resident company or other entity whose assets are more than 90 per cent portfolio investment must value the interest at its fair market value. Any increase or decrease in the value of the interest is included annually in the taxpayer's income unless the participation exemption applies. A special flat rate of 15 per cent applies to the first revaluation gain that results from the application of these rules.

The application of these provisions is limited in its nature. Furthermore, the participation exemption plays a major role in ensuring that IHC investors are generally excluded from the application of these anti-avoidance measures.

7.3.6 Transfer Pricing

The Dutch tax law applies transfer pricing provisions for transactions between connected persons. Article 8b(1) of the Dutch *Wet op de Vennootschapsbelasting*[26] provides that -

> *Indien een lichaam, onmiddellijk of middellijk, deelneemt aan de leiding van of het toezicht op, dan wel in het kapitaal van een ander lichaam en tussen deze lichamen ter zake van hun onderlinge rechtsverhoudingen voorwaarden worden overeengekomen of opgelegd (verrekenprijzen) die afwijken van voorwaarden die in het economische verkeer door*

[24] See article 29a of the Individual Income Tax Act 1964 (IB 1964)
[25] Sandler *Tax Treaties and Controlled Foreign Company Legislation: Pushing the Boundaries* (1998) 48.
[26] *Wet op de Vennootschapsbelasting* 1969.

> *onafhankelijke partijen zouden zijn overeengekomen, wordt de winst van die lichamen bepaald alsof die laatstbedoelde voorwaarden zouden zijn overeengekomen.*[27]

The transactions between connected persons should be documented. Such documentation should include the nature of the relationship between the entities, the description of the terms of the transactions involved and a thorough analysis of the comparability factors.[28] The documentation should also establish how the prices were determined and provide a basis for determining whether the terms of the transactions would have been adopted if the parties were not connected.[29] If such information is not available, the taxpayer bears the burden of proof that the prices are at arm's length and failure to discharge this burden of proof could expose the taxpayer to non-compliance penalty charges.[30] Taxpayers can use the transfer pricing regulations[31] for guidance as to the allowable pricing. These regulations are based on the Organisation for Economic Co-operation and Development (hereinafter referred to as "the OECD") transfer pricing guidelines and merely provide

[27] This provision is translated into English in *Netherlands Transfer Pricing Country Profile* http://www.oecd.org/dataoecd/19/58/38415233.pdf accessed on 06 February 2009 as follows: "[w]here an entity participates, directly or indirectly, in the management, control or capital of another entity, and conditions are made or imposed between these entities in their commercial and financial relations (transfer prices) which differ from conditions which would be made between independent parties, the profit of these entities will be determined as if the last mentioned conditions were made."

[28] See Doets and Van Dam "Transfer Pricing in the Netherlands – The 'Rules of the Road'" (2006) *Bulletin for International Taxation* 345-346.

[29] Article 8b(3) of the *Wet op de Vennootschapsbelasting* provides as follows: "*De in het eerste en tweede lid bedoelde lichamen nemen in hun administratie gegevens op waaruit blijkt op welke wijze de in dat lid bedoelde verrekenprijzen tot stand zijn gekomen en waaruit kan worden opgemaakt of er met bettrekking tot de totstandgekomen verrekenprijzen sprake is van voorwaarden die in het economische verkeer door onafhankelijke partijen zouden zijn overeengekomen.*" The Netherlands Transfer Pricing Country Profile translates it as follows: "The entities referred to in paragraphs 1 and 2 should include in their records information that shows in which way the transfer prices referred to in paragraph 1 were established, and from which can be determined whether – with respect to these transfer prices – conditions were made to which third parties would have agreed."

[30] Spoelder and Bosch "Transfer Pricing Developments in the Netherlands" (2004) *Bulletin for International Fiscal Documentation* 159-160.

[31] *Besluit verrekenprijzen* IFZ 2001/295

the Dutch version thereof.[32] The OECD transfer pricing guidelines are discussed in Chapter 6.[33]

7.3.7 Thin Capitalisation

Thin capitalisation rules were introduced in the Netherlands in 2004 and apply to any financial years starting on or after 1 January 2004. Under these rules interest expenses with respect to connected party loans may be disallowed if the taxpayer is part of a group of companies. The interest will be disallowed if the debt exceeds three times the equity of the debtor company. Thus, the regime has a maximum debt-to-equity ratio of 3:1. However, the excess debt is considered excessive if it exceeds EUR 500 000. The regime considers debt to be the difference between the taxpayer's outstanding loan liabilities and its outstanding loan receivables.[34] The interest that is not deductible "must be due to a related party and is calculated as a pro rated part of the total net interest payments of the taxpayer".[35]

7.3.8 Foreign Tax Credit

The Dutch resident taxpayers receive a credit against corporate income tax for dividends, interest and royalties from sources outside the Netherlands that are included in their taxable income. The credit applies if the dividends, interest and royalties have been subject to income tax in the source state. Furthermore, the credit is only available if the taxpayer is deemed to be the beneficial owner of the dividend, interest or royalties. The amount of the credit is the lower of the amount of tax levied by the source country and

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[32] See Oosterhoff "Transfer Pricing Landscape: Legislation and Guidance" in *The New Netherlands Transfer Pricing Regime* (ed Betten) (2002) 3–4. See also Ernst & Young *Worldwide Corporate Tax Guide* (2006) 647–648.
[33] See par 6.3.1.2. For a further discussion on the Dutch transfer pricing system see Van Dam "Transfer Pricing Rules and Practice in the Netherlands – An Overview" 2006 *Tax Management International Journal* 443–458; Kamphius, Gillis and Diakonova "Group Financial Services Companies: Tax and Transfer Pricing Policy" in *The New Netherlands Transfer Pricing Regime* (ed Betten) (2002) 29–58.
[34] See Müller 86; Ernst & Young 646.
[35] Müller 86.

the amount of tax which would have been due under the Dutch tax law had the credit not been applicable.[36]

7.2.9 Exchange Control

The Netherlands law does not contain exchange control provisions. Therefore there are no restrictions imposed on the movement of funds into and out of the Netherlands.[37]

7.4 THE DUTCH HOLDING COMPANY

7.4.1 Defining a Holding Company

The Dutch civil, corporate and tax laws do not contain the concept of a holding company as such. Thus there are no provisions in these legal instruments that specifically provide for Dutch holding companies.[38] Accordingly, a holding company is subject to normal company law.[39]

Dutch corporate law comprises a closed system of legal entities. In terms of this system, no new types of legal entities can be created by the will of the parties.[40] The legal entities provided for in the Dutch Civil Code are the association, co-operative, mutual insurance society, limited liability company, public company and the foundation. A limited liability company is a closed company with limited liability referred to in Dutch as *Besloten Vennootschap met beperkte aansprakelijkheid* and abbreviated as "BV".[41]

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[36] Müller 155.
[37] Ernst & Young 646.
[38] Lambooij and Portengen par 1.1.1.1.
[39] See Book 2 of the Dutch Civil Code.
[40] Lambooij and Portengen par 1.1.1.1.
[41] See http://www.tax-consultants-international.com/read/How_to_incorporate_a_BV, where it is further stated that "[i]n comparison to other jurisdictions the BV can be seen as the equivalent of the German 'GmbH', the American 'LLC', or the English 'Ltd'. The BV has legal personality and it has an equity divided into shares. A BV can only have registered shares, and shares are always not freely transferable. The shareholders of a BV are in general not personally liable for acts performed in the name or on behalf of the B.V., nor can they be compelled to make more funds available than that part of the capital for which they have subscribed."

For tax purposes, a Dutch holding company is an ordinary company. A European company with its seat in the Netherlands can also be used as a Dutch holding company.[42] As with any other company, the Dutch holding company is subject to the normal tax system and files the same tax returns as any other corporate taxpayer.[43]

In practice the legal form of the co-operative (*coöperatie*, abbreviated as coop) is also used in specific situations. Commonly the co-operative is chosen as an IHC or for personal holding companies. The main reason for the prevalence of co-operatives being used as IHCs is that, as a matter of law, distributions of a co-operative are not subject to any Dutch dividend withholding tax. It is essential that a co-operative is indeed factually and formally treated as a true co-operative for tax purposes, and cannot be considered, *de facto*, to have its capital divided into shares. If the capital is so divided, the distributions of the co-operative will be subject to the dividend withholding tax.[44]

In specific tax-planning situations, the limited partnership (*Commanditaire Vennootschap*), abbreviated as "CV" (or internationally as "Dutch CV") is sometimes used to fulfil the role of a holding company. A CV which fulfils certain criteria as to the transferability of partnership interests is subject to corporate income tax.[45] This form is only used in specific tax-planning situations and is therefore not as widely used as a BV.[46]

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[42] Lambooij and Portengen par 1.1.1.1. Incorporating a holding company in the form of a European company with a seat in the Netherlands is not a commonly used structure.
[43] Lambooij and Peelen *Bulletin for International Taxation* par 4.1. See also *Netherland Holding Company Overview* http://www.ocra.com/solutions/eu_holding/Netherlands.asp accessed on 06 July 2008.
[44] *The Dutch co-operative in international tax planning* http://www2.asiaoffshore.org/html/articles01/JimmievanderZawwn_2008-05_id7592.pdf accessed on 06 July 2008. See also Lambooij and Portengen par 1.1.3.
[45] A limited partnership or CV which fulfils the criteria as to the transferability of partnership interests is generally referred to for corporate income tax purposes as an "open CV".
[46] Lambooij and Portengen par 1.1.3.

Generally, holding companies are incorporated as BVs. The BV is regulated by Dutch corporate law, which in comparison to the corporate laws of other countries is quite flexible. The specific relevant attributes of a holding company are as follows:[47]

- Dividends can be paid at the end of the year or, if the proper provisions are included in the articles of incorporation of the BV, during the year as an interim dividend. The general limitation for paying a dividend is that the company has sufficient "free reserves".
- Equity can be contributed to the company as a payment on shares or as a share premium without the issuance of shares or as a combination of these two. The contribution of share premium and the repayment of share premium can be achieved through a shareholders' decision which allows an easy and quick transit of funds.
- There are no special limitations for foreign shareholders or directors.

The provisions in the Dutch Civil Code regarding the BV are currently being reviewed.[48] The objective of the review is to create a more flexible legal form. A preliminary text of a legislative proposal was published by the Dutch Ministry of Justice for consultation in three separate sections in 2005 and 2006. These have led to a number of reactions from various experts on corporate law.

The legislative amendments relate to the structuring of the BV from a company law perspective and not the tax status of the BV. As a result, the changes are not expected to affect the tax treatment of the BV and therefore would not affect the context in which the BV is used as a holding company for tax purposes. Due to their specific functions and the rarity of their use, the tax implications where the co-operative and the CV are used as holding companies will not be further discussed here, unless if absolutely necessary or relevant.

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[47] *The Dutch Holding Company* www.atrium-incorporators.com/Dutch%20Holding%20Companies.htm accessed on 31 July 2008.
[48] See Fernández and Olffen *Regulation and application of LLP and LLC* (2007) 1–3 available on http://www.wodc.nl/images/1423_summary_tcm44-81289.pdf. accessed on 8 June 2009.

7.4.2 Various Uses of the Dutch Holding Company

The Dutch holding company can be used for holding reasons both within the Netherlands and outside the Netherlands, including outside the Kingdom of the Netherlands and the European Union. Both for local and international purposes, the Dutch holding company can be used for various purposes.

In international tax structuring the Dutch holding company is commonly used for the following purposes:

- It is more popularly used as an IHC, acting as the head of a regional or functional group or subgroup of subsidiaries. This function is usually coupled with the function of reducing the overall dividend withholding tax costs or converting capital gains into dividends for parent companies;[49]

- Where the group intends to list on a stock exchange, the Dutch holding company is often used as a top holding company the shares of which are or will be traded on a stock or securities exchange. Listing on an exchange has several advantages. The main advantages are: firstly, it is often cheaper to raise equity capital rather than to rely on debt finance to fund the expansion of a company's business, and a listed company is more able to raise such equity capital. Secondly, a listing better enables the company to obtain other forms of finance, such as bank loans. A listing enhances the status of the company. Prospective providers of finance may take some comfort from the fact that its financial information and actions will be subject to the rules and regulations of the stock exchange and public scrutiny. Thirdly, a listing enables a company to use its shares to fund acquisitions, as sellers are more likely to accept listed shares as consideration.[50]

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[49] http://www.freemontgroup.com/eng/jurisdicties/cyprus.php accessed on 10 November 2008.
[50] See http://www.jse.co.za/docs/listings/guidelines.pdf accessed on 1 June 2008.

- A Dutch holding company is also used when two or more investors from different countries wish to set up a joint-venture company. This is due to the combination of the flexible corporate law system of the Netherlands and the tax regime applicable to the Dutch holding company.

- A Dutch holding company is also commonly used as an acquisition vehicle for acquisitions on the Netherlands domestic market. This is because the Dutch holding company can set off interest expenses against the tax base of the target company by forming a fiscal unity or by merging with the target entity.[51]

- In addition to holding shares in operating subsidiaries, the functions of the Dutch holding company are often combined with management and control functions over the subgroup that it heads.[52] As Lambooij and Peelen state, "[t]he combination with a group financing function (both group financing and treasury functions) is also feasible. This function can be carried out within the holding company or in a separate finance subsidiary."[53] The holding company could also perform other functions such as group audit, group consolidation, business development and information technology services.[54]

7.5 TAX ASPECTS THAT MAKE THE NETHERLANDS POPULAR

From a tax perspective the Netherlands is a very popular jurisdiction for multinational structures. Mainly this is due to the structure of three tax instruments, i.e. the

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[51] Lambooij and Peelen *Bulletin for International Taxation* par 2.2. "Both scenarios are subject to several limitations. If the acquiring group already has a company with a Netherlands taxable base, this company can be used as an acquisition vehicle, and it can set off, within the thin capitalization limitations, financing expenses against the Netherlands taxable base. Specific loss carry-over restrictions may apply in these cases" Lambooij and Peelen at 2.2 footnote no 8.
[52] Lambooij and Peelen *Bulletin for International Taxation* par 2.3.1. Transfer pricing rules apply in relation to the pricing of these services.
[53] Lambooij and Peelen *Bulletin for International Taxation* par 2.3.2.
[54] Lambooij and Peelen *Bulletin for International Taxation* par 2.3.3.

participation exemption, the double taxation agreement network and the advance tax rulings system.[55]

Dating back from the provisions of the Business Tax Act of 1893, the Dutch participation regime exempts dividend payments and capital gains payments by subsidiary companies to holding companies from the Dutch corporate income tax in the hands of the holding company.[56] The rationale for this exemption is that profits should not be taxed twice in the corporate tax sphere and that a group of companies should be treated as one whole.[57]

The Netherlands has, and has for a long time had, an extensive network of DTAs which provide for a zero withholding tax for dividends, interest and royalties. By preventing double taxation these treaties stimulate trade and investment between the Netherlands and its treaty partners. The first treaty was signed in 1933 with Belgium. Currently, the Netherlands has treaties with more than 80 countries.[58]

The Dutch system of advance tax rulings is a system in terms of which the taxpayer can provide the tax authorities with a planned structure prior to implementation. The taxpayer would also provide the tax authorities with the tax implications of such structure as the taxpayer understands it. If the tax authorities agree with the application of the tax code to the structure, an agreement is reached to the effect that the tax authorities would impose the tax as per the agreement. Thus, advance tax rulings are agreements with tax authorities on how much will be taxed, given the specific method of calculation. They provide upfront certainty regarding the tax consequences of planned transactions.[59]

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[55] See Van der Voort "Tax Planner's Guide to Holding Companies" (1998) *International Tax Review* http://proquest.umi.com/pqdweb?did=35146916&Fmt=3&clientId=27625&RQT=309&VName=PQD accessed on 14 November 2009.

[56] Spenke and Lier 79.
[57] Van Dijk, Weyzig and Murphy *The Netherlands: A Tax Haven?* http://somo.nl/html/paginas/pdf/netherlands_tax_haven_2006_NL.pdf accessed on 15 July 2008.
[58] See Van Dijk, Weyzig and Murphy par 4.2.3.
[59] See Van Dijk, Weyzig and Murphy par 4.2.3; see also Ernst & Young 636.

In addition to the advance tax ruling system and as an alternative to the usage of the tax treaties and the participation exemption, tax residents of the Netherlands have the added facility of the European Union Parent-Subsidiary Directive.[60] This specifically deals with the tax treatment of distributions by a subsidiary to its parent or holding company located in another EU member state. It aims to promote the creation of an internal market for dividend flows between group companies incorporated within the member states of the EU.

In terms of the Parent-Subsidiary Directive the member state in which a holding company is established must refrain from taxing profitable distributions the parent company receives. As an alternative such member state must grant relief for the tax the subsidiary's member state levies on the profit from which the dividend was distributed. On the other hand, the subsidiary's member state must exempt profits distributed by the subsidiary from withholding taxes.[61]

7.5.1 The Participation Exemption

7.5.1.1 The Nature of the Participation Exemption

The participation exemption is one of the main features which make the Netherlands tax regime attractive as a means of avoiding taxation.[62] Participation exemption is defined as synonymous with "affiliation privilege" which is in turn defined as "tax relief accorded to a company in respect of distributions it receives from, or (in some cases) capital gains it realizes on certain shareholdings on another company, typically where the shareholding exceeds a certain minimum percentage or acquisition cost. A minimum holding period

[60] European Union Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States.
[61] See KPMG Parent-Subsidiary Directive available at http://www.meijburg.com/advisory_services/european_union/directives_on_direct/the_directives/parents_and accessed on 10 June 2009.
[62] See Van Dijk, Weyzig and Murphy par 4.2.1.

may also be required."[63] As its name indicates, this affiliation privilege takes the form of an exemption.[64]

The justification for a participation exemption is to eliminate double taxation of income when transferred to shareholders. In an accounting period, a company may pay corporate income tax on its taxable profit which reduces the amount of post-tax profit available for a dividend distribution to shareholders. In the absence of a participation exemption, or other form of tax relief, shareholders may be taxed on the amount of dividend income received. This results in double taxation of the same income if the dividend is paid out of profits previously taxed in the hands of the company.[65]

A participation exemption typically provides that certain types of dividends on income taxed in the hands of the company are not taxable in the hands of shareholders. In addition, many participation exemption regimes provide that capital gains on shares are not taxable to the extent that the share capital portion to which the gain relates has been held for a specified period. A participation exemption may apply to qualifying shareholdings in both foreign companies and domestic companies.[66]

7.5.1.2 Application of the Dutch Participation Exemption

The Dutch participation exemption was introduced with respect to dividends as early as 1893. This makes it one of the oldest participation exemption regimes. Due to its long existence, there are substantial sources and precedents in the form of case law, administrative decisions, rulings and literature. These sources make it such that most technical concerns and questions arising from specific situations can be answered with a reasonable degree of certainty.[67]

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[63] *IBFD International Tax Glossary* definition of "participation exemption". See also Arnold and McIntyre *International Tax Primer* (2002) 35.
[64] Internationally, the affiliation relief does not only take the form of an exemption. In certain cases the relief can also take the form of a deduction and, theoretically, a credit.
[65] Spenke and Lier 80.
[66] See Arnold and McIntyre 35.
[67] Lambooij and Peelen *Bulletin for International Taxation* par 1. Bakker "Netherlands: Changes to Dutch Participation Exemption are postponed" (December 2000/January 2001) *International Tax Review*

The Dutch participation exemption is laid out in Article 13 of the Corporate Income Tax Act of 1969 (*Wet op de vennootschapsbelasting* 1969). Lambooij and Portengen[68] state the following:

> Under the participation exemption, qualifying elements of the profit are excluded from the taxable profit. Under this system, these elements (in general dividends, capital gains, certain costs and losses, certain currency exchange results) are included in the normal profit calculation and subsequently are excluded from the taxable profit. Therefore, in contrast to jurisdictions such as Belgium and Switzerland where the participation exemption results in a reduction of the tax payable, the Dutch system functions as a full exemption system.

The participation exemption excludes all benefits received from or realised on qualifying participations from the taxable profit of the recipient. The full exemption implies that in computing the taxable profit from the commercial profit, the full amount of the exempt elements is subtracted. The fact that the exempt elements are excluded from the calculation of the taxable profits applies not only to positive elements, but also to negative elements. Thus, profits, as positive elements, and losses and costs, as negative elements, are treated as neutral for tax purposes. The result is that losses and costs attributable to exempt elements are not deductible.[69]

According to the Dutch Ministry of Finance the main features of the participation exemption are as follows: [70]

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http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=12634&SID=468288&SM=&SearchStr=%22intermediary%20holding%20company%22 accessed on 12 November 2009.

[68] Lambooij and Portengen par 1.3.1.

[69] See the European Court of Justice's decision in *Bosal Holding BV v Staatssecretaris van Financiën* Case C – 186/01: referred by Supreme Court of the Netherlands *(Hooge Raad der Nederlanden)* 11 April No 35 729. See also Lambooij and Portengen par 1.3.9; Wattel "Pending Cases Filed by Dutch Courts in Direct Taxation" *Recent ECJ Developments* (ed Lang) (2003) 153.

[70] *Corporate Income Tax, Participation Exemption* http://www.minfin.nl/en/subjects,taxation/corporate-income-tax/Participation-exemption.html accessed on 19 August 2008.

> [a]ll benefits gained from shareholdings are exempt. In principle, the term 'benefits' covers profits and losses. Profits comprise dividends and hidden profit distributions. Exempt returns also cover the profit realised on the sale of a participation. However, losses realised are not deductible. If the value of a participation decreases as a result of losses suffered, its write-down by the parent company is in principle not deductible either. The costs associated with a shareholding are deductible. Losses arising from liquidation of a shareholding may be set off under certain conditions.

In principle if the participation exemption applies, the following elements are excluded from the taxable base: [71]

- All forms of dividends (whether in cash or dividends *in specie*) including constructive or deemed dividends;[72]
- Capital gains;
- Refunds of foreign tax credits and refunds of foreign withholding taxes;
- Losses on subsidiaries;
- Currency exchange results realised on instruments used to cover exchange risks on qualifying participations; and
- Certain types of hybrid loan granted to qualifying subsidiaries, under such conditions that the loan *de facto* has the function of equity.

a. Qualifying participations

The participation exemption is available to the Dutch holding company if (i) the Dutch holding company owns a minimum of 5% of the share capital of the subsidiary; (ii) the subsidiary has capital that is divided into shares; and (iii) the Dutch holding company

[71] See Lambooij and Portengen par 1.3.9; Bakker *International Tax Review*.

[72] This requirement goes further: it requires that the dividend should result in a benefit for the participation exemption to apply. "Purchased dividends are generally booked off from the cost price of the participation and, therefore, are generally not included in the profit and loss account. Consequently, the participation exemption does not apply, but the purchased dividends are not effectively taxed." Lambooij and Portengen par 1.3.9.

does not hold the shares in the subsidiary as inventory. Additional conditions apply where the subsidiary is not resident in the Netherlands.

(i) Ownership of at least 5%

The participation exemption applies to income derived by a Dutch holding company from an investment in a subsidiary, either resident in the Netherlands or resident elsewhere. It is required that for the participation exemption to apply the Dutch holding company should hold at least 5% of the nominal paid-up share capital of such subsidiary.[73]

The low participation percentage makes the Netherlands a particularly attractive jurisdiction in which to base an IHC, offshore holding company or international holding company. Similar regimes in other countries require much higher percentage shareholdings if the company is to qualify for favourable tax treatment. For example, Belgium[74] and Luxembourg[75] require a holding of at least 10% while Switzerland[76] requires a minimum holding of 20%. Furthermore, most jurisdictions require that the company be a proper holding company in the sense that its sole economic activity should be to hold shares in subsidiaries. In the Netherlands, by contrast, a company which trades but also happens to own shares in another corporate entity can be deemed a holding company for the purposes of the participation exemption rules.[77]

This rule is subject to three exceptions where the Dutch holding company owns less than 5% of the shares of the subsidiary. Firstly, the Dutch holding company should not hold the shares in the company declaring the dividend as a portfolio investment. In determining whether the shares are held as a portfolio investment the criterion is whether the shareholding in the foreign subsidiary has the nature of a portfolio investment from the perspective of the Netherlands holding company. What is relevant in this

[73] Spenke and Lier 80. Bakker *International Tax Review*.
[74] Vanhaute *Belgium in International Tax Planning* (2008) 153.
[75] See http://www.investors.oriflame.com/files/Oriflame_dividend_withholding_tax.pdf accessed on 10 November 2008.
[76] *Taxation in Switzerland* http://www.swissprivacy.com/swiss_taxes.htm accessed on 10 November 2008.
[77] *Netherlands: Dutch Holding Companies* http://www.lowtax.net/lowtax/html/offon/netherlands/nethold.html accessed on 21 August 2008.

determination is the purpose of the shareholding in the enterprise by the Dutch holding company and not the activities of the company declaring the dividend.

> The purpose of the shareholding in the enterprise of the Netherlands holding company (or parties related to it) is relevant, rather than the activities of the subsidiary on a stand-alone basis. Elements that are relevant for determining whether [the shareholding is a portfolio investment or not] are: the size of the shareholding, the control of the shareholder over the subsidiary, the activities of the subsidiary in relation to the activities of the shareholder or related parties (the 'business link' test), the marketability of the shares, and the shareholder's expressed motives for acquiring and owning the shares. As a general test, shares are held as a portfolio investment if the holding of shares in the subsidiary is aimed at obtaining an increase in value and a yield that could be expected in the case of normal, active asset management (i.e. without a specific 'business link' interest).[78]

The second exception applies where the Dutch holding company holds less than 5% of the nominal paid-up share capital and a company related to that holding company owns at least 5% of the shares in the subsidiary. Companies are generally deemed to be related in the case of a direct or indirect interest of one third or more (i.e. generally direct and indirect subsidiaries, parent companies and sister companies are covered).[79]

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[78] Lambooij and Peelen *Bulletin for International Taxation* par 5.2.2.

[79] The related party position is different from a group position. "In general, a group is a parent company with all its subsidiaries, provided that the subsidiary is 'controlled' by the parent company. 'Control' is generally described as the power to govern the financial and operating policies of an enterprise so as to obtain the benefits from its activities. It is presumed to exist when the parent company owns more than half of the voting rights in the subsidiary." Sunderman "Netherlands, Thin Capitalization Rules Introduced" *Bulletin for International Taxation* (2004) 40. Lambooij and Portengen par 1.3.2. state that '[u]nder the participation exemption rules that applied before 1 January 2007, a taxpayer with an interest below 5% of the nominal paid-in capital could nevertheless apply for the participation exemption if the participation was in line with the normal exercise of the taxpayer's enterprise, or if the acquisition of the participation served a public interest. The possibility for smaller holdings to qualify had been generally interpreted in a restrictive way by case law. In more recent case law, however, the Supreme Court had relaxed its restrictive position. In this respect, the Supreme Court decided that as long as the shareholding was not held as portfolio investment (i.e. for passive investment purposes) the participation would apply." Sunderman *Bulletin for International Taxation* par 1.3.2. See SC 14 March 2001, 95/9695, BNB 2001/210; SC 5

Thirdly, the participation exemption would apply if the Dutch holding company does not hold the shares in the subsidiary as trading stock or inventory (i.e. the holding company does not hold the shares for sale in the ordinary course of business). This requirement does not exclude the application of the participation exemption by companies that trade in shares. The exemption is available for these share traders on shares that they hold as an investment and not as trading stock.

Contrary to the position in other countries, the minimum shareholding in a subsidiary is not linked to a minimum holding period.[80] Thus, if at the time that the investment is realised the holding company holds the required percentage, the participation exemption would apply. This makes it possible for the shareholding to be increased to coexist with the realisation of the investment, after which the shareholding could be reduced to below 5% depending on the business requirements. The minimum holding period applies in the special cases where the holding company holds less than 5% and the participation exemption applies.

The participation exemption only applies to companies which are subject to normal corporate income tax. Companies that benefit from a special tax regime cannot access the participation exemption.[81]

(ii) <u>Subsidiary's capital divided into shares</u>

For the participation exemption to apply, it is required that the subsidiary should have capital that is divided into shares. This requirement exhibits a strong linkage with the 5% holding requirement. As a general rule, all corporate taxpayers in the Netherlands have capital that is divided into shares. The common forms of corporations such as the BV and NV have capital divided into shares.[82]

November 1997, VN 1997/4393 and 5 November 1997, VN 1997/4399. Participations that qualified under the pre-2007 rule prior to 31 December 2006 are deemed to meet the 5% shareholding threshold until 1 January 2010. See Lambooij and Portengen par 1.3.2. Bakker *International Tax Review*.

[80] The minimum holding period in Luxembourg and Belgium is one year.

[81] Lambooij and Peelen *Bulletin for International Taxation* par 5.2.1. Bakker *International Tax Review*.

[82] See http://www.ftc.nl/holland/ftctrust-legalas.html accessed on 22 January 2009.

Different rules apply to specific forms that are not as common as the BV and the NV. For example, as Janssen[83] states, a cooperative association

> may only be considered to have a capital divided into shares if the membership is based on a participation in the equity of the cooperative association; which is the case if the cooperative association issues shares, certificates of ownership or similar instruments that are separate and distinct from the membership interests, or where the membership interests, either with or without the shares, certificates of ownership or similar instruments, can be transferred without the prior consent of all other members.

(iii) Shares not held as trading stock

The participation exemption will apply if the Dutch holding company does not hold the shares in the subsidiary as trading stock. Shares are held as trading stock or inventory if the following conditions are met: [84]

1. The holding company holds the shares with the intention to sell those shares and the shares constitute part of the holding company's floating assets;
2. The subsidiary in which the holding company holds the shares is not, or is no longer engaged in active trade or business; and
3. The subsidiary has no assets or virtually no assets other than cash or assets that, immediately and without any significant loss, can be converted into cash.

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[83] See Janssen "Repurchase transactions in the Netherlands" *International Financial Law Review* (2008) http://www.iflr.com/includes/supplements/PRINT.asp?SID=515115&ISS=16382&PUBID=213 accessed on 16 August 2008.
[84] Lambooij and Peelen *Bulletin for International Taxation* par 5.2.1.

(iv) Additional requirements for foreign subsidiaries

As mentioned earlier, the participation exemption is available for holding companies income from investments in both resident and non-resident subsidiaries. The above requirements apply where the subsidiary is resident in the Netherlands. Where the subsidiary is a foreign company the following two additional requirements should be met for the exemption to apply: [85]

1. The subsidiary must be subject to tax on its profits levied in the subsidiary's residence country. This "subject to tax" requirement does not imply that there must be a tax payable. Furthermore, there is no requirement as to the level of such tax, e.g. that it should be reasonably similar to the Dutch corporate income tax.
2. The Dutch holding company must not hold the shares in the subsidiary as a portfolio investment.

7.5.2 Advance Tax Rulings

An advance tax ruling (hereinafter referred to as "an ATR") is a procedure in terms of which a taxpayer may obtain confirmation of the related tax consequences from the tax authorities in advance of entering into a transaction.[86] The Dutch Ministry of Finance considers an ATR to be an agreement on the tax characterisation of international corporate structures, such as advance certainty on the application of the participation exemption.[87] The ATRs are mere interpretations of the Dutch law. They do not offer any privileges or concessions to taxpayers.[88] Their purpose is to take away the uncertainty in tax areas where uncertainty exists, such as where there is little or no case law, in new

[85] Lambooij and Peelen *Bulletin for International Taxation* par 5.2.2.
[86] See the *IBFD International Tax Glossary* definition of "advance ruling." "In some countries an advance ruling will bind the tax authorities if the taxpayer uses the ruling. In other countries an advance such rulings cannot be obtained for hypothetical cases.
[87] Kröner and Van Doorne "Legal Aspects of Tax Rulings in the Netherlands" in *International Tax Planning* (ed Campbell) (1995) 149. Jansen "Netherlands: New APA and ATR Policy, and Transfer Pricing Guidelines" (2001) *International Tax Review* http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=12630&SID=468493&SM=&SearchStr=%22intermediary%20holding%20company%22 accessed on 12 November 2009.
[88] Van Herksen "New and Improved: Advance Pricing Agreements" in *The New Netherlands Transfer Pricing Regime* (ed Betten) (2002) 109–113.

areas and in areas where certain income must be reported within a certain range.[89] Rulings may be issued in respect of matters relating to holding companies, future companies, royalty or intellectual property holding companies, permanent establishments, foreign sales companies and transfer pricing matters.[90]

The tax administration has a dedicated team called the ATR team or Ruling Team specifically dealing with the tax ruling requests. The Ruling Team is located in the Rotterdam branch of the Rijnmond Tax Administration department in the inspectorate for Large Enterprises.[91] The purpose of this centralisation is to avoid each tax inspectorate in the different branches having to expend time and expertise discussing and agreeing on tax subjects with a major financial impact.[92]

> The Ruling Team is under no obligation to actually issue an ATR. They have full liberty to not agree to any tax analysis made by a tax adviser on which he bases his ATR request. The Ruling Team may also decide that although they do not see fault with the tax analysis, to refuse issuing an ATR if they believe that granting one would upset the tax authorities of other countries and might cause drawbacks to the willingness of other countries to enter into tax treaties with the Netherlands or into treaty renegotiations. The Ruling Team may also decide that an ATR request was made 'to test the boundaries of tax law', cases which they do not want to bless with advance certainty to the tax payer.[93]

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[89] *Advance Pricing Agreement and Advance Tax Ruling* http://www.minfin.nl/en/subjects,taxation/international-aspects-of-taxation-in-the-netherlands/Advance-Pricing-Agreement-and-Advance-Tax-Ruling.html accessed on 22 August 2008.
[90] See Jonker and Loos "Tax Rulings in The Netherlands and The Netherlands Antilles" in *International Tax Planning* (ed Campbell) (1995) 151; Jansen *International Tax Review*.
[91] This team works in conjunction with the APA team, which is the Advance Pricing Agreement team. An "Advance Pricing Agreement entails providing advance certainty on the fiscal acceptability of the price (transfer pricing) that the Dutch group company pays to or receives from a foreign group company for receiving or delivering a service or goods." See *Advance Pricing Agreement and Advance Tax Ruling*.
[92] See http://www.royaltytax.com/merlyn.asp?p=35 accessed on 08 June 2008.
[93] http://www.royaltytax.com/merlyn.asp?p=35 accessed on 8 June 2008. The request for the issue of an ATR is addressed to the competent tax inspector. In order to ensure the co-ordination of the practice, the tax inspector will submit the request to the Ruling Team for a binding advice. Where necessary, the Ruling Team consults with the relevant knowledge groups to secure a uniform policy, both in principle and in practice. Because the Ruling Team is represented in all of the relevant knowledge groups, this form of

The ATR is an agreement with the tax authorities and the particular taxpayer based on the given circumstances. Should the taxpayer proceed with the transaction in question with altered facts, the ruling may not be applied to such transaction. Furthermore, the ruling cannot be applied by a different taxpayer against the tax authorities even if the circumstances are identical.[94] However, the previous ruling would be a persuasive instrument to command a similar tax treatment or a treatment that is suitable for the taxpayer. Correspondingly, the ruling does not form a precedent. However, it may establish an unenforceable but persuasive trend for treating certain specific transactions. A ruling is valid only for a period of no more than four years from the moment on which the activities to which it applies have commenced in the Netherlands.[95]

The ATR system is a very attractive tool for international investors hoping to access the participation exemption through the use of a holding company.[96] Its use is relatively extensive.[97] Be that as it may, there is normally no need to obtain an ATR since sufficient comfort can often be obtained from case law, policy statements and precedents.[98]

7.5.3 Treaty Network

The purpose of a tax treaty is the avoidance of double taxation. According to Holmes,[99] "[f]rom their inception the *raison d'être* of DTAs has been the avoidance of double taxation."[100] The solution to the problem of double taxation involves taxing income only

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consultation can take place during the assessment process, thereby helping to ensure that the request is dealt with both swiftly and efficiently. Dutch Policy for Advance Tax Rulings; See http://www.tax-consultants-international.com/read/Dutch_policy_for_advance_tax_r accessed on 11 June 2008.

[94] See Jansen *International Tax Review*.

[95] Kröner and Van Doorne *International Tax Planning* 153.

[96] See Jansen *International Tax Review*. For more on advance tax rulings see Van Dam and Jacobs "Advance Tax Rulings in *The New Netherlands Transfer Pricing Regime* (ed Betten) (2002) 119–130.

[97] By way of comparison, Shelton applauds the Dutch advance tax rulings system by stating that "although Denmark has a system of advance rulings, it is not nearly as useful as the Dutch system" (Shelton N "Denmark Squares up for Holding Battle" (December 1998/January 1999) *International Tax Review* http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=12655&SID=468670&SM=&SearchStr=%22intermediary%20holding%20company%22 accessed on 13 November 2009).

[98] Lambooij and Peelen *Bulletin for International Taxation* par 5.2.2.

[99] Holmes *International Tax Policy and Double Tax Treaties – An Introduction to Principles and Application* (2007) 54.

[100] Holmes 54. *Raison d'être* is a phrase borrowed from French where it means simply 'reason for being'; in English use it also comes to suggest a degree of rationalisation, as the claimed reason for the existence of

once and that leads to consideration of which country will have the taxing right. The determination of which country will have the taxing right is customarily contained in the DTAs.

The Dutch treaties provide persons to whom the treaties apply with additional treaty benefits in two forms, namely, the high number of treaties and the elimination of certain taxes payable by Dutch residents.

Generally, Dutch DTAs contain articles that award the taxing rights on dividends, interest and royalties to the Netherlands or to the other contracting state. The Dutch treaties often result in dividend withholding tax on dividends paid to the Netherlands holding company being reduced to zero. This is a special feature of the Dutch tax treaties emanating from the Dutch government's policy on tax treaties. In most countries' treaties the dividend withholding tax is usually set at a rate between 5% and 15%.[101] The Dutch treaties also reduce the tax rates for dividends paid by a Dutch holding company to its parent from 25% to a maximum of 15%.

Treaties also eliminate the withholding tax on interest and limit withholding tax on royalties to a maximum of 15% on interest and royalties paid to the Netherlands. On the other hand, in terms of the Dutch domestic law withholding tax from the Netherlands is always zero on interest and royalties, irrespective of the target country. A combination of these attributes establishes the Netherlands as an ideal jurisdiction to host a variety of companies in multinational structures. As Van Dijk, Weyzig and Murphy observe, "[t]his makes it especially attractive for foreign companies to establish a conduit company in The Netherlands to route royalty, licence or patent payments, tax international markets and intermediate in group financing structures."[102]
The Netherlands has concluded treaties with over 80 countries. This is a favourable treaty network for a vast number of investors from all over the world. Quite importantly, the

something or someone; see http://tiscali.co.uk/reference/dictionaries/difficultwords/data/d0010875.html accessed on 19 November 2008.
[101] Van Dijk, Weyzig and Murphy par 4.2.2.
[102] Van Dijk, Weyzig and Murphy par 4.2.2.

Netherlands has concluded treaties with the world's financial strongholds, including, the United States of America, the United Kingdom, China, Germany, Japan and France. Save for France and the United Kingdom (with about 90 and 100 treaties respectively), the Netherlands has more treaties that any of these countries.

7.5.4 Parent-Subsidiary Directive

The Parent-Subsidiary Directive ("the directive") is a multilateral agreement between the European Union ("EU") member states contained in the European Union Council Directives.[103] It specifically deals with the tax treatment distributions by a subsidiary to its parent or holding company located in a foreign EU member state. It aims to promote the creation of an internal market for dividend flows between group companies incorporated in the EU. Dividend distributions to non-EU shareholders do not qualify for the parent-subsidiary directive treatment.[104]

Since the directive was adopted in July 1990 it has had the most immediate effect on cross-border business transactions in Europe. It has proven to be of great help to countries with poor treaty networks in the EU, either because they are considered to be tax havens[105] or because of their limited cross-border business relations.[106] Without a tax treaty, investors in these countries had to rely on the unilateral tax relief provided by their home countries.[107] The directive deals with these issues that were previously exclusively dealt with in bilateral tax treaties.

The directive is based on two basic premises contained in its preamble. Firstly, when the holding company receives a distribution of profits from the subsidiary, the state of the holding company should refrain from taxing such profits or tax such profits while

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[103] EU Council Directive (90/435/EEC) of 23 July 1990. See Schonewille "Some Questions on the Parent-Subsidiary Directive and the Merger Directive" (1992) *International Tax Review* 13-20.
[104] Peters "National Report Netherlands" in *WTO and Direct Taxation* (eds Lang, Herdin and Hofbaner) (2005) 506.
[105] An example of a country with few tax treaties because it is considered to be tax haven is Cyprus.
[106] Bulgaria and Estonia are examples of limited cross-border relations countries.
[107] Thömmes and Nakhai *Introduction to the Parent-Subsidiary Directive*, http://online2.ibfd.org/data/ectl/cm/CM-CH-06.doc.p0005.html accessed on 29 August 2008.

authorising the holding company to deduct from the amount of tax due that fraction of the corporation tax paid by the subsidiary which relates to those profits.[108] Secondly, the profits which a subsidiary distributes to its holding company should be exempt from withholding tax in the hands of the holding company.[109]

The status of a holding company to which the directive applies is attributed to a company resident in a member state which has a minimum holding of 10% in the capital of a company of another state.[110] This minimum holding requirement was reduced from 15% on 1 January 2009. For the directive to apply –

(i) the holding company and the subsidiary must be companies in the nature of NV, BV, or SE, i.e. entities whose capital can be divided into shares;[111]
(ii) the subsidiary should not, under the terms of a bilateral tax treaty concluded with a third state, be resident for tax purposes outside the EU;[112] and
(iii) the holding company and the subsidiary must be subject to corporate income tax.[113]

The directive allows member states to set minimum periods for which shares must be held. However, such period may not exceed two years. Under this provision, the Netherlands prescribed a minimum period of one year. This requirement was abolished in January 2007.[114] The abolition of the one-year minimum holding period was to align the application of the directive with the participation exemption. Certain investors' circumstances would have been better suited to apply the participation exemption over

[108] Preamble and Article 6 of the EU Council Directive.
[109] Preamble and Article 6 of the EU Council Directive. The exemption from withholding tax on the subsidiary is directed at ensuring fiscal neutrality. Germany and Greece, by reason of the particular nature of their corporate tax systems, and Portugal for budgetary reasons are authorised to temporarily maintain a withholding tax.
[110] Article 3 of the EU Council Directive. Prior to 1 January 2007 the minimum holding percentage was 20% and was reduced to 15% on that date. The gradual reduction of the minimum holding percentage was brought by the amendment to the directive by Council Directive 2003/123/EC of 22 December 2003 to improve the directive's practicality.
[111] Article 2(1)(a) of the EU Council Directive.
[112] Article 2(1)(b) of the EU Council Directive.
[113] Article 2(1)(c) of the EU Council Directive. See also *Parent-Subsidiary Directive* http://www.meijburg.com/advisory_services/european_union/directives_on_direct/the_directives/parents_and accessed on 28 August 2008.
[114] Corporate Income Tax Act of 2007.

the directive, thus placing EU investors in an adverse tax position where there is no tax treaty between the Netherlands and the investor's home country.

Due to its multilateral nature, the directive provides broader tax relief than bilateral treaties. As Thömmes and Nakhai observe,

> … even in a tax treaty situation, the benefits of the Parent-Subsidiary Directive significantly outweigh the benefits granted by bilateral tax treaties. On the one hand, the criteria under the Parent-Subsidiary Directive are uniform for all Member States (even though some countries were granted special transition periods and certain details of the application may vary in different countries). On the other hand, the benefits granted by the Parent-Subsidiary Directive are usually more far-reaching than the ones granted by individual tax treaties which usually only provide for a reduction of withholding tax but not for a complete elimination of withholding taxes. Last but not least, the fact that the application and interpretation of the Parent-Subsidiary Directive by the individual Member States is subject to the jurisprudence of the European Court of Justice (ECJ) proved to be another significant advantage for taxpayers over the past years.[115]

Because the EC law prevails over bilateral agreements between individual member states, the directive overrides a bilateral tax treaty if and to the extent that provisions in that treaty which differ from those of the directive are less favourable to the companies affected than the directive's position. Conversely, if a bilateral treaty grants more benefits than the directive or requires less stringent conditions to be met than the directive in order to obtain the same benefits under both regimes, the bilateral treaty provisions cannot be

[115] Thömmes and Nakhai par 4.

objected to as an infringement of EC law.[116] The directive's benefits may be limited under the member state's anti-tax abuse legislation.[117]

For purposes of the directive, "withholding tax" does not cover an advance payment or prepayment of corporation tax to the member state of the subsidiary which is made in connection with a distribution of profits to its holding company.[118] Furthermore, the directive does not affect the application of domestic or provisions contained in any agreement designed to eliminate or lessen economic double taxation, in particular provisions relating to the payment of tax credits to the recipient of dividends.[119]

7.5.5 Comparison between the Directive and the Participation Exemption

The directive and the participation exemption apply in the same circumstances and in relation to the same nature of transactions. However, the directive is limited to member countries. In relation to the distributions by Dutch companies, there is no dividend withholding tax in both cases. The requirements for the exemption from the dividend withholding tax are the same.

With regard to distributions to Dutch companies, even prior to the implementation of the directive the Netherlands already refrained from taxing such distributions by using the participation exemption. The requirements under the directive and the participation exemption are the same. The difference exists with regard to the minimum holding percentage, which is 5% for the participation exemption and 10% for the directive. It has to be noted that this difference has been marginally reduced since prior to 2006, when it was 25%.

[116] Thömmes and Nakhai par 5.
[117] Article 2.2 of the EU Council Directive.
[118] Article 7(1) of the EU Council Directive.
[119] Article 7(2) of the EU Council Directive.

7.6 PROPOSALS FOR THE DUTCH CORPORATE TAX REFORM

The Dutch State Secretary of Finance issued a consultation document on 15 June 2009 containing proposals for changes to the Dutch corporate tax regime.[120] If implemented this regime would allow foreign operations to be leveraged from and through the Netherlands without incurring significant Dutch tax burden. The main changes that would enhance the position of the Netherlands as a holding location are the following:

- Interest box regime – Interest income would be taxed at an effective rate of 5%. Interest expenditure would be equally deducted at 5%. The regime would be mandatory to intragroup interest income and expenditure.
- Participation exemption regime – The participation exemption is to be applicable if the participation is not held as a portfolio investment. The intention of the taxpayer is decisive in determining whether the holding is portfolio or not.
- Carry back of losses – It is proposed that the tax loss carry back period be extended from 1 year to 3 years.
- Limitation of interest deductions – In the Netherlands it is possible to deduct interest expenditure on financing of qualifying participations while the income on such participations is exempt under the participation exemption. It is proposed that the thin capitalisation rules be abolished and the transaction based anti-avoidance rules be expanded to address this anomaly.[121]

7.7 CONCLUSION

As has been seen in this analysis of the aspects of the Dutch tax system that apply to holding companies, the Netherlands is a very suitable tax jurisdiction for the hosting of

[120] Ernst & Young *Dutch Government Issues Consultation Document on Tax Reform* http://www.ey.com/Publication/vwLUAssets/N_Dutch_International_Tax_Alert,_June_12_2009/$FILE/N_Dutch%20International accessed on 11 January 2010; Ruijten and De Vries *Dutch State Secretary Issues Discussion Paper Regarding Tax Treatment of Interest and Relaxation of Participation Exemption Rules* http://www.bakernet.com/BakerNet/Resources/Publications/Recent+Publications/AmsterdamDiscussionPaperTaxCAJun09.htm accessed on 11 January 2010
[121] See Ruijten and De Vries; Ernst & Young.

an IHC. It allows access to tax relief to a wide range of investors with different countries of origin. Its corporate and tax law systems are flexible. Furthermore, as has been observed, the corporate law is currently under review with a view to making it even more flexible.

Entities whose identity is the same as those of a conventional company can access the tax attributes of the Dutch system that makes it popular. These forms are common and investors are familiar with their nature, operation, uses and the risks they involve. In its very nature an IHC is a company that is a subsidiary of some company in a group of companies. Its shares can either be held by sister-subsidiaries, a holding company that is a subsidiary of a company within the group or the ultimate holding company. The shareholding in the IHC by any of these group companies generally exceeds 50% in order to allow control of the IHC, thus the 5% holding requirements are exceeded.

Once formed, the IHC in the Netherlands can be used for multiple functions. The uses that the Dutch holding company can be put to are common functions in the financial industry. It is more popularly used as an IHC, acting as the head of a regional or functional group or subgroup of subsidiaries, coupled with the function of reducing the overall dividend withholding tax costs or converting capital gains into dividends for parent companies.

With the benefits of listing on a stock exchange, the Dutch holding company is often used as a top holding company whose shares are or will be traded on a stock exchange. With listing it is often cheaper to raise equity capital rather than to rely on debt finance, and the company is therefore able to raise equity capital more readily. A listing better enables the company to obtain other forms of finance, such as bank loans. A listing also enables a company to use its shares to fund acquisitions.

A Dutch holding company is also used when two or more investors from different countries wish to set up a joint-venture company. It is also commonly used as an acquisition vehicle for acquisitions on the Netherlands domestic market. Besides the

holding of shares in subsidiaries, the function of the Dutch holding company is often combined with management and control functions over the subgroup it heads.

The IHC would access the benefits of the participation exemption and the directive where the group operates within the EU as soon as it is formed, due to the fact that there is no minimum holding period in the Netherlands, on application of either the participation exemption or the directive. This is essential for a group where the group has accumulated profits that should be distributed but could be eroded by the tax system of the ultimate holding company.

As indicated in the discussion on group taxation,[122] the Netherlands applies the fiscal unity system of group taxation in terms of which a Dutch holding company is allowed to file a consolidated tax return with its resident domestic subsidiaries.[123] Because fiscal unity is allowed for companies that are tax-resident in the Netherlands it includes foreign incorporated subsidiaries which are tax-resident in the Netherlands due to the place of effective management being the Netherlands.

The Dutch fiscal unity regime allows group companies to pool their profits and losses and to transfer the assets within the group without a capital gains tax liability. Thus, losses of one subsidiary may be offset against profits of other members of the group. Furthermore, reorganisations have no direct tax consequences. Added to the inherent relief provided by the Dutch tax system as discussed, this fiscal unity system further enhances the Netherlands as the ultimate holding company regime.

The Netherlands holding company regime indisputably provides an ideal environment for investors to set up IHCs to perform their functions in the Netherlands without the tax regime eroding the finance base of the group.

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[122] See Chapter 4 at 4.6.
[123] See Spenke and Lier 87.

CHAPTER 8

MAURITIUS

8.1 INTRODUCTION AND BACKGROUND

In this chapter the Mauritian tax system applicable to holding companies is discussed with a view to identifying the tax attributes that could be adopted by South Africa in enhancing South Africa's suitability to host IHCs. As mentioned in Chapter 1, Mauritius is similar to South Africa in key respects. Like South Africa (i) it is an African country; (ii) it is a developing country; and (iii) it is a member of the Southern African Development Community. Furthermore, Mauritius is successfully being used by multinational investors as a gateway to invest in countries in Africa and around the world. Mauritius has adjusted its tax system specifically to attract interposition of companies for investment elsewhere. These features make Mauritius the ideal country to study in order to assess and enhance the suitability of South Africa to host IHCs.

Mauritius is a small multi-cultural island situated in the southern Indian Ocean to the east of Madagascar. It comprises four islands: Mauritius, Rodrigues, Saint Brandon, and Agalega. With the exception of its coral reefs and beaches, the land area of 1,865km^2 is of volcanic origin. The other islands comprise another 175km^2 of land area. Sugar cane farming is prevalent in Mauritius. About 90% of the Mauritian cultivated land area is devoted to sugar cane.[1]

The population of Mauritius is approximately 1.28 million[2] of which about 150 000 live in the capital city, Port Louis. The official language is English, although Creole, French,

[1] *Mauritius: Country and Foreign Investment Regime,* http://www.lowtax.net/lowtax/html/jmucfir.html accessed on 13 March 2008.
[2] This estimate is the population estimate of July 2008.

Hindi, Urdu, Hakka and Bojpoori are also spoken. The Mauritian currency is the rupee (MR).[3]

It gained independence from Britain in 1968 and became a republic in 1992. Mauritius is a multi-party democracy and a sovereign state within the British Commonwealth of Nations. The head of state is the President of the Republic who is elected by the National Assembly.[4]

Mauritius is a dynamic economy with a well-developed communications infrastructure to enable the operation of business activities. The Mauritian government actively encourages foreign investment and discourages residents from actively pursuing offshore activities. To this end the Board of Investment and the Mauritius Offshore Business Activities Authority (MOBAA) were created. The MOBAA has been replaced with the Financial Services Commission in 2001. These bodies regulate such matters as foreign direct investments, trust services, trading and pooled or mutual fund programmes.[5] As a result of the keen interest in foreign investment, there is a very clear distinction between the onshore and offshore sectors. Foreigners need specific permission from the Prime Minister's office before they can own shares in an onshore company, while Mauritian residents are generally prohibited from taking part in offshore activities.[6]

Since 1991 Mauritius has developed at a fast pace. It has attracted considerable foreign investment and now has one of Africa's highest per capita incomes. In order to attract prospective investors Mauritius offers a wide range of attractive investment incentives. The focus of these incentives is to improve the Mauritian financial sector and the various

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[3] *Mauritius: Country and Foreign Investment Regime;* see also *Currency in Mauritius* http://wwp.greenwichmeantime.com/time-zone/africa/mauritius/currency.htm accessed on 3 February 2009.

[4] http://www.gov.mu/ accessed on 13 March 2008; See also *Mauritius: Country and Foreign Investment Regime.*

[5] *About Mauritius…Our World Tax Haven Director,* http://www.ascotadvisory.com/Incorporations_Directory/Mauritius.html accessed on 02 March 2008.

[6] *Mauritius Offshore Company Formation. Which Type is Best for You* http://www.content4reprint.com/finance/financial-planning/mauritius-offshore-company-formation.-which-type-is-best-for-you.htm accessed on 13 March 2008.
See also *Mauritius: Country and Foreign Investment Regime.*

services provided by it with the objective of making Mauritius offshore company formation an attractive and suitable option for investors all over the world.[7] According to the Central Intelligence Agency[8] there are about 32 000 offshore entities in Mauritius.[9]

Since independence in 1968, Mauritius has developed from a low-income, agriculturally based economy to a middle-income diversified economy with growing industrial, financial services and tourist sectors. The Mauritian government strategy centres on industrialisation (with a view to modernisation and to exports), agricultural diversification and tourism.[10] Banking and other financial services form the most rapidly growing economic sector. Due to its focus on the tourism industry, the transportation and communication networks and accomodation facilities are very well developed.[11] Mauritian politics are characterised by coalition and alliance building as well as a commitment to democracy.[12]

With English being an official language, communication is not a barrier for business in Mauritius. Mauritius is ranked 24 out of 181 countries in terms of ease of doing business.[13] From a political and socio-economic perspective Mauritius is a safe country for offshore investment because of its vibrant democracy and political and economic stability.[14]

Mauritius has a relatively sophisticated banking sector, with more than eleven domestic banks and twelve offshore banks. The offshore banks are engaged in a wide range of internationally based business, including private banking, foreign exchange trading and fund management. The central bank, the Bank of Mauritius, carries out the supervision and regulation of all banks as well as those non-bank financial institutions that are

[7] *Mauritius Offshore Company Formation. Which Type is Best for You?*
[8] Central Intelligence Agency "Mauritius" *The World Factbook* accessible on https://www.cia.gov/library/publications/the-world-factbook/geos/mp.html accessed on 03 February 2009.
[9] See http://www.taxhavenco.com/mauritius.html accessed on 22 March 2008.
[10] Oleynik *Mauritius Tax Guide* (2006) 12.
[11] Oleynik 12.
[12] Oleynik 19.
[13] World Bank *Doing Business 2009 - Country Profile for Netherlands* http://www.doingbusiness.org/ExploreEconomies/?economyid=125 accessed on 28 May 2009.
[14] *Mauritius Offshore Company Formation. Which Type is Best for You?*

authorised to accept deposits.[15] Mauritius offshore company formation and handling of other company affairs is regulated under the Companies Act 2001.[16]

Mauritian corporate law is derived from English law. Many Mauritian lawyers and attorneys have been trained in the United Kingdom. However, the primary legal system is founded on French civil law.[17]

The Mauritian tax system is constantly being adjusted in order to make Mauritius an even more attractive country to invest in. The constant adjustment is regularly influenced by tax and economic experts from all over the world recommending incentives that would be more suitable for investors from outside Mauritius.[18]

8.2 MAURITIAN CORPORATE INCOME TAX

Mauritius has a global system of corporate income tax (i.e. it is a residence-based tax system). The taxation of resident companies is governed by the Income Tax Act 1995, which is, as is the case with corporate laws, also substantially based on the equivalent law in the United Kingdom. A company is treated as resident in Mauritius if it is incorporated in Mauritius or if it is managed and controlled from Mauritius. According to Joory: [19]

> In determining whether a company's central management and control is exercised in Mauritius, the tax authorities will look at the decision-making process to ascertain whether the key decisions are taken in Mauritius. The fact that the board of directors of a company normally meet in Mauritius is

[15] "Mauritius Financial Overview". http://www.sovereignsociety.com/Default/MauritiusFinancialOverview/tabid/1678/Default.aspx accessed on 15 May 2008.
[16] *Mauritius Offshore Company Formation. Which type is Best for You?*
[17] See Central Intelligence Agency *The World Factbook.*
[18] Discussion with Professor Peter Harris, Director – Centre for Tax Law, University of Cambridge on 20 March 2009 at the University of Cambridge.
[19] Joory D, *International Taxation of Low-Tax Transactions*, International Financial Services Limited 2008, Ebene, Mauritius, at II/63, http://books.google.co.za/books?id=prLYMAwtTcC&pg=PT52&lpg=PT52&dq=Mauritius accessed on 04 September 2008.

> *prima facie* evidence that the company's central management and control is in Mauritius.

A resident company is taxed on its worldwide taxable income. The worldwide taxable income includes foreign-source income. A non-resident company carrying on business through a branch in Mauritius is subject to tax on the income of the branch.[20] Mauritius does not have a controlled foreign company regime. Non-resident companies not carrying on business in Mauritius, even though they may be wholly-owned subsidiaries of a Mauritian holding company, will not be taxed in Mauritius. In this regard Joory comments as follows:

> Foreign enterprises carrying on business in Mauritius are subject to tax only on their Mauritian-sourced income. When business is carried on through a registered branch, income is determined on the basis of the local activity of the branch. Deductions are allowed for reasonable head office expenses incurred in relation to the branch operations. A branch is liable to tax at the same rate and in the same manner as a local corporation. There is no additional tax on the transfer of branch profits.[21]

Taxable income includes rents, dividends, royalties and interest. However, dividends paid by "tax incentive" companies, companies listed on the stock exchange, and companies which are fully taxable in Mauritius are exempt from tax in the hands of the receiving shareholder, whether resident or not. Capital gains are not generally subject to tax in Mauritius. However, in certain instances capital gains arising from the disposal of land are taxed. All other capital gains are not included in taxable income.[22]

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[20] *Mauritius: Domestic Corporate Taxation*, http://www.lowtax.net/lowtax/html/jmudctx.html accessed on 16 March 2008.
[21] See Joory D II/55.
[22] *Mauritius: Domestic Corporate Taxation.* See also *Mauritius: Country and Foreign Investment Regime.*

8.2.1 Rates of Tax

The rate of normal corporate income tax in Mauritius is currently 15% on taxable income, having been reduced from 25% as of 1 July 2007. Corporate profits are calculated by application of the ordinary principles of commercial accounting, subject to the rules contained in the tax legislation. In the 2007/2008 budget the Mauritian treasury introduced a Special Levy on the banking sector that applies only to profitable banks. The Special Levy combines the features of a turnover tax and a tax on profits. It is calculated at 0.5% of the turnover and 1.7% of the profits made.[23]

The 2007/2008 budget also introduced an Advance Payment System (commonly known as "APS") for companies. In terms of this system companies are required to effect quarterly provisional tax payment on the basis of the taxable income of the preceding tax return. Final reconciliation of tax liability will be done when the annual tax return for that year is submitted.[24] Furthermore, all companies with an annual turnover of above R30 million or having more than 50 employees are required to submit their income tax and VAT returns electronically.

8.2.2 Alternative Minimum Tax

Since 2004 Mauritius has also applied the alternative minimum tax (hereinafter referred to as "the AMT") system. The AMT is designed to ensure that taxpayers pay at least some tax, whatever the level of deductions. It applies if a company declares a dividend or distributes any shares instead of dividends and if the tax payable is less than 5% of that company's book profits.[25]

The AMT is payable by companies whose normal tax payable in an income year is less than 7.5% of its book profit. The tax payable under the AMT equals the lower of 7.5% of

[23] *Mauritius: Domestic Corporate Taxation.*
[24] To avoid double tax payment in the first year the tax due for the previous year is spread over three years, in equal instalments. The first quarterly payment was required from large companies as from financial year starting 1 July 2008. See *Mauritius: Domestic Corporate Taxation, supra.*
[25] See http://www.gov.mu/portal/sites/mra/efile.htm accessed on 12 November 2008.

the book profit[26] or 10% of dividends declared for that year and any amounts distributed instead of dividends. The tax payable is the higher of the AMT or the tax payable under the normal corporate tax rules. Book profit is reduced by the amount of exempt dividends from resident companies and profits and/or gains from the sale of fixed assets or securities and is increased by disallowed expenditure incurred in the production of such exempt income.[27]

The AMT does not apply to companies that are exempt from normal corporate tax. Furthermore, due to the method of calculating the normal tax (i.e. multiplying the tax rate applicable to a company by its taxable income and deducting tax credits other than foreign tax credits) most companies that are owned by non-residents normally fall outside the scope of the AMT.[28]

8.2.3 Other Tax Instruments

The Mauritian tax system does not contain most of the anti-avoidance provisions that are found in developed tax systems. There are no transfer pricing and thin capitalisation provisions, controlled foreign company provisions, exchange controls or withholding taxes.[29]

8.3 TAX ASPECTS THAT MAKE MAURITIUS POPULAR

From a tax point of view, Mauritius is a popular jurisdiction for multinational structures. As Joory[30] states, "Mauritius is a low tax jurisdiction, as well as a no-tax jurisdiction for certain offshore entities (referred to as Global Business Companies). Low taxation and

[26] Book profit is calculated in terms of the generally accepted accounting principles. For purposes of the AMT calculation, capital gains and losses on revaluation of fixed assets, dividends received from resident companies and trading profits and losses from the sale or revaluation of securities are excluded in the computation of book profit. Ernst & Young, *Worldwide Corporate Tax Guide* (2006) 581.
[27] See Joory D II/53. See also Ernst & Young 580.
[28] Joory II/53.
[29] Oleynic (ed) *Mauritius Tax Guide* (2006) 25; Ernst & Young 584.
[30] Joory D II/51.

tax exemption on sale of securities, coupled with a wide network of tax treaties makes Mauritius an attractive jurisdiction for cross-border business activities."

The nil income tax rate on total net income before distributions applies not only to companies holding Global Business Licence 2[31] (hereinafter referred to as "GBL2 companies") but also to headquarter companies, companies licensed to carry out activities in a Freeport zone and offshore trusts electing non-residence status, among others.

In addition to GBL2 companies and the other companies that are not taxed, Mauritius imposes a low tax of 15% on approximately 40 types of enterprises referred to as tax-incentive companies. The more prominent examples of these types of companies are: companies holding a Global Business Licence 1 (hereinafter referred to as "GBL1 companies"); unit trusts; authorised mutual funds; venture capital funds; manufacturing and export service companies; companies operating in priority sectors such as hotels, housing, export service and small and medium-sized industries; and internet and network service providers.

Relative to its geographical size, low-tax system and international exposure, Mauritius has an extensive treaty network. It has a network of 33 treaties with eight awaiting ratification and six more being negotiated.[32] Besides this significant number, the Mauritian tax treaty policy includes a preference for a tax sparing[33] clause and minimum (often zero) withholding taxes.

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[31] See par 8.3.1 below.

[32] *Mauritian Revenue Authority, Double Taxation Agreements* http://www.gov.mu/portal/sites/mra/dta.htm accessed on 10 September 2008.

[33] A tax sparing clause is a tax treaty provision in terms of which a contracting state agrees to grant relief from residence taxation with respect to source taxes that have not actually been paid (taxes that have been 'spared' or hypothetical taxes) in the other contracting state. See *Tax Sparing – A Reconsideration* http://www.oecd.org/dataoecd/10/48/2090389.pdf accessed on 16 September 2008. See discussion on tax sparing credit below at par 8.3.1.1 (b)(ii).

8.3.1 Companies Holding Global Business Licences

The Mauritian government provides for Global Business Licences for Mauritian incorporated companies owned by foreigners. Companies holding Global Business Licences are very popular for foreign investment into Mauritius. The special tax regime for these companies was intended at attracting foreign direct investment into Mauritius. Two kinds of Global Business Licences are on offer: the GBL1 and the GBL2.[34]

There are specific rules applicable to both GBL1 and GBL2 companies. Both kinds may only conduct offshore business activities with persons who are not resident[35] in Mauritius and in currencies other than the Mauritian rupee. They are not allowed to hold any immovable property in Mauritius, or certain securities in Mauritian corporation or any account in a bank in Mauritian currency.[36]

An additional benefit provided by the Mauritian Financial Services Development Act of 2001 (hereinafter referred to as “the FSDA”) to bodies regulated by it, including GBL1 and GBL2 companies, is that of secrecy and confidentiality. No person or body is authorised to disclose information or present documentation to any court, tribunal, committee of inquiry or other authority in Mauritius unless ordered to do so by a court of law on application by the Director of Public Prosecution. The order can only be made for inquiry into the trafficking of narcotics and dangerous drugs, arms trafficking or money laundering. With the permission of the FSC, disclosure of information may be made to

[34] Oleynik 43–44.
[35] For purposes of determining residency in respect of individuals in Mauritius, a “resident” is an individual who is domiciled in Mauritius unless his/her permanent place of abode is outside Mauritius, has been present in Mauritius in that income year, for a period of, or an aggregate period of, 183 days or more; or has been present in Mauritius in that income year and the two preceding tax years, for an aggregate period of 270 days or more. See *Mauritius, Taxation of International Executives* http://www.kpmg.com/SiteCollectionDocuments/TIES/MAURITIUS_2007_TIES.pdf accessed on 24 March 2008.
[36] Section 21(1) of the Financial Services Development Act of 2001. Specific securities that may not be held are “any share, debenture, security or any interest in any company incorporated or registered under the Companies Act 2001 or in any société or partnership under the *Code Civil Mauricien* or the *Code de Commerce*, or in any body corporate or association formed or registered under any enactment in force in Mauritius, other than in a corporation holding a Category 1 Global Business Licence.” Section 21(1)(b) of the Financial Services Development Act of 2001.

the shareholders of the company but such information is not available for public inspection.[37]

As stated in Chapter 2,[38] an IHC is incorporated as a company. It is interposed between the operating subsidiaries and the ultimate holding company. This formation accords with the nature of the companies holding Global Business Licences in Mauritius. An IHC can be formed in Mauritius as a company holding a Global Business Licence, as it does not conduct any business and does not have to hold any immovable property directly.

8.3.1.1 Taxation of GBL1 Companies

A GBL1 company is a company engaged in qualified global business that is carried on from within Mauritius with persons who are all resident outside Mauritius and where business is conducted in a currency other than the Mauritian rupee.[39] The FSDA provides that no person shall conduct any qualified global business unless that person holds a category 1 Global Business Licence.[40] A qualified global business for purposes of a GBL1 company is any business or other activity specified in the Second Schedule to the FSDA which is carried on from within Mauritius. The Second Schedule lists the following activities: aircraft financing and leasing; assets management; consultancy services; employment services; financial services; funds management; information and communication technology services; insurance; licensing and franchising; logistics and/or marketing; operational headquarters; pension funds; shipping and ship management; and trading.

The GBL1 company is the recommended structure for individuals, body corporate, trust or partnership including limited liability partnership or a *société* for investment.

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[37] *Category 1 Global Business Company* http://www.alliance-mauritius.com/gbl1.php accessed on 11 September 2008.
[38] See par 2.2 above.
[39] See *Category 1 Global Business Company*; Oleynik 44.
[40] See s 20(1)(a) of the Financial Services Development Act of 2001.

a. Tax residence of a GBL1 company

A GBL1 company is required to be a tax resident of Mauritius. Such a company should obtain a Tax Residence Certificate (TRC). The TRC is issued by the Commissioner of Income Tax. To be tax-resident, the company must demonstrate that the effective management and control thereof is in Mauritius. To satisfy the residence test the GBL1 company must satisfy the following six requirements:[41]

1. The company must have at least two resident directors in Mauritius;
2. The board meetings of the company must be initiated and chaired from within Mauritius. This requirement does not necessarily require that the meetings should be held in Mauritius. Where the meetings are held by way of, for example, tele-conferencing, the chairperson of such meeting should be located in Mauritius;
3. The company must open and maintain an account with a local bank through which funds must flow;
4. The registered office of the company must be situated and all statutory records of that company must be stored in Mauritius;
5. The company's qualified company secretary must be resident in Mauritius; and
6. The company must have a local auditor.

Where an investor plans to incorporate an IHC as in the form of a GBL1 company such investor would need to ensure that the above requirements are met. Failure to comply with these requirements could result in the IHC being disqualified as a GBL1 company and consequently face higher taxes. The investor might also be faced with more serious consequences in the home country.

[41] *Mauritius GBC I Company (Tax Resident – Treaty Access)* http://www.ocra-mauritius.com/local/resident.asp accessed on 15 September 2008. See also *Category 1 Global Business Company.*

b. Tax treatment of a GBL1 company

GBL1 companies are taxed at a flat rate of 15% on their taxable income. Prior to June 2006, this tax rate for GBL1 companies was seen to be a tax incentive rate. However, in 2007 the normal corporate tax rate was also reduced to 15%, putting it on par with the tax rate for GBL1 companies. However, to some extent companies have retained their tax incentive status as a result of the availability of tax relief provisions that apply only to GBL1 companies.

The Mauritian Income Tax Regulations of 1996 allow for foreign tax credits on the foreign-source income of a Mauritian resident. In drafting these regulations, the Mauritian approach has been to be as generous as possible to the taxpayer with regard to foreign tax credit, making the tax regime for GBL1 companies as attractive as possible.

Three forms of credits are on offer. Two of the credits apply to the actual tax paid or payable by the taxpayer and the other is a notional, presumed tax credit. The following tax credits are available:

(i) Underlying Tax Credit

An underlying or foreign tax credit is a mechanism used to reduce or eliminate double taxation when the same income is taxed in more than one country. In terms of this method of eliminating double taxation, foreign taxes paid by a resident taxpayer on foreign-source income generally reduce domestic taxes payable by the amount of foreign tax.[42] The underlying tax credit is granted in the residence country (i.e. Mauritius). The foreign tax credit can be provided by unilateral means, where the country provides for the credit in its tax laws or by virtue of the tax treaty.

[42] Arnold and McIntyre, *International Tax Primer* (2002) 36.

Foreign tax credit in Mauritius is granted through a unilateral provision contained in the tax law. Section 77 of the Mauritian Income Tax Act provides as follows:

> Credits in respect of foreign tax
>
> (1) Where a taxpayer derives income which is subject to foreign tax, the amount of foreign tax so paid shall be allowed as a credit against income tax payable in Mauritius in respect of that income.
> (2) The credit in respect of foreign tax shall, in the case of a dividend, include credit for any foreign tax imposed on the profits out of which that dividend is directly or indirectly paid.
> (3) The Minister may, by regulations, provide for the implementation of the provisions of this section and for the granting of credit for foreign tax in such manner and on such conditions as he thinks fit.[43]

The foreign tax credit is granted on the amount taxable in Mauritius to the extent that such amount has been taxed in a foreign jurisdiction. The foreign tax credit will also, in the case of dividend income and where the shareholding is not less than 5%, include any foreign tax imposed on the profits out of which that dividend has directly or indirectly been paid.[44]

(ii) Presumed Tax Credit

A presumed tax credit, like the tax sparing credit, is not based on actual taxes paid. It is based on a presumed tax paid. The presumed tax credit applies as an alternative to the foreign or underlying tax credit. In order to apply for the foreign tax credit the taxpayer must have actually paid the tax or be liable to pay such tax. However, with regard to the

[43] Section 77 of the Income Tax Act of 1995.
[44] See The Income Tax (Foreign Tax Credit) Regulations 1996GN 80 of 1996 - 20 July 1996 Regulation 7.

presumed tax credit, a certain amount of tax is presumed to have been paid, where the taxpayer produces no records of such payment or liability.[45]

The Mauritian tax legislation provides for a presumed tax credit of 80% of the Mauritius tax chargeable in case no documentary evidence is produced in support of the payment of foreign tax at the same rate as Mauritius.[46]

The Mauritian presumed tax credit presumes that 80% of the income has been taxed in the source state. The presumption is not that the income was taxed at 80%. If the latter were the case, all foreign-source income would not be taxed in Mauritius as according to the tax credit rules, the maximum tax payable in the residence country is payable. In this case, the maximum tax payable in Mauritius is 15%. As a result, only 20% of the income is taxable at a rate of 15% resulting in an effective rate of 3%.

(iii) Tax Sparing Credit

Tax sparing is a tax treaty provision in terms of which a contracting state agrees to grant relief from residence taxation with respect to source taxes that have not actually been paid (taxes that have been 'spared' or hypothetical taxes) in the other contracting state.[47] It is typically provided by way of a tax sparing credit. Put differently, it is a credit granted by the country of residence of the taxpayer for foreign taxes that for some reason were not actually paid to the source country but would have been paid under the source country's normal tax rules.[48] The credit is normally granted in respect of notional source country taxes of a certain kind, e.g. dividends, interest and royalties or to all income arising in the source state.[49]

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[45] Campbell *International Taxation of Low-Tax Transactions* (2007) II/61.
[46] The presumed tax credit was reduced by the Finance Act of 2000 from 90% to 80% in 2002.
[47] See Shannon "Tax Incentives and Tax Sparing" (1992) *International Tax Review* 84-96; *Tax Sparing – A Reconsideration* http://www.oecd.org/dataoecd/10/48/2090389.pdf accessed on 16 September 2008.
[48] Arnold and McIntyre 50.
[49] Olivier and Honiball *International Tax – A South African Perspective* (2008) 333 outline the different forms that tax sparing provisions may take as follows: (i) the state of residence may allow as a deduction or credit the amount of tax which the state of source could have imposed in accordance with its general

A distinction may be made between tax sparing and matching credit. In tax sparing the notional foreign tax represents the tax forgone by the source country under special measures that are more often than not designed to encourage foreign investment. Matching credit on the other hand operates as a kind of exemption that is not linked to the level of source country tax or any reduction thereof.[50] Without a tax sparing provision in the treaty, the actual beneficiary of the tax incentive provided by a source country to attract foreign investment would be the residence country instead of the foreign investor, or the residence country.[51]

The standard Mauritian tax sparing clause provides that for the purposes of the normal tax credit granted by Mauritius's treaty partner "the tax payable in Mauritius shall be deemed to include the amount of tax which would have been paid if the tax had not been reduced in accordance with laws designed to promote economic development in Mauritius…"[52]

The practical application of the Mauritian tax sparing provision is that where the Mauritian laws provide for the imposition of a lower rate of tax, or the exemption of income from tax, the treaty partner's tax authorities should allow a sparing tax credit for the tax which would have been chargeable in Mauritius had those incentive provisions not been enacted. This ensures that the effective tax rate of the investor is limited to the tax that would have been payable in Mauritius.

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legislation; (ii) the state of residence may allow as a deduction the amount of tax as limited by the tax treaty for a specific type of income e.g. dividends, royalties and interest; (iii) the state of residence may allow a deduction against its own tax of a specified amount fixed at a higher rate; or (iv) the state of residence exempts the income which has benefited from tax incentives in the source state. The Mauritian policy of tax sparing takes the first form.

[50] *IBFD International Tax Glossary*, definition of "Tax Sparing Credit."

[51] Arnold and McIntyre 50.

[52] See Article 23(2) of the Double Tax Agreement between Mauritius and South Africa.

(iv) Application of the Credits

A combination of the foreign tax credit or presumed tax credit and the tax sparing provisions provide a significant tax relief measure for GBL1 companies.

The Mauritian tax credit presumes that 20% of the foreign-source income has not been taxed. As a result the 20% is taxed at a tax rate of 15%, resulting in an effective rate of 3%. For example, if a GBL1 company earns MR 200 million of foreign income, a presumed tax credit for MR 160 million will be granted and the MR 40 million will be taxed at 15% resulting in an effective tax amount of MR 6. In the same circumstances, if the taxpayer chooses to apply the foreign tax credit option on all income taxed in the source country, there would not be any tax in Mauritius, unless the source country taxes income at less than a 15% rate.

Based on the aforegoing, the presumed tax credit option operates more efficiently than the foreign tax credit in circumstances where the underlying investment is located in a tax haven. According to this functional structure, investors from foreign tax partner countries wanting to invest in a tax haven or preferential tax regime are incentivised to set up a GBL1 company in Mauritius. Such company would benefit from the Mauritian tax treaties. The GBL1 company would then set up operations or a subsidiary in a tax haven. No or low lax will be levied in the tax haven. The income will be earned in Mauritius or brought in as a dividend.

The country of residence will not be able to tax because the company will be effectively managed in Mauritius. Any dividends accruing to the shareholders resident in the country of residence would be subject to a tax sparing clause, granting 15% credit of the amount of the dividend received. The effective rate would depend on the tax rate in the resident country. Assuming all dividends are declared, as per the previous example a GBL1 company earns MR 200 of foreign income, a presumed tax credit for MR 160 is granted and the MR 40 will be taxed at 15% resulting in an effective tax amount of MR 6. If the shareholders of the GBL1 company are resident in a country with a flat tax rate of 35%,

the tax sparing clause will apply to the effect that a credit of MR 30 will be granted. The shareholder's home country will levy a tax of MR 70 less the MR 30 notionally paid in Mauritius. This will result in an overall effective rate of 20% as opposed to 35% that would have been effectively levied but for the tax sparing clause.

(v) The Benefits of GBL1 Licence for an IHC

The tax treatment of GBL1 companies in Mauritius is advantageous for IHCs. This is due to the fact that the IHC can be incorporated as a GBL1 company and access the benefits of the tax sparing credit and either the underlying tax credit or the presumed tax credit. Where the foreign-source income is taxed at a rate of 15% or more applying the underlying tax credit would result in no tax in Mauritius. However, where the tax is lower than 15%, a presumed tax credit will result in an effective rate of 3% in Mauritius.

In addition, where Mauritius has a tax treaty with the country of residence of the ultimate holding company,[53] the tax sparing credit would grant a credit for the 15% tax that would have been paid in Mauritius but for the GBL1 company incentive. In effect, therefore, the effective tax rate for the company would be the sum of the higher of 3% Mauritian tax or the source-based tax levied on subsidiaries and the difference between the 15% tax that should have been levied in Mauritius and foreign dividend tax rate levied in the residence country of the ultimate holding company.

8.3.2.1 GBL2 companies

A company can qualify as a GBL2 company if it is wholly owned by persons who are not resident in Mauritius and should operate exclusively outside Mauritius. In addition, a company may only carry on business activities as a GBL2 company if it satisfies the following criteria:[54]

[53] Mauritius has tax treaties containing tax sparing credit provisions with the following countries: China, Croatia, India, Kuwait, Lesotho, Malaysia, Mozambique, Namibia, Nepal, Oman, Pakistan, Rwanda, Seychelles, Singapore, Swaziland, Sweden, Thailand, Uganda and Zimbabwe.
[54] Section 19(2) of the FSDA.

1. It must be a private company incorporated or registered under the Companies Act of 2000;
2. It should not conduct business with persons resident in Mauritius;
3. It should not conduct any dealings in Mauritian currency, the rupee; and
4. It should have obtained the GBL2 licence issued by the Financial Services Commission.[55]

The legislative regime for GBL2 companies is more flexible than that of GBL1 companies.[56] A GBL2 company may be set up either by direct incorporation or by way of continuation. Alternatively, a GBL1 company may be converted into a GBL2 company. A GBL2 company may either be limited by shares or by guarantee or limited by shares and guarantee or simply unlimited. GBL2 company may also be registered as a Limited Life Company. It must at all times have a registered agent (an Offshore Management Company) and a registered office in Mauritius where all statutory books and records are to be kept. The purpose of the registered agent is to communicate with the Mauritian authorities and ensure that the company complies with statutory requirements.[57] Unlike GBL1 companies, GBL2 companies do not have to hold board meetings in Mauritius or have them set up or chaired in Mauritius. The GBL2 company board meetings can be held anywhere in the world.

GBL2 companies are generally used to carry on activities that include non-financial consultancy; information technology services; logistics; marketing; shipping; ship management; non-financial trading, passive investment holding; and once-off transactions using a special purpose vehicle. In addition the Financial Service Commission has the power to approve any additional activities upon application by the GBL2 company.[58]

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[55] The Financial Services Commission may refuse to license a company with a GBL2 if, in its view, the impact of the company's affairs on third parties is such that it needs to be subject to a higher degree of supervision. See *International Financial Consulting* http://www.ifcconsult.com/services_GBL2.asp accessed on 11 September 2008.
[56] See Ernst & Young 580.
[57] See *International Financial Consulting*.
[58] *Category 2 Global Business Company* http://www.alliance-mauritius.com/gbl2.php accessed on 15 September 2008.

(a) Taxation of GBL2 companies

A GBL2 company is tax-exempt as it does not fall within the purview of the Mauritian tax law. It does not pay any tax on its worldwide income to the Mauritian authorities. It does not pay any withholding tax on dividends nor is any capital gains tax levied on a GBL2 company. In effect the tax cost of a GBL2 is effectively the foreign tax suffered. Because of its tax-exempt status, a GBL2 company does not have access to the Mauritian tax treaties.[59]

The fact that the GBL2 companies are not taxable in Mauritius means that when a GBL2 company earns foreign-source income such income will be fully taxed in the foreign country and when it distributes dividends to its shareholders, such dividends will be taxable in the home country of the shareholders without any tax relief. This limits the tax benefits derivable from using a GBL2 company and subjects the company to the same difficulties experienced by the erstwhile international headquarter company in South Africa.[60] As a result of these limitations, a GBL2 company (or a company of its nature) would not be ideal to use as an IHC.

8.3.2 Advance Tax Rulings

The Mauritian tax system allows taxpayers to obtain tax rulings from the Director-General of the Mauritian Revenue Authority in respect of the application of the tax law to income that such person derives or may derive.[61] The Mauritian provision is drafted in a wide form, to the extent that "any person" may apply in relation to "any income". Practically, however, only persons that are liable to tax in Mauritius have an interest in obtaining such rulings. The ruling is not in respect of the transaction as is the case with the rulings in the Netherlands and in South Africa.[62] According to the Income Tax Act, the ruling is in relation to the income. In determining the application of the Income Tax

[59] Oleynik 44.
[60] See Chapter 10 par 10.3 on the South African International Headquarter Company.
[61] See s 159(1) of the Income Tax Act 1995 read with s 1 definitions of "Director-General" and "Authority".
[62] See par 7.3.2 with regards to the Netherlands and par 10.8 with regards to South Africa.

Act to the income, the Director-General would rely on the nature of the transaction giving rise to the income.

An application for a ruling should include "full details of the transaction relating to the income together with all documents relevant to the transaction"[63] and "specify precisely the question as to which the ruling is required".[64] Upon application of the tax ruling, the applicant is required to give a statement setting out the opinion of the applicant as to the taxation of such income.[65] The tax ruling is binding on the Director-General.[66] Thus, the taxpayer will be entitled to be taxed on the income in the manner in which the Director-General indicated the tax implications of such income to be.[67] However, the ruling would not be binding on the Director-General if there is any material difference between the facts relating to the transaction and the details contained in the application.[68]

8.4 CONCLUSION

The Mauritius tax system is one of the most attractive tax systems in the world for holding companies. The corporate income tax rate of 15% is one of the lowest compared to the corporate tax rates of most African countries.[69] Despite this low rate of tax, there are special low rates for companies undertaking certain business activities, including exporting and construction companies and companies in the financial services sector. The effective tax rate of 3% on GBL1 companies is a main attraction to use Mauritius as a host for an IHC.

The fact that dividends and capital gains are not subject to tax further enhances Mauritius as an ideal tax jurisdiction for most kinds of businesses. This is in light of the fact that no

[63] S 159(2)(a) of the Income Tax Act 1995.
[64] S 159(2)(b) of the Income Tax Act 1995.
[65] S 159(2)(c) of the Income Tax Act 1995.
[66] S 159(4) of the Income Tax Act 1995.
[67] S 159(7) of the Income Tax Act 1995.
[68] S 159(5) of the Income Tax Act 1995.
[69] The worldwide average corporate tax rate for 2008 was 25.9%. See KPMG *Corporate and Indirect Tax Rate Survey* (2008) 14 available on http://www.kpmg.com/SiteCollectionDocuments/Corporate-and-Indirect-Tax-Rate-Survey-2008v2.pdf accessed on 02 February 2009.

special circumstances need to exist in order for the dividends or capital gains to receive tax-free treatment. Furthermore, tax losses can be offset against future income for an indefinite period of time, with no monetary limit applying to such losses. In addition, where the alternative minimum tax applies, it limits the tax compliance cost and liability for the eligible companies.

Besides these positive general tax attributes, Mauritius achieved and maintains its attraction as a host for IHCs through the special tax dispensation that was designed to invite and draw foreign investment. The tax-exempt status of GBL2 companies makes these vehicles quite attractive in a group business structure. The fact that the GBL2 companies do not have access to the Mauritian tax treaty network severely diminishes the tax benefits of this entity. However, it is the GBL1 companies that yield the most tax benefits. The combination of the tax sparing clause in the DTAs and the presumed tax credits give the GBL1 company a major competitive tax advantage over structures that countries worldwide offer to investors.

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CHAPTER 9

SPECIAL FEATURES IN OTHER TAX REGIMES

9.1 INTRODUCTION AND BACKGROUND

As was seen in Chapters 7 and 8, the Dutch and Mauritian tax systems make these countries ideal as the location of an IHC. The purpose of this chapter is to highlight special features in the tax systems of other countries that have special tax regimes for holding companies that are intended to attract IHCs to their shores. This chapter is also intended to expose the reasons why some countries are not necessarily successful, despite having specific legislation to attract IHCs. In this context the tax systems of three countries, namely Belgium, Ireland and the United Kingdom (hereinafter referred to as "the UK"), will be discussed briefly.

This section focuses on special features in different tax jurisdictions that are beneficial to, and could result in the attraction of, IHCs. The general corporate tax systems of these jurisdictions are briefly outlined in order to contextualise the application of the special features concerned. That is followed by a detailed analysis of the special features of each system.

Belgium, Ireland and the UK are all members of the European Union (hereinafter referred to as "the EU"). The EU's Parent-Subsidiary Directive applies to dividends declared by companies resident within the EU to companies resident in these countries.[1] The result of the application of the Parent-Subsidiary Directive is that when the holding company receives a distribution of profits from the subsidiary, the country of the holding company should refrain from taxing such profits or should tax such profits while authorising the holding company to deduct from the amount of tax due that fraction of the corporation

[1] Council Directive of 23 July 1990, Parent-Subsidiary Directive 90/435/EEC. See a detailed discussion of the Parent-Subsidiary Directive in par 7.5.4 and sources referred to therein.

tax paid by the subsidiary which relates to those profits.[2] Furthermore, the profits which a subsidiary distributes to its holding company should be exempt from withholding tax in the hands of the holding company.[3]

9.2 BELGIUM

9.2.1 Introduction

Belgium is located in Western Europe bordering the North Sea. It is located between France and the Netherlands. It has a population of about 10 million people. Dutch, French and German are the official languages, although less than 1% of the population speak German. The Belgian currency is the Euro and the capital city is Brussels.[4] In the 2009 Doing Business report from the World Bank, Belgium was ranked 64th out of 181 countries in relation to the ease of paying taxes.[5]

9.2.2 Corporate Income Tax

In Belgium resident companies are subject to tax on their worldwide income and non-residents on their Belgian-sourced income. A company is resident in Belgium if it is registered, or its central management is exercised, in Belgium.[6] The corporate income tax rate is 33.99%.[7]

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[2] Preamble and Article 6 of the EU Council Directive.

[3] Preamble and Article 6 of the EU Council Directive. The exemption from withholding tax on the subsidiary is directed at ensuring fiscal neutrality. Germany and Greece, by reason of the particular nature of their corporate tax systems, and Portugal for budgetary reasons are authorised to temporarily maintain a withholding tax.

[4] Central Intelligence Agency "Belgium" The World Factbook accessible on https://www.cia.gov/library/publications/the-world-factbook/geos/be.html#top accessed on 02 November 2009.

[5] See *Doing Business* http://www.doingbusiness.org/documents/paying_taxes_2009.pdf accessed on 15 October 2009.

[6] See Vanhaute *Belgium in International Tax Planning* (2008) 94. See also Ernst & Young *Worldwide Corporate Tax Guide* (2006) 85.

[7] Deloitte *Holding Companies in Belgium* http://www.deloitte.com/dtt/cda/doc/content/Holding%20Companies%20in%20Belgium.pdf accessed on 22 October 2009.

Foreign tax relief is only available through treaty application.[8] Capital gains are treated as ordinary company profits and are therefore subject to tax at the standard corporate income tax rate. However, as is discussed below, capital gains on shares are fully exempt.[9] Belgium has a tax treaty network covering some 88 countries.[10] A general advance tax ruling system was introduced on 1 January 2003.[11] There is no restriction of inward and outward movement of capital through exchange controls.[12]

9.2.2.1 CFC Legislation

There is no specific controlled foreign company (hereinafter referred to as "CFC") legislation, although general anti-avoidance measures may achieve the same effect as CFC legislation would have achieved.[13] In terms of Article 344 § 2 of the Belgian Income Tax Code, the *Wetboek van de Inkomstenbelastingen* (hereinafter referred to as "the ITC"), certain transfers on income-producing assets, such as shares, receivables, debt instruments, intellectual property rights and cash to a foreign entity subject to a privileged tax treatment can be disregarded by the tax authorities. The transfer could be valid for tax purposes if the taxpayer is able to prove that the transaction was entered into for genuine business or financial purposes, or when the transferred assets produce taxable income.[14]

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[8] Ernst & Young 89; Schoonvliet "Unilateral and Treaty Measures in Belgium for the Avoidance of Double Taxation" (2008) *Bulletin for International Taxation* 430.
[9] Vanhaute 101.
[10] Deloitte *Comparison of European Holding Company Regimes* https://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/dtt_tax_holdcomatrix_europe_072309.pdf accessed on 22 October 2009.
[11] The Belgian advance tax ruling "is legally binding on the [Federal Public Service for Finance] vis-à-vis the taxpayer that requested the advance tax ruling, provided that the situations or transactions materialize in accordance with their description by the taxpayer. However, there is no obligation on the part of the taxpayer to carry out the transactions that are the subject of the ruling request" (Vanhaute and Huygens *Belgium: Holding Companies* (2009) par 8.4.1.4. http://online2.ibfd.org/hold/ accessed on 06 November 2009). See also PricewaterhouseCoopers *Belgium's Advance Ruling Practice: A Powerful Risk Management Instrument in Tax Planning* http://www.doingbusiness.pwc.be/index.html?page=117 accessed on 22 October 2009; Ernst & Young 87.
[12] Ernst & Young 91. For statistical purposes, the Belgian financial institutions are required to report all transactions with foreign countries to the National Bank of Belgium.
[13] Deloitte *Comparison of European Holding Company.*
[14] See Vanhaute 209.

9.2.2.2 Transfer Pricing

The Belgian tax regime contains transfer pricing rules. Most significant and relevant to this thesis is the principle which provides that all abnormal and gratuitous advantages granted by a Belgian enterprise are added to the taxable income of that Belgian enterprise. This transfer pricing rule does not apply if the advantages are part of the income of the recipient that is taxable in Belgium.[15]

The Belgian transfer pricing rules apply to transactions between connected persons as a general rule. However, the rules also apply to transactions with "unrelated foreign persons that are not subject to income tax in their residence state or are subject to an income tax regime that is substantially more beneficial than the normal income tax regime in Belgium".[16]

9.2.2.3 Notional Interest Deduction

The Belgian tax regime provides companies with an annual notional interest deduction, a fictitious interest deduction which is calculated as a percentage of the company's risk-bearing adjusted net equity.[17] The percentage is equal to the interest rate applicable to ten-year Belgian government bonds. By way of example, for the 2008 financial year, the percentage was 3.701%.[18]

The purpose of the notional interest deduction is to reduce the tax discrimination between debt financing and equity financing. This is because interest on borrowed funds is deductible and dividends on risk-bearing capital are not deductible.[19] According to Bird

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[15] Art 26 of the ITC. See also Feinschreiber *Transfer Pricing International – A Country-by-Country Guide* (2002) par 19.3; Vanhaute 191; Ernst & Young 91.
[16] Osterweil and Quaghebeur "Taxation of Companies under Belgian Income Tax Law" (2008) *Bulletin for International Taxation* 350.
[17] Art 205*bis*-205*novies* of the ITC. Adjusted equity consists of net equity, including capital, reserves and retained earnings, but does not include equity invested in shareholdings; see Haelterman and Verstraete "The 'Notional Interest Deduction' in Belgium" (2008) *Bulletin for International Taxation* 365; Vanhaute 228.
[18] See Vanhaute 158.
[19] Vanhaute and Huygens *Belgium: Holding Companies* par 3.4.2.1.4.

and Bird, "[t]his deduction is considered compensation for the economic cost of equity and is not subject to any condition of reinvestment or employment and may be carried forward for seven years".[20]

9.2.2.4 Dividend Withholding Tax

Dividends paid by a Belgian company are subject to a 25% withholding tax. The withholding liability arises when the dividend is paid. The withholding liability extends to foreign-sourced dividends that are paid through the intervention of a Belgian intermediary. Where there are multiple Belgian intermediaries, the first Belgian intermediary who intervenes in the payment has the liability to withhold.[21]

Dividends paid by a Belgian company to a company resident in an EU member state are subject to a zero per cent withholding in terms of the EU Parent-Subsidiary Directive.[22] Similarly, dividends paid to a company resident in a tax treaty partner country where that treaty contains an exchange of information clause are subject to a zero per cent withholding.[23] In both the cases of EU member state and treaty country, the following conditions must be met in order for the zero per cent rate to apply:[24]

1. the company receiving the dividend must hold a participation of at least 25% of the share capital of the dividend distributing company for a period of at least 12 months;

[20] See Bird & Bird *Belgian Holding Company Rules* (2008) http://springael.com/Documents/HOLD_BB_20080601.pdf accessed on 28 October 2009.
[21] Vanhaute and Huygens *Belgium: Holding Companies* par 4.2.1.1. See also Hinnekens and Drijkoningen "Belgium's Holding Company Regime – The Dividends-Received Deduction and Capital Gains Exemption for Shares" (2001) *Bulletin for International Taxation* 358–359.
[22] See Art 106(5) of the ITC.
[23] See Van Stappen "Belgium: Dividend Withholding Tax Exemption Improves Code" *International Tax Review* http://www.internationaltaxreview.com/Default.asp?Page=10&PUBID=35&ISS=23172&SID=668625&TYPE=20 accessed on 29 October 2009.
[24] See Vanhaute 155; Vanhaute and Huygens *Belgium: Holding Companies* par 4.2.3.1.

2. the company receiving the dividend must have its corporate seat within the EU and must not also be resident in a non-EU country in terms of a double tax treaty (hereinafter referred to as "a DTA") (no dual residence); and
3. the company receiving the dividend must be subject to corporate income tax or to similar tax without benefiting from a regime that deviates from the normal regime.

With regard to the 12-month holding period, the European Court of Justice in the *Denkavit*[25] case held that the exemption also applies even if the minimum 12-month holding period has not yet expired provided that the Belgian company submits a certificate indicating an undertaking to keep the minimum 25% participation for at least 12 months.[26] The second requirement stated above disqualifies dividends that are paid to companies that are not resident in an EU country from the exemption. Thus, only Belgian IHCs with ultimate investors that are resident in the EU can benefit from this exemption.

9.2.3 Special Features in the Belgian Tax System

The Belgian tax system contains three special tax features that are intended to make Belgium particularly attractive as a location for a holding company. These features are the dividend received deduction, the tax exemption for capital gains realised on shares and a liberal thin capitalisation regime.

9.2.3.1 Dividends Received Deduction

Ordinarily, dividends received by a Belgian company become part of taxable income and are therefore taxable at the 33.99% corporate income tax rate. In terms of the dividends received deduction, 95% of the dividends received by a Belgian company are deducted

[25] EU Court of Justice C-283/94 and C-292/94, 17 October 1996.
[26] For a further discussion of this case see Jakoben and De Haan "European Union: Why Withholding Taxes are under Threat" (2005) *International Tax Review* http://www.internationaltaxreview.com/Default.asp?Page=10&PUBID=35&ISS=20909&SID=596447&TYPE=20 accessed on 06 November 2009.

from taxable income.[27] The remaining 5% is taxable but costs and expenses, such as interest, are deductible therefrom.[28] The dividends received deduction applies where the shareholding by the Belgian company in the company paying the dividends meets the following conditions:[29]

1. The Belgian company must hold at least 10% of the share capital of the company declaring the dividend, or must have obtained the shareholding for acquisition value of at least EUR 1.2 million;
2. The participation must be held (or there should be a commitment to hold the participation) in full property for an uninterrupted period of at least 12 months;
3. The participation must qualify as a "fixed financial asset";[30] and
4. The company paying the dividend must satisfy the subject-to-tax requirement.

In terms of the subject-to-tax requirement the dividends will not benefit from the dividends received deduction if they are distributed by certain treasury, financing and investment companies and/or distributed by companies located in low-tax jurisdictions or tax havens.[31]

The dividends received deduction is not available if the dividends are paid by: (i) a company that is not subject to tax in Belgium or to a similar foreign corporate income tax; (ii) a company that is established in a country where the normal tax regime is substantially more advantageous than the normal Belgian tax regime; (iii) a finance, treasury or investment company that is subject to a tax regime that deviates from the normal tax regime; (iv) a company receiving non-dividend income that is subject to a

[27] Art 205 § 2 of the ITC. See also Hinnekens and Drijkoningen *Bulletin for International Taxation* 355; Deloitte "Changes Introduced to Taxation of Dividends" (2005) *Belgium Tax Alert* http://www.mdseminars.be/files/articles/FIS-A-87.pdf accessed on 23 October 2009.
[28] See Bird & Bird *Belgian Holding Company Rules*.
[29] See Art 205(ter)(1) of the ITC.
[30] As to what constitutes a "fixed financial asset" the Belgian tax law refers to the accounting legislation, i.e. Art 95 of the Royal Decree of 30 January 2001. According to Dierckx the "fixed financial asset" requirement in principle requires that at the time the dividend is payable the participation must be considered to be a long-term investment (Dierckx "Belgium's Holding Company Regime – Past, Present and Future" (2008) *Bulletin for International Taxation* 404.
[31] Deloitte *Holding Companies in Belgium.*

separate tax regime deviating from the normal tax regime in the country of residence of the company declaring dividends; (v) a company that realises profits through foreign branches (to itself) subject to a tax assessment regime that is substantially more advantageous than the Belgian regime; (vi) an intermediary distributing or redistributing dividend income of which items (i)-(v) apply to 90% of the dividend concerned.[32]

The dividends received deduction is applicable only to the extent that there is sufficient taxable income available from which the deduction can be made. The taxable income can be from any source. If the company receiving the dividends does not have sufficient taxable income, or has losses, all or part of the 95% may be lost.[33]

In April 2003, the Court of First Instance of Brussels in Belgium ruled that the application of the dividends received deduction is in violation of the EU Parent-Subsidiary Directive because the EU Parent-Subsidiary Directive requires that member states should refrain from taxing qualifying dividends in the country of the company receiving dividends or to provide for a full foreign tax credit.[34] Pursuant to this the Minister of Finance announced that the dividends received deduction would be amended to be brought in line with the EU Parent-Subsidiary Directive in respect of dividends received from companies resident in the EU member states.[35] Irrespective of remedial action taken by Belgium, the ECJ ruled on 12 February 2009 in the *Cobelfret v Belgium*[36] case that Belgium has not correctly implemented the Parent-Subsidiary Directive in the dividends received deduction regime.

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[32] See De Neef and Malvaux "New Belgian Rules on Dividend Income Taxation and Capital Gains Exemption" (1997) *International Tax Review* 290–295. See Vanhaute 153; See also http://www.ing.be/xpedio/groups/ingbe/@public/@bbl/@risk_management/documents/other/262169_en.pdf accessed on 29 October 2009.
[33] See Deloitte *Holding Companies in Belgium.*
[34] Brussels Court, 25 April 2003, *F.J.F.* 2003, p. 812. See KPMG "Dividends Received Deduction and Withholding Tax: Partial Adjustment to European Legislation" (2005) *e-Tax Flash* accessible on http://kpmgbe.lcc.ch/dbfetch/52616e646f6d49562cdd4cc78bc61c14eb773c6c7c5f5b79/implementation_new_parent-subsidiary_directive.pdf accessed on 09 November 2009.
[35] See Deloitte *Belgium Tax Alert*. See also Dierckx *Bulletin for International Taxation* 409–410; Deloitte *Holding Companies in Belgium.*
[36] *Cobelfret v Belgium* (C-138/07) European Court of Justice. See also Isenbaert "Belgium Dividend Received Deduction Regime Found Contrary to the Parent-Subsidiary Directive by the ECJ in the Cobelfret Case" (2009) *Client Alert* http://www.bakernet.com/NR/rdonlyres/8332E9A5-EF15-4EFB-BC77-5DB3F7FAA2F8/0/belgium_colfretcase_ca_feb09.pdf accessed on 18 November 2009.

The dividends deduction is not available for dividends distributed by an intermediary company unless that intermediary company is an investment company which redistributes dividends from "contaminated" participators.[37] It is only under certain circumstances that the dividends deduction would remain available with respect to dividends received from EU-based finance companies, Belgian companies and certain listed companies, and companies that have been effectively taxed in Belgium on the redistributed dividends.[38]

In this regard Dierckx[39] states that the dividends received deduction will be allowed "for dividends from a direct shareholding in an EU-resident intermediary financial company if it can be demonstrated that the shareholding meets legitimate financial needs and the financial company's taxed reserves on the first day of its financial year plus its paid up capital on the last day of its financial year do not exceed 33% of its liabilities".

For the purposes of the dividend deduction, an "investment company" is defined as a company the purpose of which is to collectively invest pooled funds in the nature of a collective investment scheme such as a SICAV[40] and similar entities.[41] An IHC is not an investment scheme or similar to an investment scheme. Furthermore, it does not even carry out business activities similar to those carried out by an investment scheme. This means that the dividends received deduction does not apply to an IHC as it is not an "investment company" as defined.

The dividends received deduction is a great tax-reduction tool in the operation of a holding company. However, in effect, it does not apply to IHCs located in Belgium. This deprives Belgium of one of the main attractions of locating an IHC in the country.

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[37] Vanhaute and Huygens *Belgium: Holding Companies* par 4.1.3.2.5. For purposes of this provision, dividend income from "contaminated" participations refers to dividends of which, if distributed directly to the Belgian beneficiary, at least 90% would have been excluded from the dividend deduction under one of the exclusions.
[38] Vanhaute and Huygens *Belgium: Holding Companies* par 4.1.3.2.5.
[39] Dierckx *Bulletin for International Taxation* 408.
[40] A SICAV, *Societe d'Investissement*: A Capital Variable is "an open-ended collective investment scheme that derives its value by the number of participating investors (more investors means more available capital)"; see http://www.investorwords.com/6672/SICAV.html# accessed on 06 November 2009.
[41] Vanhaute and Huygens *Belgium: Holding Companies* par 4.1.3.2.5.

9.2.3.2 Tax Exemption for Capital Gains Realised on Shares

As stated above,[42] capital gains are treated as ordinary company profits and are therefore subject to the standard corporate income tax rate. With regard to shares, the net gain[43] realised by Belgian companies on the disposal of shares in non-resident companies is exempt from Belgian corporate income tax if the shares relate to participations that meet the "subject-to-tax" requirement as discussed under the dividend received deduction regime above.[44] The other requirements (i.e. the minimum shareholding, fixed financial asset and holding period) do not apply.[45]

The subject-to-tax requirement is not met if the company whose shares are disposed of is resident in a low-tax country.[46] This means that the tax exemption for capital gains on shares will be available only in limited cases where the company whose shares are disposed of is resident in a high-tax country.

9.2.3.3 Thin Capitalisation

The Belgian tax regime contains thin capitalisation provisions. The debt-to-equity ratio is effectively 7:1.[47] Deloitte[48] summarises the application of the thin capitalisation provisions as follows:

> When the holding company issues debt to a tax exempt company or a company at the level of which interest income is subject to a tax regime substantially more advantageous than in Belgium, the debt is regarded as

[42] See par 9.2.2.
[43] "Net gain" is gain after the deduction of the alienation costs e.g. bank fees, commissions, consultancy costs, notary fees and publicity costs (Vanhaute 154).
[44] Vanhaute 154. See also Tahon and Bogaerts "Belgium: Amendments to the Participation Exemption Regime" (2002) *European Taxation* (Vol. 42 Issue 12) 513–515.
[45] See Bird & Bird *Belgian Holding Company Rules*.
[46] See par 9.2.3.1; Art 205(ter)(1) of the ITC; Decleir "Belgian Budgetary Income Tax Measures of 1997: Major Changes for the Participation Exemption and Introduction of Thin Capitalization Rules" (1998) *The International Tax Journal* (Vol. 24 Issue 1) 60–67.
[47] See Art 198(1)(11) of the ITC.
[48] Deloitte *Comparison of European Holding Company Regimes.*

> "tainted", with the following consequences: i) interest payments related to tainted debt are only tax deductible when HoldCo proves that the debt relates to real and sincere transactions and that the conditions of the debt are not abnormal, and ii) in any case, the interest deduction will be denied to the extent that the total tainted debt exceeds seven times the equity. The part of the interest payments exceeding the market rate are not tax deductible. Interest payments on debt issued to individual shareholders and to directors (individuals and corporations other than European corporations) will be recharacterised as dividends to the extent that the total debt exceeds the company's equity and to the extent the normal market rate is exceeded.

The 7:1 limitation "can apply to foreign-based beneficiaries as well as to beneficiaries resident in Belgium who benefit from a substantially more advantageous tax regime as compared to the generally applicable regime. Accordingly, the [7:1] limitation could potentially apply to interest paid by a Belgian debtor to a Belgian coordination centre or any other not or low-taxed entity."[49] The Belgian thin capitalisation regime is liberal in its application and is thus convenient for the financing of foreign subsidiaries.[50]

Although the Belgian thin capitalisation provisions are liberal there are established methods of avoiding the application of these provisions. In this regard Vanhaute and Huygens state as follows:[51]

> The [7:1] debt/equity ratio could be avoided by using an intermediate finance company which is subject to a tax regime which is not considered to deviate substantially from the Belgian tax regime. Depending on the debt/equity ratios which may apply in the finance company's own country, the latter could be highly leveraged so that its taxable basis is substantially

[49] Vanhaute and Huygens *Belgium: Holding Companies* par 3.4.2.3.2.
[50] Hinnekens and Drijkoningen *Bulletin for International Taxation* 359; Decleir *The International Tax Journal* 66–67
[51] Vanhaute and Huygens *Belgium: Holding Companies* par 3.4.3.4.

eroded. Suitable jurisdictions for the location of such finance company would be the Netherlands and Luxembourg.

9.2.4 Conclusion

The Belgian corporate tax regime contains some features that make Belgium suitable for the operation of an IHC. These are mainly that Belgium does not have exchange control regulations and has an advance tax ruling system and a notional interest deduction system. Furthermore, there is an exemption on capital gains realised on shares (although it applies in limited cases) and liberal thin capitalisation provisions, for the avoidance of which there are established methods.

However, dividend withholding tax is a main concern for many investors. The exemption therefrom would suit investors whose home country is located in the EU, or those that are willing to interpose another company within the EU. However, the cost of such interposition might extinguish the tax benefit derived from the exemption from the dividend withholding tax.

On the other hand, the Belgian tax system also contains tax instruments that are not suited for a jurisdiction that hosts IHCs. Among these the following deserve to be mentioned: the high 33.99% corporate income tax that also applies to capital gains, the lack of foreign tax credits other than on application of a treaty as well as the presence of CFC-like legislation. The availability of the dividends received deduction, on the face of it, is a positive feature. Unfortunately, the fact that it is not available for IHCs makes the dividends received deduction useless for enhancing Belgium's position as a preferable host for IHCs.

9.3 IRELAND

9.3.1 Introduction

Ireland is located in Western Europe and occupies five-sixths of the island of Ireland in the North Atlantic Ocean, west of Great Britain. It has a population of about four million people. English is the official language that is generally used while Irish is an official language that is spoken mainly along the western coast of Ireland. The Irish currency is the Euro. The capital city is Dublin.[52]

Ireland has been at the forefront of fiscal inventive innovations for many years.[53] Currently it is seen as an attractive location for business, with a tax regime that ranks very competitively against other economies.[54] Its appeal derives from a low rate of corporation tax coupled with an educated workforce and an advanced industrial infrastructure.[55] In the 2009 Doing Business report from the World Bank, Ireland was ranked 6th out of 181 countries in terms of the ease of paying taxes, the highest in the European Union.[56]

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[52] Central Intelligence Agency "Ireland" *The World Factbook* https://www.cia.gov/library/publications/the-world-factbook/geos/ei.html accessed on 14 October 2009.
[53] Loughlin "Ireland Offers Limited Opportunities" 1993) *International Tax Review* 37.
[54] Diamond "Maintaining Ireland's Advantages as a Location for FDI" (2008) *Accountancy Ireland* (Vol. 40 Issue 5) 80–82.
[55] McGonagle "Ireland Ranks Highly as a Location for Business" (2009) *International Tax Review* http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=25377&SID=719831&TYPE=20 accessed on 19 October 2009. McGonagle "Ireland Aims to Attract Holding Companies" (2004) *International Financial Law Review* http://proquest.umi.com/pqdweb?did=783749051&Fmt=3&clientId=27625&RQT=309&VName=PQD accessed on 22 October 2009.
[56] See *Doing Business* http://www.doingbusiness.org/documents/paying_taxes_2009.pdf accessed on 15 October 2009. McGonagle "Ireland Attracts HQs and Holding Companies" (2004) *International Tax Review* http://proquest.umi.com/pqdweb?did=783742491&Fmt=3&clientId=27625&RQT=309&VName=PQD accessed on 16 November 2009.

9.3.2 Corporate Income Tax

Ireland has a global system of corporate income tax (i.e. it is a residence-based tax system). The Irish income tax provisions are contained in the Tax Consolidation Act of 1997 (hereinafter referred to as "the TCA 1997").[57] A company is treated as resident in Ireland if it is incorporated in Ireland or if its central management and control is located in Ireland.[58] Foreign companies are taxable on Irish-sourced income.

Ireland imposes corporate tax on profits or gains at two varying rates. Trading income is taxed at 12.5% while income other than trading income is taxed at 25%. The 25% rate applies to non-trading income, rental and investment income, and foreign income unless the income is part of an Irish trade.[59] In relation to holding companies, the 12.5% rate applies where the holding company's trade is carried on in Ireland. Where the holding company's trade is carried on offshore as a foreign trade, the 25% rate applies.[60]

Until 24 December 2008 capital gains tax (hereinafter referred to as "CGT") was levied at a flat rate of 20% on chargeable gains.[61] In an attempt to deal with the global and economic downturn, the Irish Minister of Finance increased the CGT rate by 2% to 22%.[62] Residents are liable to CGT on the gain accruing to that resident from the alienation of any asset regardless of where that asset is situated.[63] A non-resident company is subject to CGT on its chargeable capital gains from the disposal of land and buildings (as well as unquoted shares deriving the majority of their value from land and

[57] The TCA 1997 levies all three forms of taxation: income tax, capital gains tax and corporation tax.
[58] See s 23A(2) of the TCA 1997; *De Beers Consolidated Mines Ltd vs Howe* 5 TC 198, 213; *San Paulo (Brazilian) Railway Co vs Carter* 3 TC 407, 410.
[59] See ss 21(A)(3), 25, 26(1) and 76 of the TCA 1997.
[60] Deloitte *Comparison of European Holding Company Regimes* https://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/dtt_tax_holdcomatrix_europe_072309.pdf accessed on 19 October 2009.
[61] See s 28 of the TCA 1997. See also Haccius *Ireland in International Tax Planning* (2004) 17.
[62] McGonagle "Welcome Changes in Finance (no 2) Act 2008" (2009) International Tax Review http://www.internationaltaxreview.com/default.asp?Page=10&PUBID=35&ISS=25283&SID=716805 accessed on 19 October 2009.
[63] See s 29(2) of the TCA 1997.

buildings) and assets used in a business carried on in Ireland through a branch or agency.[64]

9.3.3 Special Features in the Irish Tax System

Ireland does not prescribe any corporate form for a holding company. This flexible system allows the holding entity to be incorporated with limited or unlimited liability.[65] Ireland does not have CFC or equivalent legislation. It also does not impose foreign exchange controls, except in very limited circumstances at the discretion of the Minister of Finance.[66] There are no thin capitalisation provisions in Ireland provided that the rate of interest charged does not exceed a reasonable rate.[67] However, interest payments to 75% non-resident affiliated companies may be treated as distributions of profit and are consequently not deductible.[68]

In addition to the above, the features that make Ireland attractive as an IHC host country are its low corporate tax rate, exemption from capital gains tax on disposal of qualifying shareholdings, a unilateral foreign tax credit system, an onshore pooling of excess foreign credit and withholding tax exemptions.[69] Ireland also has a system of group taxation in the form of group contribution. On the other hand, Ireland does not have a participation exemption. It also does not have an advance tax rulings system.[70]

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[64] See s 29(3) of the TCA 1997; Haccius 532–534.
[65] Cunningham "Ireland's New Holding Company Regime" (2004) *Bulletin for International Fiscal Documentation* 545.
[66] Ernst & Young *Worldwide Corporate Tax Guide* (2006) 421.
[67] See *Irish Holding Companies* http://www.byrnemccall.ie/byrnemccall/Main/HoldingCompanies2006-5.htm accessed on 13 October 2009.
[68] Ernst & Young 421.
[69] See Phelan "Holding Companies: the New Regime" (2005) *Accountancy Ireland* (Vol. 37 Issue 3) 44–45; Connell and O'Meara "Ireland: Ireland's New Rules on the Taxation of Dividend Income – Some Practical Considerations" (2008) *International Tax Review* http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=24924&SID=710730&TYPE=20 accessed on 14 October 2009.
[70] See Deloitte *Comparison of European Holding Company Regimes.*

9.3.3.1 Low Corporate Tax Rate on Dividends

In terms of the Irish corporation tax system, dividends received from non-Irish subsidiaries are taxed at the corporation tax rate. Prior to 24 December 2008, Irish-resident holding companies were subject to Irish corporation tax at a rate of 25% on dividends received from foreign subsidiaries. The Finance Act (no. 2) of 2008 reduced the tax rate to 12.5% for dividends paid to the Irish holding company out of trading profits of companies resident in a European Union member state or country with which it has a DTA.[71] According to Connell and O'Meara:

> Broadly, the provisions operate by providing that a dividend paid out of trading profits of a company resident in a relevant territory is treated as trading profits in the hands of the recipient company. This allows for trading profits to be traced up through a chain of companies to the top Irish holding company.

The rules require that the dividend be paid out of trading income. However, trading is not defined. Three rules are used to determine whether the lower rate of 12.5% applies. Firstly, dividends received from portfolio investment automatically qualify. Portfolio investment refers to shareholding of less than 5%. Secondly, the amount of the dividend will be deemed to be wholly paid from trading profits where at least 75% of the total profits of the company paying the dividend comprise trading profits, and at least 75% of the aggregate value of the assets of the Irish holding company relates to assets used for trading purposes.[72] Thirdly, in all other cases, only the proportion of the dividend that represents trading income will qualify for the 12.5% rate.[73]

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[71] See Connell and O'Meara *International Tax Review*. See also Hickson "Ireland" (2009) *International Tax Journal* (Vol. 35 Issue 2) 33–34.

[72] The assets of the Irish holding company in this case include assets of its 5% held companies in the foreign country. Furthermore, assets exclude the shareholdings themselves as inter-company loans between those companies.

[73] See Connell and O'Meara *International Tax Review*.

These provisions could reduce the tax burden on the IHC where its subsidiaries operate in EU member states or in countries with which Ireland has a DTA. However, if the subsidiaries operate in non-EU member states which do not have DTAs with Ireland, these provisions do not apply. In that case, the IHC would be taxed on the dividend receipts as if Ireland does not have a special tax regime for holding companies. In light of the fact that Ireland has only 46 tax treaties, compared to the Netherlands with 81 and the United Kingdom at 112, the beneficial application of these provisions is considerably restricted.[74]

9.3.3.2 Exemption from CGT on Disposal of Qualifying Shareholdings

In 2004 Ireland introduced an exemption from CGT on disposals by an Irish company of a shareholding in another company.[75] The exemption applies if the following conditions are met:

1. The company whose shareholding is disposed of must be resident in Ireland, in another EU member state or in a country with which Ireland has a DTA at the time of the disposal;
2. The Irish company must have held at least 5% of the shares in the company whose shareholding is disposed of for a period of at least 12 months ending in the previous 24 months. The 5% shareholding can be direct or indirect; and
3. The company whose shares are being disposed of must be wholly or principally a trading company. Alternatively, the company disposing of the shareholding together with its 5% group and the company whose shareholding is disposed of must be wholly or principally a trading group.[76]

[74] See Deloitte *Comparison of European Holding Company Regimes.*
[75] See "Ireland's Holding Company Regime is Legal" (2004) *International Tax Review* http://proquest.umi.com/pqdweb?did=783743651&Fmt=3&clientId=27625&RQT=309&VName=PQD accessed on 16 November 2009; Cullen and Forde "Ireland Moves Ahead as a Holding Company Location" (2004) *International Tax Review* http://proquest.umi.com/pqdweb?did=609359621&Fmt=3&clientId=27625&RQT=309&VName=PQD accessed on 16 November 2009.
[76] See Ernst & Young 410. In Germany 95% of a capital gain from the sale of shares in a foreign or German company is exempt from tax when received by a company taxable in Germany (see Germany Income Taxes and Tax Laws http://www.worldwide-tax.com/germany/germany_tax.asp accessed on 29 October 2009).

As can be seen, the first requirement limits the application of this exemption to EU member states and countries with which Ireland has DTAs. The disposals of shareholding in companies that are not resident in the EU and that do not have DTAs with Ireland would be taxed as if Ireland did not have a special tax treatment for holding companies.

9.3.3.3 Tax Credit System

Ireland provides for a tax relief against foreign taxes on dividends received by an Irish holding company from foreign shareholdings. This is hailed as one of the main features that make the Irish tax system suitable for holding company operations.[77] This relief is granted in terms of the tax treaty credit relief and unilateral credit relief. The credit relief applies to dividends received from shareholdings of at least 5% in a foreign company. In addition there could be "a drilldown to lower level subsidiaries where the relationship is at least 5% and the Irish company controls at least 5% of the lower tier company".[78] This relief applies to dividends from all countries and not just EU member states or countries with which Ireland has a DTA.[79]

A tax credit system is a mechanism to eliminate double taxation. It is generally not a tax incentive or a feature that is included in the tax system to encourage investment. Without the elimination of double taxation, international business activity could be significantly hampered. As Arnold and McIntyre[80] aver:

> If income tax rates are low, as they were in the early years of the 20th century, the inefficiencies and unfairness caused by double taxation are modest enough to be bearable. But when the tax rates reach the levels that

[77] See McGonagle "Ireland Attracts HQs and Holding Companies" (2004) *International Tax Review* http://www.internationaltaxreview.com/includes/magazine/PRINT.asp?SID=470485&ISS=12595&PUBID=35 accessed on 13 October 2009.
[78] A&L Goodbody *Ireland – A Holding Company for European Acquisitions* http://docs.google.com/gviewa=v&q=cache:8YaNsZcYUjMJ:www.algoodbody.ie accessed on 13 October 2009.
[79] See Cunningham "Ireland's New Holding Company Regime" (2004) *Bulletin for International Taxation* 544; Tivnan and Lewis "Foreign Dividends: Irish HoldCo Gains Momentum" (2008) *Accountancy Ireland* (Vol. 40 Issue 3) 61–63.
[80] See Arnold and McIntyre *International Tax Primer* (2002) 27.

> now prevail, double-tax burdens can become onerous and interfere substantially with international commerce. The necessity for relief is clear on the grounds of equity and economic policy.

Elimination of double taxation is therefore an essential feature of any tax system. Without a system of elimination of double taxation, Ireland's tax system would be adverse to international business in general and not only to holding companies. Therefore, the introduction of a tax credit system merely brings Ireland into line with best practice.

9.3.3.4 Pooling of Tax Credits

Normally, an optimal IHC location would have a participation exemption which results in a complete exemption from tax on dividends received. Ireland does not have a participation exemption. Instead, it operates a credit system. As McGonagle[81] states

> *Finance Act 2004* introduced a system of onshore pooling of tax credits to deal with the situation where foreign tax on some dividends exceeds the Irish tax payable while on other dividends the foreign tax is below the Irish tax liability. Previously, any credit that exceeded the Irish tax liability attributable to that particular dividend would be lost. The new provisions allow excess so-called "credit" to be offset against Irish tax on other foreign dividends received in the accounting period concerned.

Practically, this pooling system would not be beneficial where all the subsidiaries of the IHC operate in countries with lower tax rates than Ireland or those with higher tax rates than Ireland. It would be of benefit where some subsidiaries operate in higher tax jurisdictions and others in lower tax jurisdictions than Ireland and the average tax rate is equivalent to that of Ireland.

[81] See McGonagle *International Tax Review*.

The pooling system could offset, to a limited extent, the adverse tax implications on dividends received from non-EU member states that do not have DTAs with Ireland.

9.3.3.5 Group Taxation

Ireland has a system of group taxation in the form of group contribution. In terms of this system, members of a group may surrender current-year trading losses, excess charges on income, and excess management expenses to other members of the group.[82] Two companies are members of a group if one is a 75% subsidiary of the other or both are 75% subsidiaries of a third company. Group relief is available to Irish companies, subject to certain conditions, in respect of trading losses incurred by their non-Irish subsidiary companies that are resident in EU Member States and European Economic Area states with which Ireland has a DTA. Loss relief is limited to losses incurred in a business carried on by a company that is subject to corporation tax in Ireland.

9.3.4 Conclusion

The main tax attractions in Ireland are restricted in application to companies that are resident in the EU and countries with which Ireland has a DTA. The low corporate tax rate of 12.5% is in practice not applicable to dividends received from non-EU member states and countries with which Ireland does not have DTAs. Similarly, the trading of losses in terms of the Irish group taxation system is not available to non-EU member states and countries with which Ireland does not have DTAs. The availability of a unilateral double tax relief is not something that could be hailed as an attraction to do business. It is an essential feature of any tax system that ensures equity.

The pooling of foreign tax credits could offset the adverse implications on dividends received from non-EU member states that do not have DTAs with Ireland. However, due to the limited circumstances under which this is most beneficial (i.e. where some

[82] Revenue Irish Tax and Customs *Groups* http://www.revenue.ie/en/tax/ct/groups.html accessed on 18 October 2009.

subsidiaries operate in higher tax jurisdictions and others in lower tax jurisdictions than Ireland and the average tax rate is equivalent to that of Ireland) its impact is not likely to persuade an investor to choose Ireland as a host for an IHC. In addition, with only 46 tax treaties, the Irish tax treaty network is not large enough to attract investors from most countries. Similarly, the treaty network is not large enough to encourage investment through Ireland to most countries.

The remaining features that might attract IHCs to Ireland are the absence of CFC, transfer pricing and liberal thin capitalisation provisions. Without a capital gains and dividend tax relief mechanism that applies to disposals and distributions, respectively, and that is not limited to subsidiaries in EU member states and Ireland's DTA partners only, Ireland's favourable holding company tax regime will not in itself appeal to investors worldwide.

9.4 UNITED KINGDOM

9.4.1 Introduction

The United Kingdom (UK) is located in Western Europe. It comprises four countries: England, Scotland, Wales, and Northern Ireland. It includes the northern one-sixth of the island of Ireland between the North Atlantic Ocean and the North Sea and is to the northwest of France. It has a population of approximately 61 million people. English is the official language, while Welsh and Scottish are also generally spoken by the populations of Wales and Scotland respectively. The capital city is London. Although the UK is a member of the EU, it presently still retains the Pound Sterling as its currency.[83]

In the 2009 Doing Business report from the World Bank, the UK was ranked 16th out of 181 countries in terms of the ease of paying taxes.[84]

[83] Central Intelligence Agency "Ireland" *The World Factbook – United Kingdom* https://www.cia.gov/library/publications/the-world-factbook/geos/uk.html#top accessed on 20 October 2009; Doing Business in the UK http://www.kwintessential.co.uk/etiquette/doing-business-uk.html accessed on 20 October 2009.
[84] See *Doing Business* http://www.doingbusiness.org/documents/paying_taxes_2009.pdf accessed on 15 October 2009.

9.4.2 Corporate Income Tax

The UK has a global system of corporate income tax (i.e. it is a residence-based tax system). Resident companies are subject to corporation tax on their worldwide profits. Corporation tax, as opposed to income tax, covers both income and capital gains.[85] A company is resident in the UK if it is incorporated in the UK or if the company's central management and control is exercised in the UK. Foreign companies are taxable on UK-sourced income.[86]

The UK imposes corporation tax at a rate of 28%. This rate was reduced from 30% in 2008.[87] There is no CGT for companies. Instead, companies are subject to corporation tax on chargeable gains at the same rate as income.[88]

The UK does not have a system of advance tax rulings. However, the UK tax authorities "will give advice on the interpretation of the law (including in relation to a proposed transaction) if the query relates to (i) legislation passed in the last four Finance Acts; (ii) older legislation where the uncertainty is of commercial significance to the business; (iii) the application of tax treaties; or (iv) areas of major public interest".[89]

[85] Collinson and Tiley *Tiley and Collinson UK Tax Guide* 2006–2007 (2006) par 25:01.
[86] Collinson and Tiley par 25:01. See also Laing *British Master Tax Guide 2006/2007* (2006) 644–645.
[87] Watterson *Corporation Tax 2008/2009* (2008) 49. In this regard a UK tax authority spokesperson said: "At 28%, the UK's corporation tax rate is now at its lowest ever level. The UK continues to have the lowest corporation tax rate of the major G7 economies. See "UK Taxpayers Fear Corporate Tax Hike" *International Tax Review* http://www.internationaltaxreview.com/?Page=9&PUBID=210&ISS=25473&SID=722572&SM=&SearchStr=%22UK%20corporation%20tax%22 accessed on 21 October 2009.
[88] See Watterson 499.
[89] See Deloitte *Comparison of European Holding Company Regimes* https://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/dtt_tax_holdcomatrix_europe_072309.pdf accessed on 19 October 2009.

9.4.2.1 Capital Gains Exemption

An exemption exists from corporation tax on chargeable gains on the disposal of shareholdings in other companies.[90] In order for a company to benefit from the exemption, the following three requirements must be fulfilled:

1. The company disposing of the shares must hold at least 10% of the share capital of the company whose shares are disposed of for a period of 12 continuous months within the two years prior to the disposal ;
2. The company disposing of the shares must be a trading or holding company by itself during the period of 12 continuous months within the two years prior to the disposal; and
3. The company whose shares are disposed of must be a trading company or a holding company of a trading group for period of 12 continuous months within the two years prior to the disposal.[91]

9.4.2.2 Tax Credits

The UK also provides for a tax credit for corporate taxes paid by foreign countries against UK corporation tax. The claim may be made under a DTA or under the unilateral tax relief mechanism. The credit cannot exceed the UK corporation tax.[92] "The only credit available for overseas dividends is withholding tax unless the UK company owns more than 10% of the overseas company's equity."[93]

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[90] See Kavanagh "New U.K. Participation Exemption for Capital Gains on Substantial Shareholdings" (2002) *Journal of International Taxation* (Vol. 13 Issue 8) 24–29.
[91] See Ocra Worldwide *UK Holding Company Information* http://www.ocra.com/solutions/eu_holding/uk.asp accessed on 20 October 2009.
[92] See Deuchar and Van Hulsen "What next for UK mixers?" (2001) *International Tax Review* (Vol. 12) 48–51; Watterson 375.
[93] Watterson 375.

9.4.2.3 Controlled Foreign Company Legislation

(a) Application

The UK legislation contains CFC legislation. The control provisions of the UK CFC legislation are contained in section 755D of the Income and Corporation Taxes Act of 1988 (hereinafter referred to as "the ICTA 1988"). A foreign company is a CFC if UK residents hold more than 50% of the interest in that foreign company.[94] Furthermore, where UK residents hold more than 40% of the interest in a foreign company and a non-UK resident holds at least 40% of the interest in that foreign company, such company would be a UK CFC.[95]

The UK CFC rules also contain provisions which attribute certain rights and powers to persons in establishing whether or not they have control.[96] In terms of this rule, in determining whether a person has control consideration is given to the rights and powers which can be acquired in the future, those belonging to UK-connected persons and those exercised in accordance with the person's wishes (or jointly with someone else) in establishing whether that person has control.[97]

The income of the CFC is imputed to shareholders who hold 25% or more of the interest in the CFC.[98]

Certain CFCs are exempt from CFC taxation. The main companies that are exempt are:

(i) companies that distribute 50%[99] of their available profits within 18 months after the end of the accounting period to which the income relates;[100]

[94] See s 755D(1) of the ICTA 1988.
[95] See s 755D(3) and (4) of the ICTA 1988.
[96] See s 755D(5) of the ICTA 1988. See Oguttu *Curbing Offshore Tax Avoidance: The Case of South African Companies and Trusts* (LLD dissertation 2007 UNISA) 249–253.
[97] See s 755D(5) of the ICTA 1988; see also Gordon-Brown *Controlled Foreign Companies*.
[98] Ernst & Young 997
[99] The percentage increases to 90% if the CFC is not a trading company.

(ii) the CFC has a business establishment in the territory in which it is resident;

(iii) the activities of the CFC are carried out for *bona fide* commercial reasons. In order satisfy this requirement, "a company must show that neither the main purpose of the transactions which gave rise to the profits of the CFC nor the main reason for the CFC's existence was to achieve a reduction in UK tax by means of the diversion of profits".[101] The UK tax authorities' practice with regard to the motive test is unclear *inter alia* as to whether a company that is set up to avoid foreign tax passes this test.[102]

(iv) a minimum of 35% of the voting shares of the CFC are listed and traded in a recognised stock exchange; or

(v) the CFC is resident in an excluded country.[103]

(b) Analysis

The UK CFC rules are very complicated, and are among the toughest in the world when compared with other CFC regimes.[104] As KPMG reported, the prevailing UK CFC rules are hugely unpopular with investors. KPMG states as follows:[105]

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[100] See Leegaard "CFC legislation – Recent Changes to the Acceptable Distribution Policy Exemption" (2001) *European Taxation* (Vol. 41 Issue 7) 293–296.
[101] Lee *UK Finance Bill Introduces New CFC Rules.*
[102] See Gordon-Brown *Controlled Foreign Companies* http://www.tax.org.uk/showarticle.pl?id=93&n=379 accessed on 05 November 2009.
[103] See Laing 817; Ernst & Young 996–997. It should be noted that the UK CFC rules are being reviewed. See "UK Taxpayers Fear Corporate Tax Hike" *International Tax Review* http://www.internationaltaxreview.com/?Page=9&PUBID=210&ISS=25473&SID=722572&SM=&SearchStr=%22UK%20corporation%20tax%22 accessed on 21 October 2009. The UK authorities maintain a list of excluded countries divided into two. The first list contains countries which are excluded provided that income and gains derived outside that country do not exceed the greater of 10% of the company's income and gains or £50 000. The second list contains countries which are excluded subject to the additional requirement that none of the specified exemptions or relief measures are available to the overseas company. See FL Memo Ltd *FL Memo Tax 2006–2007* (2006) 260.
[104] See Gordon-Brown *Controlled Foreign Companies*. Frankly, the UK had difficulties with attracting investors for a long time. In this regard see Berner "Where the UK Falls Short" (1993) *International Tax Review* 24–26.
[105] KPMG Cadbury Schweppes Case – *Advocate General says Locating Operations on the Basis of a Low Tax Rate is Legitimate* http://www.kpmg.co.uk/news/detail.cfm?pr=2508 accessed on 05 November 2009. See also Lee *UK Finance Bill Introduces New CFC Rules* http://www.tax-news.com/archive/story/UK_Finance_Bill_Includes_New_CFC_Rules_xxxx26909.html# accessed on 05 November 2009.

> In a survey conducted on behalf of KPMG [in 2006], two-thirds of respondents said that UK tax rules had hindered cross-border investment for their groups. Asked about which specific rules were to blame, the CFC regime was the most commonly cited, affecting over half of the companies concerned. The companies questioned commented that they would like to see changes to the CFC legislation because it was unfair and complex, they felt that it was difficult for them to understand where they stood, it made normal business transactions difficult and that companies could be caught up by the rules even when they had a true commercial purpose.

As a result of the stringent UK CFC rules, a number of companies made "public declarations about moving out of the UK, and a number have gone to Ireland … Some have gone to the Netherlands."[106]

The UK CFC legislation has also come under scrutiny at the level of the European Court of Justice (hereinafter referred to as "the ECJ") when the UK tax authorities applied the CFC legislation to Irish companies on the basis that they were established and operated in order to avoid tax. In the *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue*[107] the EJC held that such a tax measure must not be applied where it is proven, on the basis of objective factors which are ascertainable by third parties, that despite the existence of tax motives that controlled company is actually established in the host EU member state and carries on genuine economic activities there.[108] In this regard it was the view of the ECJ that the UK's motive test went beyond what is necessary to achieve the objective of preventing wholly artificial arrangements intended to avoid UK national tax.[109]

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[106] See http://www.strategicrisk.co.uk/story.asp?storycode=380661 accessed on 03 November 2009; Oguttu 271–273.

[107] Judgment of the Court (Grand Chamber) of 12 September 2006 (reference for a preliminary ruling from the Special Commissioners, London — United Kingdom) — Cadbury Schweppes plc, *Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* Official Journal of the European Union C 281/5.

[108] See Tran "*Cadbury Schweppes plc v. Commissioners of Inland Revenue*: Eliminating a Harmful Tax Practice or Encouraging Multinationals to Shop around the Bloc?" http://ilr.lls.edu/issues/30/documents/Article330.1Tran.pdf accessed on 04 November 2009.

[109] See Dodwell and Sarrau "*Cadbury Schweppes*: the ECJ Decides" (2006 November) *Tax Adviser* 26. The *Cadbury Schweppes* case had an impact on other tax systems and resulted in some countries amending their

Currently, the UK is considering a review of its CFC legislation as it considers that CFC legislation goes "to the heart of the taxation regime for UK multinationals and raise[s] issues regarding the competitiveness of the UK as a holding company location".[110]

9.4.3 Special Features in the UK Tax System

The UK does not have statutory thin capitalisation provisions. However, highly leveraged non-resident companies are closely scrutinised by the tax authorities. This may result in interest deductions being disallowed on the grounds that "based on all of the circumstances, the loan would not have been made at all, or that the amount loaned or the interest rate would have been less, if the lender was an unrelated party acting at arm's length".[111]

The UK does not have exchange control regulations (these were abolished in 1979), and it also has one of the largest treaty networks in the world, with 112 concluded tax treaties.[112]

9.4.3.1 No Withholding Tax on Dividends

The UK further provides incentives that are intended to encourage the location of holding companies in the UK. It does not impose any withholding tax on dividends distributed by resident companies to UK non-resident shareholders, irrespective of their residence.

CFC rules to bring them in line with the ECJ ruling, for example see Brenfield "Sweden's New CFC Regime after Cadbury Schweppes – Comments and Analysis" (2008) *Bulletin for International Taxation* 295–301; Malherbe *et al* "Controlled Foreign Corporations in the EU after Cadbury Schweppes" (2007) *Tax Management International Journal* 607–650.

[110] See "UK throws out Controlled Foreign Companies Regime" (2008) *International Tax Review* http://proquest.umi.com/pqdweb?did=1456135201&Fmt=3&clientId=27625&RQT=309&VName=PQD accessed on 16 November 2009.

[111] Ernst & Young 997; Laing 813.

[112] Deloitte *Comparison of European Holding Company Regimes*.

9.4.3.2 No CGT on Sale of UK Subsidiary

CGT is not levied on non-residents. As a result no tax is levied on the sale of shares of a UK subsidiary of a non-resident parent company.[113]

9.4.3.3 Group taxation

The UK tax law provides for group taxation in the form of group relief. The aim of the UK group relief system is to ensure the fiscal neutrality of the effects of the creation of a group of companies.[114] A group of companies comprises the UK parent company and all UK-resident subsidiaries that are owned directly or indirectly by a percentage of 75% or more by a holding company, unless the shares are held as inventory. In this regard Collinson and Tiley[115] state the following:

> Group relief enables current trading losses, capital allowances, a non-trading deficit on loan relationships, excess management expenses of investment companies and excess charges on income to be surrendered by one company (the surrendering company) to another (the claimant company) enabling the latter to put the other company's loss against its total profits. Both companies must satisfy the group or consortium tests throughout their respective accounting period but need not be members of the same group or consortium when the claim is made.[116]

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[113] Ocra Worldwide *UK Holding Company Information.*

[114] Walton and Stone *Marks & Spencer: UK group relief rules at risk*, http://tax.practicallaw.com/1-200-6684 accessed on 10 July 2008.

[115] Collinson and Tiley *Tiley and Collinson UK Tax Guide 2006–07* (2006) par 28:05 and references contained therein.

[116] In Barbados, resident companies may elect to surrender only the current, not past, eligible trading losses within a group. Eligible trading losses exclude depreciation allowances, and any inter-group expenses that are claimed as expenses but not included in the taxable income for the receiving company in the same fiscal year. See Rohatgi *Principles of International Taxation* (2002) 194. In Trinidad and Tobago the taxpayer cannot reduce its tax liability by more than 25% through the tax losses of the surrendering company. See Rohatgi (2002) 194.

Foreign incorporated subsidiaries may be included, provided they are tax-resident. Thus, non-resident companies do not benefit from the group relief.[117] Where the loss arises in a group member that is not resident in the UK, group relief is available only if the surrendering company is resident in another member state of the European Economic Area (or has a permanent establishment in another European Economic Community) and the loss is not relievable in that other member state.[118]

9.4.4 Conclusion

Technically, the UK does not have a special regime for holding companies.[119] The UK tax system merely contains certain features that can alleviate the tax burden on holding companies operating in the UK. The most important of these features are the absence of withholding tax on dividends, the absence of capital gains on the sale of a UK subsidiary and the presence of group taxation as well as an extensive treaty network.

"The use of the UK as a holding company location has been fraught with difficulties over the years."[120] The failure of the UK tax system to attract IHCs can be attributed to the fact that while the UK has an adverse CFC regime, it does not have any special tax attributes that could offset the adversity of the CFC regime. The offsetting features could be a special tax regime for IHCs similar to the Mauritian taxation of GBL1 companies, or a conglomerate of tax relief features such as a combination found in the Dutch tax system.

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[117] See Foster "Losses for Companies Mean Losses for Governments" http://www.dlapiper.com/hu/global/publications/detail.aspx?pub=1412 accessed on 28 September 2009. The group relief system applicable in Ireland is analogous to the UK provisions in that it restricts loss relief to Irish companies and branches.
[118] Tiley and Collinson par 28:05.
[119] Deloitte *Comparison of European Holding Company Regimes*.
[120] Shelton N "Denmark Squares up for Holding Battle" (December 1998/January 1999) *International Tax Review* http://www.internationaltaxreview.com/?Page=10&PUBID=35&ISS=12655&SID=468670&SM=&SearchStr=%22intermediary%20holding%20company%22 accessed on 13 November 2009.

In addition to the complex CFC legislation, the 28% corporate tax rate and the absence of advance tax rulings system, as well as the seemingly discretional disallowance of interest on highly leveraged non-resident companies, could deter potential investors to the UK.

9.5 CONCLUSION

As indicated in the introduction to this chapter, the three countries discussed in this chapter have the benefit of the Parent-Subsidiary Directive. However, the Parent-Subsidiary Directive only benefits investors on dividend payments within the EU.

For the UK the problem is clear: the UK CFC legislation is expansive and complex. This in itself repels investors from the UK, and illustrates that one significantly adverse aspect in the tax system has the potential to sabotage concerted efforts to promote a country as an ideal host for IHCs. In the UK this is exacerbated by the fact that the UK does not have abundant special features that are favourable for IHCs.

Ireland, on the other hand, does have numerous features that make the Irish tax system ideal for the operation of an IHC. However, most of the features are available for optimal use only by investors from EU countries and those resident in countries with which Ireland has a DTA. This restricts the suitability of Ireland as an IHC host country to a limited number of investors. This limitation is exacerbated by the relatively small number of DTAs that Ireland has concluded. This illustrates the point that the suitability of a country as a host for IHCs can be curtailed by the limited or focused applicability of enabling tax provisions.

With regard to Belgium, the factors that inhibit the ability of Belgium to attract IHCs are two-fold. The one is the high corporate income tax rate that also applies to capital gains, the lack of foreign tax credits other than on application of a treaty as well as the presence of CFC-like legislation. The other is that the dividends received deduction is not available to IHCs. This basically makes the dividends received deduction useless for enhancing Belgium's position as a preferable host for IHCs. This illustrates the point that the

application of highly effective tax instruments could be rendered worthless by excluding from their application entities that are commercially essential for operating in a country.