TAX IMPEDIMENTS TO HOLDING COMPANY
STRUCTURES IN BELGIUM, IRELAND AND
THE UNITED KINGDOM: CAUTION FOR
SOUTH AFRICA*

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I INTRODUCTION

The South African National Treasury announced in the 2010 Budget Review¹ that government intends to promote South Africa as a gateway for investment into Africa. This would entail a degree of adjustment to the South African general business and legal framework, but substantial changes to the tax law and exchange control framework.²

It is envisioned that investment in Africa and South Africa would take the form of holding companies incorporated in South Africa and holding interests in operating subsidiaries located in South Africa or the rest of Africa.³ These holding companies would generally take the form of a headquarter company or an intermediary holding company. This article will only refer to holding companies unless the need arises for specific reference to any particular form of holding company.⁴ The location of these companies is to a large extent influenced by the tax systems of the potential host countries. As a result, it is necessary that the South African government devise a system that would assist in attracting holding companies.

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¹ National Treasury Budget Review (2010) 78.
² Ibid.
³ Ibid.
⁴ Other forms of holding companies include intellectual property holding companies, offshore holding companies and personal holding companies.
II BACKGROUND

Over the years many different countries have tried to attract holding companies to their shores. Some countries such as the Netherlands\(^5\) and Mauritius\(^6\) have succeeded in designing tax systems that attract holding companies. Other countries have not been as successful. The purpose of this article is to highlight special features in the tax systems of those countries that have special tax regimes that are intended to attract holding companies to their shores. A further purpose is to expose the reasons why some countries are not necessarily successful, despite having specific legislation to attract holding companies. 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.

This article focuses on the special features that are beneficial to, and could result in the attraction of, holding companies. The general corporate tax systems of these jurisdictions are briefly outlined first, in order to contextualise the application of the special features concerned.

Belgium, Ireland and the UK are all members of the European Union (hereinafter ‘the EU’). The EU’s Parent-Subsidiary Directive applies to dividends declared by companies resident within the EU to companies resident in these countries.\(^7\) 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 tax paid by the subsidiary which relates to those profits.\(^8\) Furthermore, the profits which a subsidiary distributes to its holding company should be exempt from withholding tax in the hands of the holding company.\(^9\)

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9 Ibid. 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 maintain temporarily a withholding tax.
III BELGIUM

(a) 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.\(^{10}\) The corporate income tax rate is 33.99 per cent.\(^{11}\)

Foreign tax relief is only available through treaty application.\(^{12}\) Capital gains are treated as ordinary company profits and are therefore subject to tax at the standard corporate income tax rate. However, capital gains on shares are fully exempt.\(^{13}\) Belgium has a tax treaty network covering some 88 countries.\(^{14}\) A general advance tax ruling system was introduced on 1 January 2003.\(^{15}\) There is no restriction of inward and outward movement of capital through exchange controls.\(^{16}\)

(i) Controlled foreign company 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.\(^{17}\) 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

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\(^{12}\) Ernst & Young op cit note 10 at 89; E Schoonvliet ‘Unilateral and treaty measures in Belgium for the avoidance of double taxation’ (2008) Bulletin for International Taxation 430.

\(^{13}\) Vanhaute op cit note 10 at 101.


\(^{15}\) 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’ (P.A.A Vanhaute & D Huygens Belgium: Holding Companies (2009) para 8.4.1.4 available at http://online2.ibfd.org/hold/, accessed on 6 April 2010). See also PricewaterhouseCoopers ‘Belgium’s advance ruling practice: A powerful risk management instrument in tax planning’ available at http://www.doingbusiness.pwc.be/index.html?page=117, accessed on 9 April 2010; Ernst & Young op cit note 10 at 87.

\(^{16}\) Ernst & Young op cit note 10 at 91. For statistical purposes, the Belgian financial institutions are required to report all transactions with foreign countries to the National Bank of Belgium.

\(^{17}\) Deloitte op cit note 14.
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.18

(ii) **Transfer pricing**

The Belgian tax regime contains transfer pricing rules. Most significant and relevant to this article 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.19

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’.20

(iii) **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.21 The percentage of the company’s risk-bearing adjusted net equity 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 per cent.22

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.23 According to Bird & 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’.24

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18 See Vanhaute op cit note 10 at 209.
21 Article 205bis–205novies of the ITC. Vanhaute op cit note 10 at 91.
22 See Vanhaute op cit note 10 at 158.
23 Vanhaute & Huygens op cit 15 para 3.4.2.1.4.
(iv) **Dividend withholding tax**

Dividends paid by a Belgian company are subject to a 25 per cent 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.\(^\text{25}\)

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.\(^\text{26}\) 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.\(^\text{27}\) In both the cases of EU member states and treaty country, the following conditions must be met in order for the zero per cent rate to apply:\(^\text{28}\)

The company receiving the dividend must:

1. hold a participation of at least 25 per cent of the share capital of the dividend distributing company for a period of at least 12 months;
2. 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. 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 twelve-month holding period, the European Court of Justice (hereinafter referred to as ‘the ECJ’) in the *Denkavit*\(^\text{29}\) case held that the exemption also applies even if the minimum twelve-month holding period has not yet expired provided that the Belgian company submits a certificate indicating an undertaking to keep the minimum 25 per cent participation for at least twelve months.\(^\text{30}\) The second requirement stated above disqualifies from the exemption dividends that are paid to companies that are not resident in an EU country. Thus, only Belgian holding

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\(^{26}\) See Article 106(5) of the ITC.


\(^{28}\) See Vanhaute op cit note 10 at 155; Vanhaute & Huygens op cit note 15 para 4.2.3.1.

\(^{29}\) EU Court of Justice C-283/94 and C-292/94, 17 October 1996.

companies with ultimate investors that are resident in the EU can benefit from this exemption.

(b) 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.

(i) Dividends received deduction

Ordinarily, dividends received by a Belgian company become part of taxable income and are therefore taxable at the 33.99 per cent corporate income tax rate. In terms of the dividends received deduction (hereafter DRD), 95 per cent of the dividends received by a Belgian company are deducted from taxable income.31 The remaining 5 per cent is taxable but costs and expenses, such as interest, are deductible therefrom.32 The DRD applies where the shareholding by the Belgian company in the company paying the dividends meets the following conditions:33

1. The Belgian company must hold at least 10 per cent of the share capital of the company declaring the dividend, or must have obtained the shareholding for acquisition value of at least €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 twelve months;
3. The participation must qualify as a ‘fixed financial asset’;34 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.35

The DRD 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)

32 See Bird & Bird op cit note 24.
33 See art 205ter(1) of the ITC.
34 As to what constitutes a ‘fixed financial asset’ the Belgian tax law refers to the accounting legislation, ie 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 (F Dierckx ‘Belgium’s holding company regime — Past, present and future’ (2008) Bulletin for International Taxation 404.
35 Deloitte op cit note 11.
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 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 per cent of the dividend concerned.36

The DRD 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 per cent may be lost.37

In April 2003, the Court of First Instance of Brussels in Belgium ruled that the application of the DRD is in violation of the EU Parent-Subsidiary Directive because that 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.38

Pursuant to this the Minister of Finance announced that the DRD 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.39 Irrespective of remedial action taken by Belgium, the ECJ ruled on 12 February 2009 in the Cobelfret v Belgium40 case that Belgium has not correctly implemented the Parent-Subsidiary Directive in the DRD regime.

The DRD is not available for dividends distributed by an intermediary company unless that company is an investment company which redistributes

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37 See Deloitte op cit note 11.
39 See Deloitte op cit note 11. See also Dierckx op cit note 34 at 409–10.
dividends from ‘contaminated’ participators.\textsuperscript{41} 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.\textsuperscript{42}

In this regard Dierckx\textsuperscript{43} states that the DRD 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 collectively to invest pooled funds in the nature of a collective investment scheme such as a SICAV\textsuperscript{44} and similar entities.\textsuperscript{45} A holding company in its general form 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 DRD does not apply to a general holding company as it is not an ‘investment company’ as defined.

The DRD is a great tax-reduction tool in the operation of a holding company. However, in effect, it does not apply to holding companies other than those that qualify as an investment company located in Belgium. This deprives Belgium of one of the main attractions of locating a holding company in the country.

(ii) Tax exemption for capital gains realised on shares

As stated above,\textsuperscript{46} 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\textsuperscript{47} 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.

\textsuperscript{41} Vanhaute & Huygens op cit note 15 para 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 per cent would have been excluded from the dividend deduction under one of the exclusions.

\textsuperscript{42} Vanhaute & Huygens op cit para 4.1.3.2.5.

\textsuperscript{43} Dierckx op cit note 34 at 408.

\textsuperscript{44} 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 6 February 2010.

\textsuperscript{45} Vanhaute & Huygens op cit note 15 para 4.1.3.2.5.

\textsuperscript{46} See part III(a) above.

\textsuperscript{47} ‘Net gain’ is gain after the deduction of the alienation costs eg bank fees, commissions, consultancy costs, notary fees and publicity costs (Vanhaute op cit note 10 at 154).
The other requirements (i.e., the minimum shareholding, fixed financial asset, and holding period) do not apply. The subject-to-tax requirement is not met if the company whose shares are disposed of is resident in a low-tax country. 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.

(iii) Thin capitalisation

The Belgian tax regime contains thin capitalisation provisions. The debt-to-equity ratio is effectively 7:1. Deloitte 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 “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. The Belgian thin capitalisation regime is liberal in its application and is thus convenient for the financing of foreign subsidiaries.

Despite this liberal regime, there are established methods of avoiding the application of these provisions. In this regard Vanhaute & Huygens state as follows:

49 See Bird & Bird op cit note 24.
51 See art 198(1)(11) of the ITC.
52 Deloitte op cit note 14.
53 Vanhaute & Huygens op cit note 15 para 3.4.2.3.2.
54 Hinnekens & Drijkoningen op cit note 25 at 359; Decleir op cit note 50 at 66–7.
55 Vanhaute & Huygens op cit note 15 para 3.4.3.4.
'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 eroded. Suitable jurisdictions for the location of such finance company would be the Netherlands and Luxembourg.'

(c) Précis on Belgium

The Belgian corporate tax regime contains some features that make Belgium suitable for the operation of a holding company. 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 holding companies. Among these the following deserve to be mentioned: the high 33.99 per cent 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 DRD, on the face of it, is a positive feature. Unfortunately, the fact that it is not available for companies other than investment companies makes the DRD useless for enhancing Belgium's position as a preferable host for holding companies in general.

IV IRELAND

(a) Corporate Income Tax

Ireland has a global system of corporate income tax (ie 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'). 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. 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 per cent while income other than trading income is taxed at 33.99 per cent.

56 The TCA 1997 levies all three forms of taxation: income tax, capital gains tax and corporation tax.

57 See s 23A(2) of the TCA 1997; De Beers Consolidated Mines Ltd vs Howe 5 TC 198 at 213; San Paulo (Brazilian) Railway Co vs Carter 3 TC 407 at 410.
income is taxed at 25 per cent. The 25 per cent rate applies to non-trading income, rental and investment income, and foreign income unless the income is part of an Irish trade. In relation to holding companies, the 12.5 per cent 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 per cent rate applies.

Until 24 December 2008 capital gains tax (hereinafter referred to as ‘CGT’) was levied at a flat rate of 20 per cent on chargeable gains. In an attempt to deal with the global and economic downturn, the Irish Minister of Finance increased the CGT rate by 2 per cent to 22 per cent. 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. 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 buildings) and assets used in a business carried on in Ireland through a branch or agency.

(b) 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. 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. There are no thin capitalisation provisions in Ireland provided that the rate of interest charged does not exceed a reasonable rate. However, interest payments to 75 per cent non-resident affiliated companies may be treated as distributions of profit and are consequently not deductible.

In addition to the above, the features that make Ireland attractive as holding company host country are its low corporate tax rate, exemption

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58 See ss 21(A)(3), 25, 26(1) and 76 of the TCA 1997.
60 See s 28 of the TCA 1997. See also C Haccius Ireland in International Tax Planning (2004) 17.
62 See s 29(2) of the TCA 1997.
63 See s 29(3) of the TCA 1997; Haccius op cit note 60 at 532–4.
65 Ernst & Young op cit note 10 at 421.
67 Ernst & Young op cit note 10 at 421.
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. 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, nor does it have an advance tax rulings system.

(i) 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 per cent on dividends received from foreign subsidiaries. According to Connell and O’Meara, the Finance Act (no 2) of 2008 reduced the tax rate to 12.5 per cent 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, and they add further:

‘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 per cent applies. Firstly, dividends received from portfolio investment automatically qualify. Portfolio investment refers to shareholding of less than 5 per cent. Secondly, the amount of the dividend will be deemed to be wholly paid from trading profits where at least 75 per cent of the total profits of the company paying the dividend comprise trading profits, and at least 75 per cent of the aggregate value of the assets of the Irish holding company relates to assets used for trading purposes. Thirdly, in all other cases, only the proportion of the dividend that represents trading income will qualify for the 12.5 per cent rate.

These provisions could reduce the tax burden on a holding company 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

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69 See Deloitte op cit note 59.


71 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.

72 See Connell and O’Meara op cit note 68.
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member states which do not have DTAs with Ireland, these provisions do not apply. In that case, the holding company 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, South Africa with 58 and the United Kingdom at 112) the beneficial application of these provisions is considerably restricted.73

(ii) 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.74 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 per cent of the shares in the company whose shareholding is disposed of for a period of at least twelve months ending in the previous 24 months. The 5 per cent 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 per cent group and the company whose shareholding is disposed of must be wholly or principally a trading group.75

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.

(iii) 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

73 See Deloitte op cit note 59.
75 See Ernst & Young op cit note 10 at 410. In Germany 95 per cent 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 available at http://www.worldwide-tax.com/germany/germany_tax.asp, accessed on 29 December 2009).
operations. 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 per cent 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’. This relief applies to dividends from all countries and not just EU member states or countries with which Ireland has a DTA.

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 & McIntyre 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 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 such a system, 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 international tax best practice.

(iv) Pooling of tax credits

Normally, an optimal holding company 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 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

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80 See McGonagle op cit note 76.
‘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 holding company operate in countries with lower or 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.

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.

(v) 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.81 Two companies are members of a group if one is a 75 per cent subsidiary of the other, or both are 75 per cent 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.82

(c) Précis on Ireland
The main tax attractions in Ireland are restricted to companies that are resident in the EU and countries with which Ireland has a DTA. The low corporate tax rate of 12.5 per cent 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, as set out above its impact is not likely to persuade an investor to choose Ireland as a host for a holding company. 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.

82 Ibid at 81.
The remaining features that might attract holding companies 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.

V UNITED KINGDOM

(a) 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. 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.

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

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’.

(i) Capital gains exemption
An exemption from corporation tax exists on chargeable gains on the disposal of shareholdings in other companies. In order for a company to

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86 See Watterson op cit note 85 at 499.
benefit from the exemption, the following three requirements must be fulfilled.

1. The company disposing of the shares must hold at least 10 per cent of the share capital of the company whose shares are disposed of for a period of twelve 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 twelve 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 twelve continuous months within the two years prior to the disposal.\(^89\)

(ii) 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.\(^90\) "The only credit available for overseas dividends is withholding tax unless the UK company owns more than 10% of the overseas company’s equity."\(^91\)

(iii) Controlled Foreign Company legislation

Application

The UK legislation contains CFC legislation. The control provisions of the UK CFC legislation are contained in s 755D of the Income and Corporation Taxes Act, 1988 (hereinafter referred to as ‘the ICTA 1988’). A foreign company is a CFC if UK residents hold more than 50 per cent of the interest in that foreign company.\(^92\) Furthermore, where UK residents hold more than 40 per cent of the interest in a foreign company and a non-UK resident holds at least 40 per cent of the interest in that foreign company, such company would be a UK CFC.\(^93\)

The UK CFC rules also contain provisions which attribute certain rights and powers to persons in establishing whether or not they have control.\(^94\) 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

\(^91\) Ibid.
\(^92\) See s 755D(1) of the ICTA 1988.
\(^93\) See s 755D(3) and (4) of the ICTA 1988.
the person’s wishes (or jointly with someone else) in establishing whether that person has control.95

The income of the CFC is imputed to shareholders who hold 25 per cent or more of the interest in the CFC.96

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

(i) those that distribute 50 per cent97 of their available profits within eighteen months after the end of the accounting period to which the income relates;98
(ii) the CFC which has a business establishment in the territory in which it is resident;
(iii) where 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’.99

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.100
(iv) a minimum of 35 per cent 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.101

Analysis

The UK CFC rules are very complicated, and are among the toughest in the world when compared with other CFC regimes.102 As KPMG reported, the prevailing UK CFC rules are hugely unpopular with investors. KPMG states as follows:103

95 See s 755D(5) of the ICTA 1988.
96 Ernst & Young op cit note 10 at 997
97 The percentage increases to 90 per cent if the CFC is not a trading company.
accessed on 5 November 2009.
100 See M Gordon-Brown ‘Controlled Foreign Companies’ available at http://www.tax.org.uk/showarticle.pl?id=93&n=379,
accessed on 05 March 2010.
101 See Laing op cit note 84 at 817; Ernst & Young op cit note 10 at 996–7. It should be noted that the UK CFC rules are being reviewed. See ‘UK taxpayers fear corporate tax hike’ op cit note 85; FL Memo Ltd FL Memo Tax 2006–2007 (2006) 260.
103 KPMG ‘Cadbury Schweppes case — Advocate General says locating operations on the basis of a low tax rate is legitimate’ available at http://www.kpmg.co.uk/news/detail.fmt?pr=2508,
accessed on 5 November 2009. See also Lee op cit note 99.
‘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’.104

The UK CFC legislation has also come under scrutiny at the level of 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 Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue105 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.106 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.107

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

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105 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.
106 See P Tran ‘Cadbury Schweppes plc v. Commissioners of Inland Revenue: Eliminating a harmful tax practice or encouraging multinationals to shop around the bloc?’ available at http://ilr.lls.edu/issues/30/documents/Article330.1Tran.pdf, accessed on 4 April 2010.
UK multinationals and raise[s] issues regarding the competitiveness of the UK as a holding company location’.108

(b) 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’.109

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.110

(i) No withholding tax on dividends
The UK further provides incentives 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.

(ii) 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.111

(iii) 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.112 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 per cent or more by a holding company, unless the shares are held as inventory. In this regard Collinson & Tiley113 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...

109 Ernst & Young op cit note 10 at 997; Laing op cit note 84 at 813.
110 Deloitte op cit note 87.
111 Ocra Worldwide op cit note 89.
113 See Collinson & Tiley op cit note 83 para 28:05 and references contained therein.
TAX IMPEDIMENTS TO HOLDING COMPANY STRUCTURES

(the surrendering company) to another (the claimant company) enabling the latter to put the other company’s loss against its total profits.114

Foreign incorporated subsidiaries may be included, provided they are tax-resident. Thus, non-resident companies do not benefit from the group relief.115 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.116

(c) Précis on the United Kingdom

Technically, the UK does not have a special regime for holding companies.117 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.’118 The failure of the UK tax system to attract holding companies 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 holding companies similar to the Mauritian taxation of GBL1 companies,119 or a conglomerate of tax relief features such as a combination found in the Dutch tax system.120

114 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 R Rohatgi Principles of International Taxation (2002) 194. In Trinidad and Tobago the taxpayer cannot reduce its tax liability by more than 25 per cent through the tax losses of the surrendering company. See Rohatgi loc cit.


116 Tiley & Collinson op cit note 83 para 28:05.

117 Deloitte op cit note 87.


In addition to the complex CFC legislation, the 28 per cent 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.

VI ELIMINATION OF IMPEDIMENTS: WHAT SHOULD BE DONE?

As was seen above, the Belgian, Irish and British tax systems are sabotaged by features that restrict the applicability of the tax systems for use of holding companies. Some countries have successfully partly adjusted their tax law provisions to suit the use of holding companies within their shores. Prominent amongst these are the Netherlands and Mauritius. What follows is an overview of the key features in these two countries that make them attractive as hosts for holding companies.

(a) The Netherlands

The Netherlands has been very successful in attracting international business, mainly in the form of holding companies from all over the world, including within the European Union.121 This is largely due to the tax regime which contains tax instruments that ease the tax burden for holding companies.122 These tax instruments are mainly the participation exemption, the double taxation agreement network, and the advance tax rulings system.123

The Dutch participation exemption excludes qualifying elements of the profit from the taxable profit.124 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. Thus, the Dutch system functions as a full exemption system.125 The rationale for this exemption is that profits should not be taxed


124 See in IBFD International Tax Glossary definition of ‘participation exemption’ read with the definition of ‘affiliation privilege’.

125 Lambooij & Portengen op cit note 120 para 1.3.1.
twice in the corporate tax sphere and that a group of companies should be treated as one whole. The Dutch system does not require any minimum holding period.

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. 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.

The purpose of ATRs is to take away the uncertainty in tax areas where uncertainty exists, such as where there is little or no case law, in new areas and in areas where certain income must be reported within a certain range.

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.

The Dutch participation exemption and the ATR system apply universally regardless of whether the country of residence of the person to whom they are supposed to apply is a tax treaty partner of the Netherlands or not.

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. Currently, the Netherlands has treaties with more than 80 countries.

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

127 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.
131 See Van Dijk, Weyzig & Murphy op cit note 126 para 4.2.3.
dividends paid to the Netherlands holding company being reduced to zero. In most countries’ treaties the dividend withholding tax is usually set at a rate between 5 per cent and 15 per cent.\textsuperscript{132} The Dutch treaties also reduce the tax rates for dividends paid by a Dutch holding company to its parent from 25 per cent to a maximum of 15 per cent.\textsuperscript{133}

The benefits of the tax treaties apply in addition to or as a substitute for the normal tax attributes available to investors. Thus investors whose country of residence has a treaty with the Netherlands have a choice of either applying the normal tax attributes or the tax treaty provisions. This is in contrast with the situation in Belgium and Ireland, where tax attributes that are intended to attract foreign investors are only accessible by residents of tax treaty partners with the result that the coverage of the tax benefits is significantly reduced.

(b) Mauritius

Within the African Union, Mauritius has been aggressive in attracting investment into African as well as other countries to be channeled through Mauritius.\textsuperscript{134} The Mauritian approach focused on using the tax regime to achieve this purpose. While aggressive, the Mauritian authorities have succeeded in attracting investment in this way.\textsuperscript{135} The Mauritian tax system is constantly being adjusted in order to make Mauritius an even more attractive country in which to invest.\textsuperscript{136} This process 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.

The Mauritian government provides for Global Business Licences (hereafter ‘GBLs’) for Mauritian incorporated companies owned by foreigners. Companies holding GBLs 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 GBLs are on offer: the GBL1 and the GBL2.\textsuperscript{137}

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\textsuperscript{138} in Mauritius and in currencies other than the Mauritian

\begin{footnotes}
\item[132] Ibid para 4.2.2.
\item[133] Ibid.
\item[136] Ibid.
\item[138] 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
\end{footnotes}
rupee. They are not allowed to hold any immovable property in Mauritius, or certain securities in Mauritian corporations or any account in a bank in Mauritian currency. A GBL1 company is particularly attractive for investors due to its tax efficiency occasioned by the availability of three forms of tax credits, namely the underlying tax credit, presumed tax credit and the tax sparing 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. The underlying tax credit is granted in the residence country (i.e., Mauritius).

A presumed tax credit, like the tax sparing credit, is not based on actual taxes paid, but 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 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.

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. 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. The credit is normally granted in respect

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’ available at http://www.kpmg.com/SiteCollectionDocuments/TIES/MAURITIUS_2007_TIES.pdf, accessed on 24 March 2010.

139 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 of 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’. See s 21(1)(b) of the Financial Services Development Act of 2001.

140 Arnold and McIntyre op cit note 79 at 36.


143 Arnold & McIntyre op cit note 79 at 30.
of notional source country taxes of a certain kind, e.g., dividends, interest and royalties or to all income arising in the source state.\textsuperscript{144}

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 per cent of the foreign-source income has not been taxed. As a result the 20 per cent is taxed at a tax rate of 15 per cent, resulting in an effective rate of 3 per cent.

VII CONCLUSION

As indicated in the introduction, the three countries discussed 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 holding companies. In the UK this is exacerbated by the fact that it does not have abundant special features that are favourable for holding companies.

Along the same lines Ireland does have numerous features that make the Irish tax system ideal for the operation of a holding company. 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 a holding company 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 holding companies can be significantly 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 holding companies 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 DRD is not available to pure holding companies. This basically makes the DRD useless for enhancing Belgium’s position as a preferable host for holding companies in the form of headquarter-companies or intermediary holding companies specifically. This illustrates the point that the application of highly effective tax instruments

\textsuperscript{144} Lynette Olivier & Michael Honiball \textit{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 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.
could be rendered worthless by excluding from their application entities that are commercially essential for operating in a country.

On the other hand, the Dutch participation exemption and the advanced tax rulings apply to all taxpayers who qualify regardless of the fact that they are not tax resident or that they are resident in countries with which the Netherlands has tax treaties. Furthermore, persons subject to tax in the Netherlands benefit from the double tax relief measures provided by the extensive network of tax treaties regardless of the nature of the business carried on by such investors. Where the treaties do not provide such relief the Parent-Subsidiary Directive applies to the benefit of investors who are resident within the European Union. This combination expands the net of investors that benefit from the favourable tax treatment in the Netherlands. Thus, where a special regime is designed, it is advisable for such regime to apply to as wide a range of taxpayers as is possible in order to have the attractive attributes thereof more pronounced.

Similarly, the Mauritian GBL1 companies enjoy a conglomerate of tax attributes intended to attract holding companies. In addition to the unique presumed tax credit, they qualify for the benefits of tax treaties. In the Mauritian approach, tax relief is granted to holding companies whose presence does not adversely impact on the fiscus of the host country, ie companies whose presence in Mauritius is for pure administrative and management purposes of the group of companies.

It is important for countries intending to attract investment through holding companies to follow the Mauritian example by allowing incentivised holding companies to benefit from the facility of tax treaties. This would eliminate the risk of the tax that has been saved in Mauritius from being picked up by another country, for example by way of a tax on foreign dividends or attribution of controlled foreign company income in the country where the ultimate holding company of the group is located. As we have seen, Mauritius achieves this by including tax-sparing provisions in its treaties. For a country to be successful in attracting holding companies it should also eliminate the application of restrictive features such as the controlled foreign company provisions and the UK’s seemingly discretionary disallowance of interest on highly leveraged non-resident companies.

This analysis should serve as a lesson for South Africa, and any other country that plans to create a tax system that is conducive for the operation of holding companies, that a compromise of the tax base for the benefit of holding companies should be structured meticulously to ensure that it yields the best benefits. It should not be sabotaged by avoidable externalities. For South Africa, this should be a lesson from experience, as the headquarter regime enacted at the introduction of the residence based system in 2001 was mainly undermined by a similar foreseeable externality, exchange control.