

September 13, 2010

## "Open for Business" - The Tax Benefits of United Kingdom Holding Companies

The United Kingdom has announced tax changes which could see it become the jurisdiction of choice for the establishment of European holding companies including, most recently, a reduction in the headline rate of corporation tax to 24% by 2014.

Tax lawyers in the UK are often asked, "which is the best European Union country in which to establish an intermediate, or even ultimate, holding company?", by US clients who are expanding their operations or considering moving the location of their parent company.

Despite the many good business and commercial reasons for choosing the United Kingdom, a comparison of tax regimes has often proved a deciding factor in favour of the Netherlands, Luxembourg or Ireland, each of which has developed fiscal systems which actively encourage inward investment.

As an expanding business considers the tax consequences of establishing in possible jurisdictions the main questions in relation to the taxation of a new holding company ("Holdco") will be:

- How will the Holdco be taxed on dividend receipts from its subsidiaries?
- When subsidiaries are sold, will Holdco be taxed on the profit?
- Is Holdco required to withhold tax when it distributes profits to its shareholders?
- What rate of tax applies Holdco's profits?
- Can Holdco access a useful network of double tax treaties?

Now, at last, the UK can give positive answers to all these questions.

**Dividends** received by a UK Holdco from both UK and non-UK companies are exempt from UK corporation tax in the majority of cases. Unlike the 'participation exemptions' in some other jurisdictions there is no minimum equity holding requirement for a UK Holdco to qualify for the exemption from tax on foreign dividends.

If the recipient is a "small company", generally one that has fewer than 50 employees and whose annual turnover and/or annual balance sheet total does not exceed EUR 10 million, the exemption for non-UK dividends only applies if the payer is established in a jurisdiction with which the UK has a double tax treaty containing a non-discrimination provision. However, the UK is party to a wide network of double tax treaties so this will seldom be a problem unless the dividend is received from a tax haven.

In order to protect what is a very generous foreign dividend exemption from abuse it is subject to targeted anti-avoidance provisions. Broadly, the exemption will not apply to dividends which are paid as part of a tax driven scheme where the main purpose, or one of the main purposes, is to obtain a tax advantage.

**Capital gains** realised on the disposal of trading subsidiaries or trading sub-groups are also generally free from UK tax in Holdco's hands. In fact, this exemption can apply to a sale of shares if Holdco has owned as little as 10% of the equity for at least 12 months. Once again, anti-avoidance rules will deny relief if arrangements have been made to exploit the exemption from tax.

**Withholding tax** is not levied by the UK on dividends paid by UK companies even if the recipient shareholder is overseas. Often, of course, funding will be by way of medium to long term debt in order for Holdco's cost of funds to be deductible for tax purposes and there is a potential requirement to withhold income tax at 20% on cross-border interest payments. However, in practice, this charge to tax is usually relieved under a double tax treaty, for example, the US/UK treaty reduces the withholding to 0%.

**Corporation tax** is currently charged at a mainstream rate of 28% for the corporate tax year beginning 1 April 2010 on the taxable worldwide profits and gains of UK resident companies. However, the new coalition government announced on 22 June 2010 that the mainstream rate will reduce by 1%, to 27%, for the year commencing 1 April 2011 and by a further 1% for each of the following 3 tax years so that from 1 April 2014 it will be just 24%.

**Double tax treaty** access has long been a benefit of UK residence and of inward investment into the UK. The UK is party to over 100 double tax treaties which, amongst other things, generally reduce the source-country withholding tax applied on the repatriation of profits to a UK Holdco.

## Conclusion

Before it can be concluded that the UK now has a tax system which welcomes the establishment of holding companies there are two final questions. First, if that is so, why have a number of UK corporate groups moved their holding companies out of the UK in recent years, often publicly citing the UK's taxation system as a decisive factor; and, secondly, how does the UK's system compare with the more established holding company regimes?

The majority of the group migrations occurred at a time when the business community feared that the Labour Government might extend the UK tax charging provisions in relation to offshore interests and before the foreign dividend exemption was introduced in 2009. Although policy makers would never admit it, it's likely that those high profile moves offshore, and rumours of further migrations, actually prompted some of the positive changes introduced by that Government and the new Conservative/Liberal Democrat Coalition.

Whilst we are unlikely to see the same level of migrations under the revised regime, it is too soon to say whether the tax changes will be successful in reversing the tide and attracting inward investment to UK. However, as well as recognising the positive changes in the UK it is worth mentioning that some of the more traditional EU holding company locations have undergone negative tax changes in recent years. Ireland, for example, has introduced transfer pricing rules and Luxembourg, under pressure from the European Union, has revoked its beneficial "1929" holding company tax regime.

Ultimately, the choice of an EU jurisdiction for a new holding company will take account of many factors and the tax efficiency of a particular jurisdiction will depend on the client's priorities and business requirements. Also, of course, tax laws are subject to frequent change and in this area, perhaps more than any other, clients look not only for current certainty but future stability. Now, as a result of the changes discussed in this Alert, the United Kingdom should figure as a serious contender in any discussion on the location of a new European holding company. But what of the future?

When the new Chancellor, George Osborne, announced his emergency tax Budget in June he was keen to stress throughout his speech that enterprise promotion would be at the heart of the coalition government's plans for the UK's economic recovery, effectively promising a stable 'pro-business' tax

regime. When clients say, "OK, the current rules look good, but what about going forward?", the answer can be found in Mr. Osborne's Budget speech, "We live in world where the competition for business is growing ever more intense," he said. "I want a sign to go up over the British economy that says 'Open for Business'."

**Our client alerts are for general informational purposes and should not be regarded as legal advice. If you would like additional information or have any questions, please contact:**

**Principal Author**

Paul White  
+44 (0)20 7337 8039  
[pwhite@chadbourne.com](mailto:pwhite@chadbourne.com)

**Contact for More Information**

Stuart D. Baker  
+1 (212) 408-5435  
[sbaker@chadbourne.com](mailto:sbaker@chadbourne.com)

Edouard S. Markson  
+1 (212) 408-1084  
[emarkson@chadbourne.com](mailto:emarkson@chadbourne.com)

William G. Cavanagh  
+1 (212) 408-5388  
[wcavanagh@chadbourne.com](mailto:wcavanagh@chadbourne.com)

Lawrence Rosenberg  
+1 (212) 408-5274  
[lrosenberg@chadbourne.com](mailto:lrosenberg@chadbourne.com)

Eli M. Katz  
+1 (212) 408-1013  
[ekatz@chadbourne.com](mailto:ekatz@chadbourne.com)

Donald Schapiro  
+1 (212) 408-5305  
[dschapiro@chadbourne.com](mailto:dschapiro@chadbourne.com)

Lauren D. Kelly  
+1 (212) 408-5520  
[lkelly@chadbourne.com](mailto:lkelly@chadbourne.com)

Leslie J. Schreyer  
+1 (212) 408-5335  
[lschreyer@chadbourne.com](mailto:lschreyer@chadbourne.com)

Richard M. Leder  
+1 (212) 408-5128  
[rleder@chadbourne.com](mailto:rleder@chadbourne.com)

George E. Zeitlin  
+1 (212) 408-5311  
[gzeitlin@chadbourne.com](mailto:gzeitlin@chadbourne.com)

**About Chadbourne & Parke LLP**

Chadbourne & Parke LLP, an international law firm headquartered in New York City, provides a full range of legal services, including mergers and acquisitions, securities, project finance, private funds, corporate finance, venture capital and emerging companies, energy/renewable energy, communications and technology, commercial and products liability litigation, arbitration/IDR, securities litigation and regulatory enforcement, special investigations and litigation, intellectual property, antitrust, domestic and international tax, insurance and reinsurance, environmental, real estate, bankruptcy and financial restructuring, employment law and ERISA, trusts and estates and government contract matters. Major geographical areas of concentration include Russia, Central and Eastern Europe, the Middle East and Latin America. The Firm has offices in New York, Washington, DC, Los Angeles, Mexico City, São Paulo, London, Moscow, St. Petersburg, Warsaw, Kyiv, Almaty, Dubai and Beijing. For additional information, visit: <http://www.chadbourne.com/>

[www.chadbourne.com](http://www.chadbourne.com)

New York Washington Los Angeles Mexico City  
São Paulo London Moscow St. Petersburg Warsaw  
Kyiv Almaty Dubai Beijing

CHADBOURNE  
& PARKE LLP