



11 Raven Wharf, Lafone Street, London, SE1 2LR Tel: +44 (0)20 7403 5959 Fax: +44 (0)20 7403 3111
Email: gba@greenback-alan.co.uk Web: www.greenback-alan.co.uk

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Choosing a location for a European Holding Company

It is generally recognised that, across Europe, there is a downward trend in the headline rates of Corporation Tax. This trend has been partly driven by the competition to attract inward investment. Typically, a group will seek to set up a European Holding Company once its operations in Europe have reached a certain volume and complexity. In some cases it is a necessity for legal or tax reasons.

Although tax is often a key driver in the decision of location, the commercial background must not be overlooked. Factors which must be considered include;

- Location of existing European operations.
- Human resource matters.
- Accounting requirements.
- Language barriers.
- Economic infrastructure.
- Political and legal stability.

This article concentrates only on the taxation issues and in particular:

- Rates of Corporation Tax .
- Tax Treaty Networks and Withholding Taxes.
- Taxation of Capital Gains.
- Dividends Receivable.
- Interest Costs.
- Anti-Avoidance Legislation.

Rates of Corporation Tax

European tax rates in Western Europe, with the exception of Ireland (12.5%) are on average in the region of 30%. Germany, as mentioned in an earlier article, is currently cutting its tax rate to take it from one of the highest rates to just below 30%, when other similar taxes are taken into account. On the other hand, countries like Cyprus (10%) and Estonia (0% on retained profits) are providing stiff competition to the traditional locations such as Luxembourg and Switzerland which have very favourable regimes for some holding companies.



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Tax Treaty Network and Withholding Taxes

Double Taxation Agreement's (DTA's) commonly offer reduced rates of withholdings on dividends, interest and royalties paid to other treaty countries. Since the advent of the European Union Parent/Subsidiary Directive, these payments should no longer suffer withholdings for payments between companies resident in Europe. In addition, the UK, Cyprus and Hungary do not impose any withholdings on dividends regardless of where the payee resides. Others do not withhold unless payment is made to a tax haven company.

Another consideration is whether withholdings apply to distributions on liquidation, as some countries e.g. Austria, Denmark, Luxembourg and Sweden, tax these in the same way as dividends; others do not withhold or have different rates of tax for dividends and liquidation distributions.

With regard to interest, countries such as Germany, France, Luxembourg and The Netherlands do not impose a withholding tax. Others offer a reduced rate through the DTA's.

Taxation of Capital Gains

A number of countries within Europe now offer a total "participation exemption", i.e. not only are foreign dividends not taxable, but capital gains arising on the disposal of a subsidiary are exempt. It is also important to consider the impact of DTA's as a number of countries retain the right to tax gains on the sale of subsidiaries where the main assets are local real estate.

Dividends Receivable

A number of European countries provide an exemption from corporation tax on dividends from foreign subsidiaries. Some however, have various conditions to satisfy for the exemption to apply, for example, the subsidiary must be trading or liable to tax at a minimum rate. Some countries deal with the issue indirectly. Germany does not impose any withholding but does have a rule that the equivalent of 5% of the dividend is deemed to be a non-deductible business expense. This gives an effective exemption of 95%. In the UK, H M Revenue & Customs have issued a consultative



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document considering whether an exemption should be introduced into the UK. Currently, dividends received from foreign subsidiaries are taxable.

Interest Costs

The treatment of interest costs varies across Europe. In the main, most countries allow at least a degree of deductibility. However, difficulties can arise from country to country for example, in Germany, under the proposed reforms a limit is to be placed on the amount of interest deductible by reference to profits.

Anti-Avoidance Rules

A number of European jurisdictions impose Controlled Foreign Company (CFC) rules. Notable exceptions are Austria, Cyprus, Luxembourg and Switzerland. CFC rules are intended to prevent a parent setting up holding companies or subsidiaries in jurisdictions where the corporate tax rates are much lower.

The impact of CFC rules is far more critical outside Europe as the recent European Court of Justice decision in the case of Cadbury Schweppes has cast doubt as to the validity of these rules within Europe. The UK's intention to take a very narrow interpretation of the European Courts decision, contrasts with Germany's stance that the CFC rules will not apply to European subsidiaries. Given that some European countries have tax rates which can range between 0% and 12.5%, this is an area which is likely to see a number of cases taken through the Courts in the future.

Another area which is developing along similar lines is that of thin capitalisation. Some jurisdictions do not impose any restrictions on the deductibility of interest on loans where the company is thinly capitalised. Others do and as this is contrary to the European Courts of Justice view, many countries are in the process of introducing local thin capitalisation restrictions.

Finally, the newer DTA's often include clauses to prevent "treaty shopping" whereby the treaty's are used to obtain an unfair advantage.



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As will be noted, it is not possible to generalise as to where would be the best location for a European headquarters. Each country's rules, although moving towards harmonisation, are still very different. Consequently, it is important to consider each group's circumstances in detail before any decision is made.