The use of UK holding companies in international group structures

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The location of a holding company is a significant consideration in any international corporate structure. Choice of jurisdiction for a group holding company ('Holdco') is relevant both from the point of view of tax optimisation (maximising withholding tax free dividend, interest and royalty flow up through the group and minimising tax charges on capital gains) and for commercial reasons. Commercial considerations are important when selecting a holding jurisdiction as it is important that the Holdco is located in a credible 'blue chip' jurisdiction when seeking to access the international equity and debt capital markets. Choice of Holdco location will also be relevant in circumstances where private equity investment is envisaged or where a trade sale is planned. For example, a Western buyer is often more comfortable buying a Dutch or UK Holdco that owns an underlying operating business in Russia or Kazakhstan rather than directly purchasing the shares in a local Russian/Kazakh holding company that owns these assets.

Until quite recently, the UK was not always a good choice for Holdco location due to potentially high UK tax charges on inbound dividends and on capital gains. However, over the last fifteen years, the UK has addressed certain negative aspects in its tax legislation in these areas and the UK is now frequently seen as a good choice for a jurisdiction in which to establish a Holdco.

There are, of course, further non-tax considerations that need to be given attention when considering whether the UK is a suitable Holdco location. A brief outline of the various tax and non-tax aspects of using a UK Holdco in an international group structure are set out below.

Corporation tax

UK resident companies are subject to corporation tax on worldwide income and gains at a competitive rate of tax that is currently fixed at 20% but which is due to fall to 19% in 2017 and to 18% in 2020. This will mean that the UK will have the lowest tax rate on corporate profits of any country in the G20.

A low tax rate is important because, although a UK Holdco may often have little income from its own business activities (if any) that is subject to corporation tax (see below), it may receive taxable royalties and interest along with management fees.

Dividends/Interest/Royalties paid by subsidiaries to UK Holdco

UK Holdco may receive dividends, interest and royalties from its foreign subsidiaries. Depending on the relevant domestic law of the subsidiary, these payments may be subject to a withholding tax. However, if there is a double taxation agreement in force between the UK and the jurisdiction of the subsidiary, then any withholding taxes may be eliminated or reduced by the relevant article of the agreement. In this connection, the UK is a party to around 110 double taxation agreements which is more than any other country. The UK is also a Member State of the EU which means that it is a party to both the EU Parent/Subsidiary Directive and the EU Interest and Royalties Directive. Under certain conditions, these Directives will operate to remove foreign withholding taxes that would otherwise be paid in the other EU Member State on dividends, interest and royalties paid by a subsidiary to the UK Holdco. In summary, the UK's double tax treaty network and EU membership mean that in many cases there will be no foreign withholding taxes where there is a UK Holdco, thereby minimising an international group's overall tax cost.

Inbound dividends

Since 1st July 2009, most dividends received by a UK Holdco from a foreign subsidiary will be exempt from UK corporation tax. Although the legislation is complex the end result is that nearly all dividends will be exempt as they are likely to fall within one of the specific exemption regimes which apply to small companies on the one hand and medium sized/large companies on the other. For exemption to apply under either of these regimes it is a condition that the dividend should not be a deductibility item in the country of the subsidiary paying the dividend.

Dividends received by small companies, that is companies with less than 50 employees and a turnover less than €10 million and/or a balance sheet total of less than €10 million, are fully exempt from corporation tax provided they are received from territories that have a double taxation agreement with the UK that contains a non-discrimination article.

A number of classes of dividend payment are tax exempt for medium and large UK companies, such as dividends paid on:

(a) shares where the UK recipient controls the payer in terms of, shareholding, powers or economic rights;

(b) non-redeemable ordinary shares;

(c) shares where the recipient (together with their connected persons) holds less than 10% of the issued share capital of the paying company (or, where there is more than one class in issue, less than 10% of the class of shares held); and

(d) dividends derived from transactions which are not designed to achieve a reduction in UK tax.

Where, rarely, dividends received by a UK Holdco do not fall within one of the above exemptions then the dividends will be subject to corporation tax at the normal 20% rate.

Outbound dividends

Subject to a minor exception (relating to real estate investment trusts) the UK does not under its domestic law levy any withholding tax on outbound dividends, share buybacks or liquidation distributions paid by UK companies regardless of the residency of the person or entity to whom the dividend is paid. This means that a UK Holdco can be owned by an individual or a company established in an onshore or an offshore jurisdiction and no dividend withholding tax will apply. This lack of outbound dividend withholding has traditionally given the UK a considerable advantage over some of the other traditional European holding company jurisdictions (such as the Netherlands and Luxembourg) which do impose dividend withholding taxes.

Outbound Interest and Royalties

The UK does impose a 20% withholding tax on outbound interest and on some royalties.

Interest withholding tax applies to payments of annual interest (i.e. interest on a debt capable of being outstanding for over one year) made to, broadly, a non-resident. However, in practice the UK interest withholding tax that would otherwise be payable by a UK Holdco will often be eliminated or at least reduced by the interest article in the many double taxation treaties to which the UK is a party or by the EU Interest and Royalties Directive. Where a UK Holdco borrows from a parent located in an offshore jurisdiction then the debt can be structured in the form of Eurobond that is listed on a recognised stock exchange (such as the Channel Islands Stock Exchange). In these circumstances the interest can be paid gross and there is no withholding tax.

Interest Deductibility

Funding costs and, in particular, interest payments are usually deductible for corporation tax purposes. However, where a loan is made between connected persons then the level of debt incurred, and the rate of interest payable, must meet arm's length standards to be deductible for UK corporation tax purposes. The UK also has complex 'worldwide debt cap' rules that operate to restrict corporation tax deductions for interest by reference to a group's consolidated finance costs.

In addition, there are also anti-avoidance measures that apply where the main purpose of the financing is to avoid tax and anti-arbitrage rules to counter tax advantages arising from funding structures involving hybrid entitles or hybrid instruments.

The substantial shareholding exemption

Broadly, a gain arising from a disposal of shares by a UK Holdco may not be a chargeable gain subject to corporation tax if the Holdco is the holding company of a trading group which disposes of a trading company in which the Holdco has held an equity interest of at least 10% throughout a period of twelve months. Note, that there is no need for the UK Holdco to dispose of its entire shareholding to benefit from this exemption.

The company making the disposal must continue to satisfy the relevant conditions immediately after the disposal of the shares. Therefore, where a UK Holdco is incorporated solely for the purpose of owning shares in a single trading subsidiary then, on the sale of the subsidiary, it will no longer be a holding company of a trading group and will not, in principle, be able to benefit from the exemption. However, in practice the exemption will still be available if the UK Holdco is wound up promptly after the sale of the subsidiary.

It is important that the UK Holdco will be regarded as a holding company of a trading group and not as an investment company. A trading group is defined as a group whose members carry on trading activities which (disregarding intra-group activities) do not include to a substantial extent activities other than trading activities.

Transaction taxes

Transfers of shares or of interests in shares in UK registered companies worth more than £1,000 are subject, generally, to stamp duty or stamp duty reserve tax at a rate of 0.5% (rounded upwards to the nearest £5 in the case of stamp duty) by the purchaser of the shares.

An issue of shares is not subject to either stamp duty or to capital duty.

Anti-avoidance measures

The UK does have various anti-avoidance measures contained in its tax system that may sometimes affect a UK Holdco. Generally, these provisions are intended to bring non-UK trading profits or chargeable gains into the charge to UK tax to the extent that they have been artificially diverted from the UK.

Controlled Foreign Company ('CFC') Regime

A CFC is a non-UK resident company that is controlled by a UK resident.

The CFC rules are designed to target profits which have been artificially diverted away from the UK so that they are generated in low-tax jurisdictions. The rules do not affect profits from genuine economic activity from outside the UK and, therefore, do not affect the majority of UK holding companies.

The rules apply by imposing a charge on the controlling UK company on the profits of its CFCs as they arise to the extent that such profits are connected to the UK and the CFC is not entitled to benefit from any exemptions.

One such exemption applies where the CFC is resident in a jurisdiction with an effective tax rate that corresponds to at least 75% of the corresponding level of tax exposure in the UK.

If a charge arises, the UK company is charged corporation tax in respect of some of the profits of the CFC.

Note that as a result of the July 2015 Budget, UK resident companies subject to a CFC charge will no longer be able to set current and carry-forward losses and surplus expenses or group relief against the CFC charge. This applies to profits arising on or after 8th July 2015.

The main UK CFC regime applies to income but there are other rules that operate to attack the use of artificial offshore structures as a means of avoiding UK taxation of capital gains by companies (or other types of taxpayer).

Transfer pricing

In broad terms the UK's transfer pricing rules apply to large companies where services or transactions take place, or loans are entered into, between connected parties for a price calculated to provide a UK tax advantage. The effect of the rules is to treat the service as being supplied on an 'arm's length price' rather than the price actually charged.

For example, these rules may prevent a full corporation tax deduction being available in respect of interest paid by a UK Holdco to shareholders who have provided debt finance.

Parent-Subsidiary Directive – anti-abuse clause

The Parent-Subsidiary Directive was recently amended to require EU Member States to deny the benefits of the Directive to arrangements that are not 'genuine' and which have a main purpose of obtaining a tax advantage that defeats the objectives of the Directive. An arrangement is genuine to the extent that it is introduced for valid commercial reasons reflecting economic reality. This means that where a company has been inserted in a structure purely to obtain withholding tax free treatment for dividends then the benefit of the Directive will be disallowed. The deadline for transposing the amendment to the Directive into national law is 31st December 2015.

Beneficial ownership Register

As part of the UK government's drive to greater transparency with effect from April 2016 UK companies will be required to maintain a register of their beneficial owners and this register will be publicly accessible. It is likely that all the other Member States of the EU will also bring in a requirement for similar registers over the next two years.

General commercial factors

In addition to the above tax incentives, the UK has a number of commercial advantages. London is a leading global financial centre, is well regulated and is an attractive location to list, raise debt finance and manage a business. It also offers a stable legal, political and economical system and companies incorporated in the UK are seen as inherently 'respectable'. In addition, the incorporation process is both straightforward and cheap.

Bilateral Investment Treaties

A final consideration when focusing on the UK as a Holdco jurisdiction is the availability of bilateral investment protection with the countries where UK Holdco's subsidiaries are located. In this connection, the UK has a very wide range of in force bilateral investment treaties.

Withers LLP is uniquely qualified to assist you on matters of UK tax and commercial law structures.
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