



The use of UK holding companies in international group structures – **tax considerations**

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THE JURISDICTION FOR A HOLDING COMPANY is an important 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 efficiency (maximising withholding tax free dividend, interest and royalty flow up through the group structure and minimising tax charges on capital gains) and for commercial reasons.

From a commercial viewpoint it is important that the Holdco is located in a reputable jurisdiction when seeking to access international equity and debt capital markets. The 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 UK or US investor is often more comfortable buying a Dutch or UK Holdco that owns an underlying operating business in Russia rather than directly purchasing the shares in a local Russian holding company that owns these assets.

Generally we are seeing a trend away from the use of offshore locations such as the British Virgin Islands (BVI) towards onshore jurisdictions. Structures are also becoming less complex. This is all probably the result of the OECD BEPS project as well as events such as the 'Panama papers'. The UK is now a prime candidate as the location for an onshore Holdco.

Until quite recently, the UK was not always a good choice for the Holdco location due to potentially high UK tax charges on inbound dividends and on capital gains. However, in recent years, the UK has addressed certain negative aspects in its tax legislation in these areas and is now frequently seen as a good choice for a jurisdiction in which to establish the Holdco. A brief outline of the most significant tax aspects of using a UK Holdco in an international group structure is set out below.

Corporation tax

UK resident companies are subject to corporation tax on worldwide income and gains at a competitive tax rate that is currently fixed at 19% but is due to fall to 17% on 1 April 2020. This will mean that the UK will have the lowest tax rate on corporate profits of any country in the G20. Although some items of Holdco's income should be exempt (such as dividends) interest, royalties and management fees will be taxable so a low tax rate is important.

Dividends/interest/royalties paid by subsidiaries to UK Holdco

The 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 (DTA) 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 probably has the largest DTA network of any jurisdiction.

The UK is also a Member State of the EU (currently) which means that it is a party to both the EU Parent/Subsidiary Directive and the EU Interest and Royalties Directive. However the UK will only get access to these until the transition period ends on 31 December 2020. 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.

Inbound dividends

Since 1 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.

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 19% 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 residence 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 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 ‘yearly interest’ (interest on a debt capable of being outstanding for over one year) made to, broadly, a non-resident.

However, in practice UK interest withholding tax otherwise payable by a UK Holdco will often be eliminated or, at least, reduced by the interest article in one of the many DTAs to which the UK is a party or by the EU Interest and Royalties Directive.

Where a UK Holdco borrows from a company located in an offshore jurisdiction (in which case no relief under

generally, to either stamp duty or Stamp Duty Reserve Tax (SDRT) at a rate of 0.5% (rounded upwards to the nearest £5 in the case of stamp duty) by the buyer of the shares. An issue of shares is not subject to either stamp duty or capital duty.

Anti-avoidance measures

The UK has 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.

The most important of those rules are the Controlled Foreign Company (CFC) Regime and Transfer Pricing set out below.

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a DTA will be available), then the debt can be structured in the form of a 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. The deductibility of interest payments by a UK Holdco will, broadly, now be restricted to 30% of EBITDA subject to a de minimis limit of £2 Million (where full relief will apply).

Substantial Shareholding Exemption (SSE)

Broadly, a gain arising from a disposal of shares by a UK Holdco may be exempt from corporation tax under the SSE provided that Holdco has held at least 10% of the shares of the company being disposed of for a 12 month period. In addition, the company being disposed of must either be a trading company or the holding company of a trading group.

Transaction taxes

Transfers of shares or of interests in UK registered companies worth more than £1,000 are subject,

CFC Regime

A CFC is a non-UK resident company that is controlled by a UK resident that holds at least 25% in the CFC. Unless an exemption applies the profit of the CFC may be subject to UK corporation tax.

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

Transfer pricing

In broad terms the UK’s transfer pricing rules apply to large companies where goods or services are sold, or loans are entered into, between connected parties for a price calculated to provide a UK tax advantage. The effect of the transfer pricing rules is that any such tax advantage is cancelled out by deeming goods/services to be supplied for the ‘arm’s length price’ rather than the price actually charged.

Bilateral Investment Treaties (BITs)

Another important consideration to focus on when considering the use of the UK as a holding jurisdiction is whether there is a BIT in force with the countries where the subsidiaries are located. In this connection the UK has a wide network of BITs.

For further information please do not hesitate to contact [Andrew Terry - Partner](#) or [Elena Solovyeva - Corporate Tax Manager](#). ■