

# The UK as a holding company jurisdiction

## Introduction

This note sets out, in overview, the tax advantages and disadvantages of the UK as an intermediate holding company jurisdiction. The note is intended as a summary only. Further detail about the tax and legal aspects of establishing a holding company in the UK can be provided upon request.

The UK is an attractive location for a holding company from a commercial perspective. It has a skilled labour force, good transport links and its corporate and contract law are settled and based on principles familiar to global businesspeople. It is relatively easy and cheap to establish “substance” in the UK – a UK holding company is less likely to be viewed negatively by tax authorities in other jurisdictions than a holding company in a low tax jurisdiction.

## Overview

The basic rules of the UK corporate tax system are as follows:

- (a) The current rate of corporation is 26%. The effective rate can be reduced for groups with profits of less than £1.5 million per year. UK resident companies are subject to corporation tax on their worldwide income and gains, although a UK company can elect for exemption from corporation tax on the profits of an overseas branch.
- (b) The UK does not impose withholding tax on dividends paid to shareholders. There is a broad exemption from corporation tax on dividends received.
- (c) Non-UK residents will generally not be liable for UK tax on disposal of their shares in a UK company. Capital gains realised by UK companies on sales of shares in trading companies, or holding companies of trading groups, may be exempt from tax under the UK’s participation exemption, the “substantial shareholding exemption.” However, this exemption is more complex and less broad than participation exemptions in other popular holding company jurisdictions.
- (d) The UK has no capital duty or wealth tax. There is no stamp tax on share issues or capital contributions in the UK. Stamp duty is payable at 0.5% on the transfer of shares, unless an exemption applies.
- (e) The UK has “controlled foreign company” (“CFC”) rules which can tax undistributed profits of a non-resident subsidiary if it is UK-controlled and is established in a low tax jurisdiction (less than 75% of the UK equivalent tax). There are exemptions from the CFC rules, including where the non-resident subsidiary is carrying on genuine commercial transactions.

The UK regime for taxing dividends and capital gains compares favourably to the regimes applicable in many other jurisdictions. However, the UK has detailed and complex rules governing the taxation and deductibility of interest:

- (a) There is a 20% withholding tax on interest payments made to non-residents. It may be possible to avoid withholding tax in practice, as (i) there are several UK law exemptions, (ii) many of the UK’s double tax treaties provide for the reduction or elimination of the liability, and (iii) the UK has implemented the provisions of the EC Interest and Royalties Directive.
- (b) The UK has detailed anti-avoidance legislation which can restrict the corporation tax deductibility of interest paid by a UK company, including extensive transfer pricing/ thin capitalisation and anti-arbitrage rules.
- (c) A “worldwide debt cap” has recently been introduced. This measure applies to companies that are part of a “large” group (applying the definition of “large” from Commission Recommendation 2003/361/EC). The aim of the debt cap is to prevent a group’s UK interest deductions exceeding its gross worldwide external interest expense. This is achieved by disallowing a tax deduction for interest to the extent that the net interest expense on the debt of the UK part of the group, i.e. borrowings from third parties and from non-UK group members, less interest income, exceeds the interest expense on the external borrowings of the worldwide group.

## Proposed changes

The UK coalition government has announced its intention to make clear that the UK is “open for business.” With this in mind, the government has announced the following changes to the UK’s tax system:

- (a) The rate of corporation tax will be reduced by 1% each year until it reaches 23% by April 2014. This will be the lowest corporation tax rate in the G7 group of countries.
- (b) The CFC rules are being reformed so that they operate in a more targeted and territorial way. The broad, general intention is that only profits that have been artificially diverted from the UK should be targeted by the CFC rules. A finance company partial exemption will be introduced which, broadly, will result in profits derived from overseas group financing arrangements being taxed at an effective rate of one quarter of the normal corporation tax rate. This will result in an effective rate of 5.75% by 2014.
- (c) The UK is committed to introducing a “patent box” regime with effect from April 2013. The government has indicated

that a 10% corporation tax rate will apply to profits from patents first commercialised after 29 November 2010. However, the patent box will only apply to patent rights and not to brands or trademarks.

(c) The HMRC “Advance Agreements Unit” provides a personalised service to businesses making significant investments in the UK. For these purposes, “significant” means £250 million in value or more, or otherwise of importance to the economy or in the public interest.

## Clearances

HMRC provide advance rulings on tax issues. Businesses, including intermediate holding companies, can obtain advance tax rulings in a broader range of situations than individuals.

- (a) For businesses, HMRC provide advance rulings on areas of material uncertainty arising within four years of the introduction of any new legislation. Rulings can also be obtained on legislation more than four years old where there is material uncertainty around the tax outcome of an issue of commercial significance to the business, determined by reference to the scale of the business and the impact of the issue upon it.
- (b) There are also a number of statutory clearance procedures relating to specific provisions of the tax legislation.

## Summary

The UK has a number of strengths as a holding company location. The tax treatment of dividends is particularly advantageous. The CFC rules, which have previously been considered one of the UK’s principal disadvantages, are being reformed and should be less onerous in their application in the future. The UK regime for taxing passive income other than dividends still compares unfavourably to the regimes applicable in more benign jurisdictions but recent developments are helping to redress the balance. However, although the taxation of holding companies in the UK is unlikely ever to be as generous as in (for example) Cyprus or Luxembourg, the UK offers practical and commercial advantages over these jurisdictions.

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