"A key ambition... is to create the most competitive tax system in the G20. As well as lowering tax rates, the Government wants to make the UK the best location for corporate headquarters in Europe."

David Gauke
Exchequer Secretary to the Treasury

Introduction

The Government has taken steps to make the UK tax system much more competitive for holding companies. This has led to the return of companies who previously migrated from the UK, as well as the establishment of a number of new holding companies.

Particular attractions include:
- Majority of share disposals and dividends received are exempt from tax
- Introduction of an attractive offshore finance company regime
- Rewritten “controlled foreign company” rules from 2013. The rules will now apply only to narrowly targeted classes of profits
- An election to exempt overseas branches from UK tax
- Interest expense on funding for share acquisitions is tax deductible
- EU membership together with an extensive treaty network, and
- UK tax authorities now provide informal clearances

Overall the UK has significantly improved its competitive position relative to other more established holding company locations. A recent survey of UK and foreign companies undertaken by KPMG indicates that the UK is considered to have the most competitive tax regime for holding and headquarters companies.
Share disposals

The ‘substantial shareholding exemption’ provides an exemption for capital gains on the disposal of most shareholdings in active operating businesses. The exemption stipulates that three requirements must be met.

1. The ‘substantial shareholding’ requirement – a company (the ‘investing company’) must hold 10% or more of the ordinary shares in another company (the ‘company invested in’) for a continuous period of twelve months during a two year period preceding the disposal.

2. The ‘investing company’ requirement – broadly, the company must be an active operating business or a member of a group of such companies for a twelve month period before, and immediately after, the disposal, and

3. The ‘company invested in’ requirement – the company must be an active operating business or the holding company of a group or sub-group of such businesses for a twelve month period before, and immediately after, the disposal.

Where the requirements are met, any capital gain or loss on the disposal is exempt from tax. In practice, the exemption covers most share disposals by active operating groups. By contrast, the exemption is not available to investment groups, for example in the real property area. It is possible to obtain clearance from the UK tax authorities in areas of doubt.
Dividends

For company shareholders, most dividends in the UK are free from tax.

There is no withholding tax on dividends paid by a UK company.

For dividends received by a UK company there is an exemption system that should apply to most dividends from subsidiaries (with the exception of dividends in relation to which a tax deduction is claimed in the paying country).

There is no minimum holding period requirement nor any requirement for the paying country to be in an EU or tax treaty country (except where the number of staff employed by the group worldwide is less than 50).

For dividends from companies engaged essentially in making loans or deposits, the exemption generally applies only if the shareholding is above 50%.

Controlled foreign company rules

A completely new set of CFC rules applies for accounting periods beginning from 1 January 2013. They are intended to ensure that CFC taxation applies only to profits that have been artificially diverted from the UK. Specifically:

- Subsidiaries that are taxpaying in a wide list of “excluded territories” are generally excluded from CFC taxation if not more than 10% of their income in the territory/country is either exempt or benefits from a notional interest deduction like the one applicable in Belgium. The new list is wider than the list of “excluded countries” under the old CFC rules.

- Profits other than interest income in all remaining companies is subject to CFC taxation only if a majority of the business functions relating to assets used/risks borne by the company are performed in the UK and even then only if taxed at an effective rate less than 75% of the UK tax rate (the UK corporation tax rate is now 23%, reducing to 21% from April 2014 and 20% from April 2015).

- Interest income, if taxed at less than 75% of the UK rate, is subject to CFC taxation but only if it arises from capital invested ultimately from the UK (or if the funds are managed in the UK). Additionally, 75% of the interest on lending to direct or indirect non-UK subsidiaries of the UK parent can be exempted from CFC taxation if an appropriate election is made.
Branches

In 2011, the Government introduced a new regime which exempts the profits (including capital gains) of a company’s overseas permanent establishments (branches).

The regime is optional. A company can elect to exempt from UK tax all the profits or losses of all its overseas branches involved in active operating business (not investment business); by way of exception, the exemption can apply to investment profits derived from assets effectively connected with the branch’s exempt trade or property business. The election does not need to be made by all the companies in a group. Where the election is not made branch losses can be offset against UK profits.

The profits or losses are calculated using OECD treaty principles. There is an anti-diversion rule which operates in a broadly similar way to the controlled foreign company regime (except that the 75% exemption for interest on loans to direct or indirect non-UK subsidiaries of the UK parent is not available for branches). There are transitional rules to deal with branch losses.
Financing expenses

The starting point is that interest is normally a tax deductible expense for a UK company.

The Government recently considered, but rejected, a proposal to introduce a specific restriction on the deductibility of interest incurred in funding equity investments (regardless of whether the investment is in a non-UK company or is acquired intra-group). As a result, there should be minimal risk of this approach changing.

There are of course transfer pricing and thin capitalisation rules as well as a number of other potential restrictions on interest deductibility (e.g. loans for non-commercial purposes, tax arbitrage rules and a restriction on having net interest expense in the UK that exceeds the total external interest expense in the worldwide group’s consolidated accounts).

While UK domestic law imposes 20% withholding tax on payments of interest to non-UK residents on loans capable of exceeding one year, this may be reduced or, more frequently, eliminated by the EU Interest & Royalties Directive or the UK’s network of over 120 treaties. There is also a widely relied on domestic law withholding tax exemption for interest on “quoted Eurobonds” (debt listed on a stock exchange recognised by the UK tax authorities). The exemption is available for intra-group as well as third party debts, and there is no requirement for the debt to be actively traded. Consequently, withholding tax need not normally create an obstacle to debt funding.

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EU membership and treaty network

The UK is a full member of the European Union and this allows a UK holding company to benefit from the EU Parent/Subsidiary Directive, the Interest and Royalties Directive, and the EU Arbitration Convention on Transfer Pricing. The first directive normally allows dividends to be paid up to the UK holding company from all EU member states free of withholding tax on any shareholding in excess of 10%; the second normally allows interest to be paid to it from all EU member states free of withholding tax, provided the UK holding company has at least a 25% shareholding in the EU company paying the interest.

The UK has one of the widest networks of double tax treaties in the world. For example, where there are substantial operations in the UK, the treaty with the US may reduce US dividend withholding tax to 5% on a shareholding in excess of 10% (nil if the UK holding company is listed and regularly traded on a recognised stock exchange). The network with countries across Asia is very wide, and the new treaty with China will reduce withholding tax on dividends from a Chinese subsidiary to 5% (the most favourable rate available in any of China’s treaties). The UK also has a wide network of treaties with countries in Africa.
How we can help

KPMG’s international network is ideally placed to assist you in evaluating the UK as a holding company location for your business. In addition, we can assist in deciding on the best way to invest into and out of the UK and in discussions with the UK tax authorities. For further information, please contact your usual KPMG contact or Robin Walduck, Head of International Tax and Treasury, tel +44 20 7311 1816, email robin.walduck@kpmg.co.uk

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