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INSIGHT: Bring it Home—Holding Companies and Repatriation

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There are many reasons why some holding locations are more attractive than others for multinationals and investment funds.

Luxembourg Luxembourg is a prime holding location offering a flexible business environment. From a tax perspective, Luxembourg notably meets the two key tax attributes for the holding structure of an international business:

- enhancing tax efficiency through a holding structure that provides tax benefits for the business; and
- minimizing tax leakage on the distribution of profits and gains to shareholders and investors.

Income realized by a Luxembourg company is, in principle, subject to corporate income tax (''CIT'') at the aggregate rate of 26.01 percent.

However, dividends, and liquidation proceeds, are tax-exempt if the Luxembourg recipient company is a fully taxable entity, holds or commits to hold at least 10 percent of the share capital of the distributing company, or has an acquisition price of at least 1.2 million euros ($1.4 million), for at least 12 months and, the distributing company is a fully taxable resident company, an EU company covered by the Parent-Subsidiary Directive, a non-EU company in a double tax treaty (''DTT'') country subject to CIT of at least 9.5 percent on a basis comparable to the Luxembourg taxable basis, or a permanent establishment of these qualifying companies.

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Dividends received by a Luxembourg company that do not qualify for the participation exemption might still benefit from a 50 percent exemption if they are paid by a qualifying entity. Capital gains can be exempt from CIT under the same conditions as the dividends received except that the alternative to the 10 percent shareholding is not 1.2 million euros but 6 million euros. Interests are fully taxable but such taxable income may be offset by expenses.

Dividends distributed by a Luxembourg fully taxable company to a foreign company are in principle subject to a 15 percent withholding tax in Luxembourg, unless the receiving company holds or commits to hold at least 10 percent of the share capital in the distributing company, or having an acquisition price of at least 1.2 million euros, for at least 12 months, and is:

- a fully taxable resident company;
- a EU company covered by the Parent-Subsidiary Directive;

■ a non-EU company in a DTT country, subject to CIT of at least 9.5 percent on a basis comparable to the Luxembourg taxable basis; or

■ a permanent establishment of these qualifying companies.

Dividends can also benefit from a withholding tax exemption or reduced rate based on a DTT. Luxembourg does not withhold tax on arm's length interest payments and, in principle, does not tax gains realized by foreign investors.

As a result, repatriation of funds can notably be made efficiently through interest payments, repayment of loans or redemption of securities, payment of (interim) dividends, redemption of shares (capital decrease) or upon liquidation (liquidation proceeds).

Netherlands Similar to Luxembourg, the Netherlands is a favorite holding location for multinationals and investment funds because of the participation exemption regime, the extensive tax treaty network and certain domestic exemptions for withholding tax on dividends, royalties and interest.

The origin of these rules is that the Netherlands has a relatively small domestic market but is a strong global trading nation. Rules to avoid double taxation are of importance for such a trading nation and provide for a level playing field for Dutch multinationals operating abroad.

In recent years the Dutch government has taken significant measures to eliminate so-called ''letterbox'' companies owned by foreign companies which are being perceived to abuse the Dutch tax system.

Measures taken by the EU and on a global level through the Organization for Economic Co-operation and Development (''OECD'') also have an impact on the Dutch tax rules.

For example, the introduction of CFC rules through the EU Anti-Tax Avoidance Directive (''ATAD'') and the principal purpose test (''PPT'') through the multilateral instrument (''MLI'') will have a significant impact on the use of Dutch (and other jurisdiction) holding structures.

Income, such as dividends and capital gains, realized by a Dutch company is in principle subject to CIT at a rate of 25 percent on profits over 200,000 euros and 20 percent on profits below 200,000 euros. These rates are expected to decrease to 21 percent and 16 percent, respectively, by 2021.

However, income from qualifying subsidiaries in which at least 5 percent of the share capital is owned is fully exempt under the participation exempt.

In order to qualify, certain conditions need to be met in order to secure that the subsidiary is not a low-taxed passive investment. No holding period applies.

The Netherlands has a domestic exemption on dividend withholding tax for shareholders which own at least 5 percent of the share capital in the Dutch company and are resident in the EU or a country with which the Netherlands has concluded a tax treaty (which includes a dividend article).

The exemption does not apply to passive investment structures and specific substance requirements need to be met in case of intermediary holding companies.

The domestic exemption may also apply in case the relevant tax treaty has a higher rate of withholding tax or includes anti-abuse clauses such as a Limitation on Benefits (''LOB''). The statutory withholding tax rate is 15 percent.

It is currently being discussed whether the Netherlands will abolish dividend withholding tax in the future and only apply a source taxation on dividends in specific abusive structures, for example on payments to EU blacklisted countries.

The Netherlands do not levy withholding tax on interest or royalties. It is currently being discussed whether a withholding tax will be introduced in the future for certain abusive structures.

The main reasons for using the Netherlands as a tax structuring jurisdiction in order to avoid double taxation are therefore still present. It does however require a focus on substance and business purposes at the level of the foreign and Dutch entities in the structure.

Switzerland Switzerland is a traditional holding location due to its low income taxation of holding companies, its participation exemption regime and its wide treaty network.

Income realized by a Swiss holding company is subject to corporate income tax at the aggregate rate of 7.83 percent.

However, for dividends including liquidation proceeds, participation exemption relief can be claimed provided the Swiss company holds at least 10 percent of the share capital of the distributing company or the shares held by the Swiss company in the distributing company have a fair market value of at least 1 million francs ($1 million).

Participation exemption relief can also be claimed on the capital gain on share quotas of 10 percent or more, provided the sold shares have been held for one year. There is no subject to tax requirement for subsidiaries.

Interest or other income is subject to the CIT rate of 7.83 percent. All expenses justified by the company purpose are tax deductible. This includes debt interest. Intercompany charges have to be at arm's length (the OECD transfer pricing guidelines apply). A Swiss holding company can opt for VAT and as a registered VAT payer, it can claim input tax on services received.

Dividends and liquidation proceeds distributed by a Swiss holding company are subject to a withholding tax of 35 percent. Swiss resident shareholders can obtain a full relief/refund of the withholding tax, provided they declare or record the corresponding dividend income.

Non-Swiss resident shareholders can obtain a full or partial relief/refund of the withholding tax based on the applicable tax treaty. It has to be noted that no treaty relief will be granted to structures with insufficient substance or if the shareholders are not the beneficial owners of the dividend.

No withholding tax is levied on royalties or interest, except for bank interest or interest on bonds issued by the Swiss holding company. Capital gains by non-Swiss shareholders are not subject to tax in Switzerland. The redemption of share capital and share premium is also exempt from withholding tax.

Planning Points

■ Choosing a holding location depends on many factors including tax considerations.

■ A thorough analysis of the business model, and notably of the cash flows, should be performed so that the holding entity is set up having regard to the receipt of dividends, interest, royalties or capital gains. This analysis is key as it is in the interests of the company and of its shareholders to be structured in a way that is adequate compared to its business modus operandi.

■ Minimizing tax leakage on the distribution of profits and gains to shareholders and investors should be considered next. At this stage, the withholding tax is the main obstacle.

■ As investments may evolve in various ways over the time, tax consequences of restructuring options should finally be taken into account as well as a flexible and business friendly environment. In this context, a strong double tax treaty network is key.

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