Holding Companies and Joint Ventures

The use of holding companies in a low tax jurisdiction is an effective method of reducing taxes and helping your business to operate more efficiently. This structure can work equally well to encompass a joint venture operation, a single operational entity or an investment company, although the rules for the jurisdiction of choice may be different. The choice of jurisdiction is of great importance when deciding on a tax minimisation strategy. The rates of corporate tax are important, but this must be assessed against variants such as how much income is derived from overseas and how much income is passive investment or active business income.

Tax treaties can also be an important consideration when choosing a jurisdiction to base a joint venture or holding company. An effective tax treaty allows for reduced withholding taxes and income tax exemptions in certain circumstances for investment income to be received and/or business profits to be earned from one treaty jurisdiction by a company resident in another treaty partner country. Beyond tax considerations the jurisdiction of choice must also provide a stable political and regulatory environment and a corporate governance system that allows flexibility with regard to corporate decision making and the distribution of profits and dividends.

Tax Considerations
Jurisdictions often have several types of corporate vehicle that can be used for this purpose and each may have different benefits depending on the corporate structure.

Barbados is a stable Caribbean jurisdiction that has a domestic tax law that features both low-tax rate companies for foreign sourced inbound investment and/or business income and withholding tax exemptions for outbound dividends to foreign shareholders, and moreover, no capital gains tax nor wealth and estate taxes. Capital share redemptions and re-purchases of a Barbados company can be made tax-free.

The Barbados International Business Company (IBC) is generally used with investment holding companies and is exempt from withholding taxes on all inbound investment income (dividends, interest, rents, royalties etc) and on outbound payments to non-residents including shareholders. Its statutory income tax rate ranges from 2.5% - 1% depending on the level of assessable income. Zero income tax is paid by a Barbados IBC if it is wholly-owned by a so called “offshore bank trust” that is managed by an offshore bank licensed in Barbados and deals exclusively in buying, selling, holding or managing securities; a structure normally used for investment holding companies based in Barbados.

The Regular Barbados Company (RBC) benefits from income tax exemption on inbound dividends received from foreign source non-portfolio investments and withholding tax exemption on outbound dividends paid out of foreign source income to foreign shareholders. The RBC rates of income tax range from the statutory rate of 25% on investment income down to a normal 1.75% net effective rate on business profits generated in foreign currency.

Tax credits are an effective way to minimise overall tax liability if structured correctly, the British Virgin Islands (BVI) has implemented a tax-neutral regime, involving zero income tax, capital gains tax, estate or wealth taxes.

There are also no withholding taxes on payments to company shareholders.

Switzerland is a stable European jurisdiction that has, historically, been a popular place to set a joint venture or holding company. In a Swiss corporate vehicle dividend income, as well as capital gains income on the sale of shares, is tax exempt (participation exemption regime or holding privilege regime). Other types of income, including interest income and royalty income of a Swiss JV holding company are taxed at an effective rate of 7.85%. There is no domestic Swiss withholding tax on royalties or interest (on loans) paid by the Swiss JV holding company.

Luxembourg is regularly used to set up a holding company or joint ventures because its special purpose vehicle (SPV) is flexible and tax is minimised. The mostly known SPV is mostly the ordinarily taxable entity SOPARFI (Financial Participation Company).

Provided the Luxembourg SPV holds a Qualifying Participation (a 10% participation held for a twelve-month period in an EU or taxable distributing company) there is no CGI on dividends, interests or royalties received. There is also no internal withholding tax on interest, royalties or on liquidation proceeds paid from the SPV.

There is a 15% tax on dividends from an SPV, but that is
Joint Ventures

Reduced by the country’s network of tax treaties or the EU directives. Capital gains are generally tax-exempt for Qualifying Participations.

Tax Treaties

Choosing a jurisdiction for a joint venture or holding company that has, or has access to, a tax treaty network can be important. Tax treaties are important for an investment holding company to benefit from treaty-reduced withholding tax rates both on inbound investment income from foreign sources and outward payment of shareholder dividends at treaty-reduced withholding tax rates.

It is important to choose a tax treaty jurisdiction where low-tax rates can sum up to tax benefits at a relatively low or minimal corporate tax rate. The treaty can be negotiated with the treaty country’s representatives and then onto the foreign shareholders at zero or even between companies in that jurisdiction and even between companies in that jurisdiction and other treaty partner countries. Whether passed by intercompany dividends within a jurisdiction, or through a combination of such tax treaty jurisdiction, low-tax active business profits of a joint venture company can then pass tax-free via intercompany dividends through a holding company and then onto the foreign shareholders at zero or treaty-reduced dividend withholding tax rates.

Tyson Thompson and Howard Henry are tax consultants based in Barbados, from where they run their Caribbean and international tax consultancy practice of Thompson Henry & Associates. They say that Barbados’ tax treaty network is important to the attractiveness of Barbados for joint venture companies because of the “permanent establishment” protection for business income sourced in other treaty partner countries, and for investment holding companies sourcing their investment income from other treaty partner countries at treaty-reduced withholding tax rates.

As an established jurisdiction, Switzerland has an extensive array of tax treaties, more than 70 as of 2015, with, among others, the United States, France, Germany, and Luxembourg.

The Importance of Flexible Corporate Governance

Flexible corporate governance allows parties to use a corporate vehicle for many different scenarios, whether that is a listed vehicle, a property holding company, investment holding company or joint venture company. Corporate statutes that stipulate the dividend regime or distributions, such as share buy-backs, allow parties to be rewarded to shareholders more easily, or allow delegation of decision-making to director level are attractive for holding companies. It is also important to consider the formation and insolvency laws of the jurisdiction on question, in case circumstances change.

According to Thompson and Henry, Barbados has a well-balanced corporate governance regime that can accommodate the right amount of oversight with the flexibility to attract parties to use it for holding company purposes. Tyson Thompson said: “Barbados does have enforced foreign currency controls to build and maintain US dollar reserves and also requires an annual audit by a local Barbados auditor. If the company has gross revenues of US$50,000 per year, then other than the corporate governance regimes for incorporations and windups and certain rules relating to the operation of the proceeds of a liquidation.”

He added: “We recently set up a JV with a UK investment fund and UK managers investing in real estate assets and distressed debt in Eastern Europe. The investors elected Luxembourg because it can attractively reformulate a tax treaty to be beneficial to the EU’s member states and its tax directives. Luxembourg tax authorities have also adopted a transparent tax planning. The company in Luxembourg attracts corporate tax at a base rate of 15%, subject to additional municipal taxes, meaning a total tax rate of 28.59%.

Mr Van Den Bulke says this is not a problem because a clever tax planning can mitigate this. He said: “Unlike other low-tax countries, the corporate tax rate of 25% entitles Luxembourg SPVs to fully benefit from our tax treaties and the EU direct tax directions. Luxembourg tax authorities have also an economic approach to the tax system allowing the optimization of the SPVs taxation through the issuance of hybrid securities. Finally, Luxembourg corporate law dates back to 1915 and has kept its original adaptability.”

Mr Sutherland, from Harneys, says the principal company legislation in the BVI Companies Act, 2004 (the “BCA”) which has some unique provisions that are especially attractive in joint venture transactions. He said: “The regulatory framework allows directors considerable flexibility under a company’s standard memorandum and articles of association (‘MAA’), which can be easily tailored to specific transaction requirements. The circumstances in which a decision can be made to wind a BVI company up voluntarily can be easily incorporated into a JV’s vehicle’s MAA, to reflect any agreement between the joint venture parties. As long as the company has no liabilities and is able to pay its debts as they fall due, the winding up procedure can be fairly simple and straightforward.”

He emphasised that the flexibility of the BCA allows ease of dividend distribution.

Mr Sutherland said: “One of the major attractions in choosing a BVI company as a JV vehicle is the relative ease in which dividends can be distributed out of the company and share repurchases/make good can be made. Under the BVI the concept of share capital is now regarded as an abstraction, which removes a number of restrictions associated with capital maintenance requirements. The BVI instead introduced a new simple insolvency test that must be satisfied for the company to make a dividend or distribution to the shareholders.”

Luxembourg has a particularly flexible corporate governance structure that is popular because it allows the articles of incorporation to be customized.

Mr Van Den Bulke said: “Unlike other civil law countries like France, Germany or Italy, corporate law is quite contractual, and it is in a sense similar to the UK and US law. Private Limited Liability Company (Société à Responsabilité Limitée) is the most flexible contractual form and is very popular among Anglo-Saxon investors.”

Foreign investors appreciate also that companies can be incorporated either in English, French or German. Luxembourg corporate law dates back to 1915 and has kept its original adaptability.

In Luxembourg, corporate law offers a unique blend of common law and civil law principles which provides in the same timeframe flexibility and shareholders protection. Investors appreciate also that companies may be set up either with a straight one-tier management structure (board of directors/managers) or a two-tier structure management structure with a supervisory board and management board.

Mr Sutherland also says that the ease with which SPVs can be formed and dissolved is attractive for JVs set up in Luxembourg, particularly if it is a short-term investment. He said: “Formation and dissolution are quite straightforward, so we can set up a JV in a few days and carry out the JV operation and then liquidate the company in a fast track process, one of the most attractive feature being the absence of tax on the distribution of the proceeds of a liquidation.”

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