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## Tax-Efficient Investments During the Financial Crisis

Prepared for TAG Alliances Fall 2013 Conference  
Hotel Vier Jahreszeiten Kempinski Muenchen  
22 October 2013

by Dmitry Zapol

The material contained herein is not intended to provide and should not be relied upon for accounting, legal or tax advice.



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## Practical Tax Planning in the New Economic Reality



- Greater transparency and exchange of information
- Increased attractiveness of the high-tax States
- Reduction in the usefulness of the offshores
- Widening of the DTTs' network and new contenders
- Focus on beneficial ownership and residence
- DTTs focus more on anti-avoidance
- Focus on cross-border anti-avoidance rules (TP, CFC)
- "Moral" tax planning

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## Ideal Jurisdiction

**Domestic provisions**

- Low corporation tax rate
- Minimum anti-avoidance rules: CFC, TP, thin capitalisation, GAAR
- Availability of rulings
- Corporate remittance basis of taxation
- Sophisticated companies law

**Taxation of income and gains**

- Broad double tax treaty network;
- Participation exemption for income and gains
- Reliefs, including tonnage tax, IPRs, exempt permanent establishment income, losses of foreign subsidiaries, aviation activities

**Taxation of distributions**

- No WHT on dividends, royalties, interest
- Broad double tax treaty network

**The Usual suspects:**

- Austria
- Cyprus
- Luxembourg
- Malta
- The Netherlands
- The United Kingdom

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## Anti-avoidance Provisions

**Austria**

- Very high tolerance to tax planning, except for clearly abusive or sham cases
- Limited TP rules, no debt-equity or thin capitalisation rules, interest fully deductible
- No CFC rules

**Cyprus**

- Very high tolerance to tax planning, except for clearly abusive or sham cases
- Limited TP rules, no debt-equity or thin capitalisation rules, interest fully deductible
- No CFC rules

**Luxembourg**

- 'Simulation' and moderate substance-over-form doctrines
- Transfer pricing rules in line with OECD. Debt:equity 85:15, hw can be exceeded if at AL or no g-tees given by related parties, also doesn't apply to unrelated party loans / back-to-back financing
- No CFC rules

**Malta**

- Moderate statutory GAAR
- No transfer pricing and thin capitalisation rules, however not AL transactions can be attacked under the GAAR
- No CFC rules

**Netherlands**

- Moderate GAAR, including *fraus legis* and *richtige heffing*
- Transfer pricing rules in line with OECD guidelines. Debt:equity 3:1, if excess >€500k
- No CFC rules

**United Kingdom**

- GAAR introduced in Finance Bill 2013
- Extensive transfer pricing rules in line with OECD guidelines; no "safe harbour" rules
- Broad CFC rules

Substance & M&C

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## Austria

**EU**

**Non-EU**

**Investment Assets**

**Austria Co**  
CT: 25%

WHT subject to EU Tax Directives

Interest: 0% WHT, Royalties: 30% WHT, Dividends: 25% WHT

Dividends / gains fully exempt

Dividends/ gains fully exempt:

- 10% shareholding;
- held for 1 year.

Portfolio dividends exempt if:

- Subsidiary in active business;
- Liable to min. 15% tax;
- DTT with a mutual assistance article.

- 25% CT;
- Losses of foreign subsidiaries deductible if calculated according to Austrian rules;
- Tax-free step-up in basis on a share for share exchange

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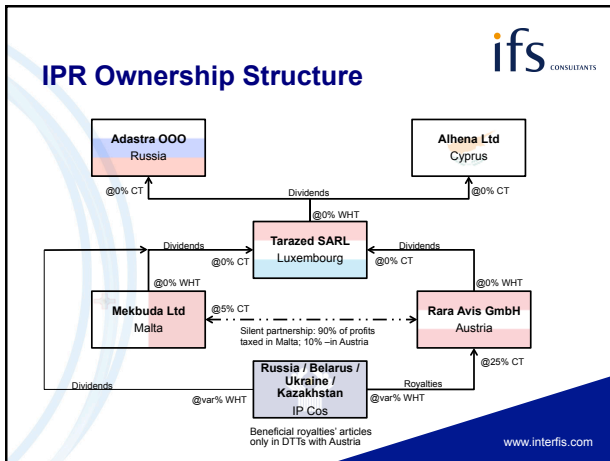
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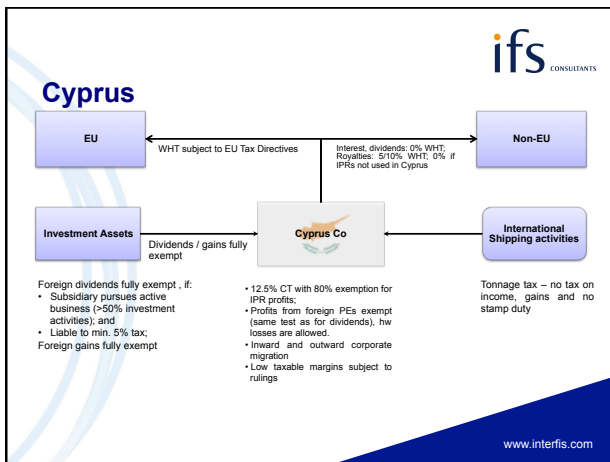
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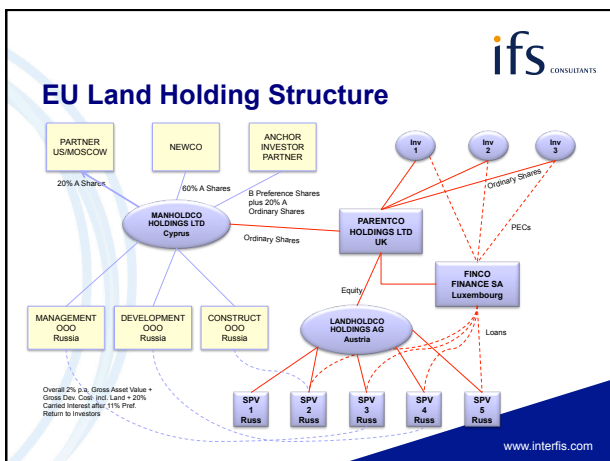
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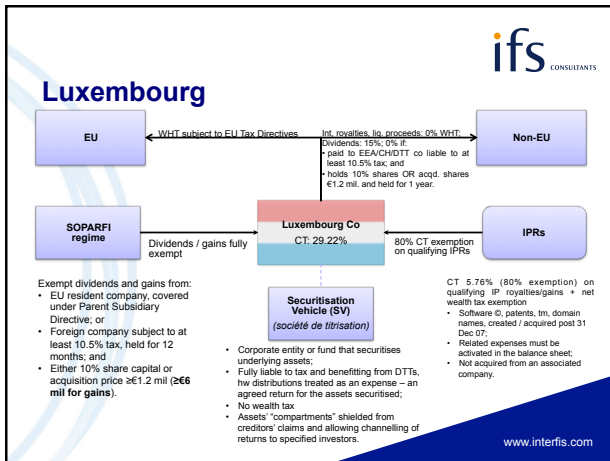
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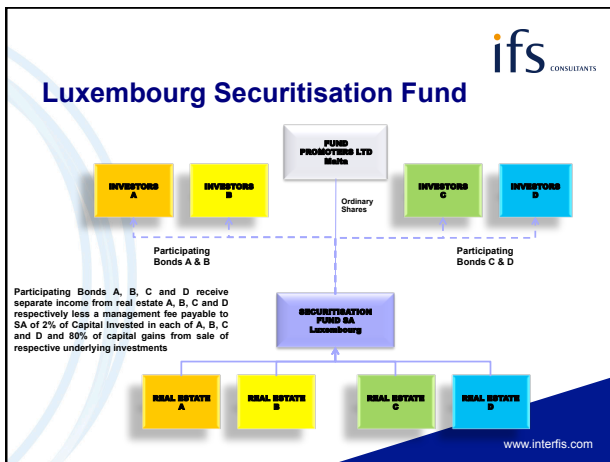
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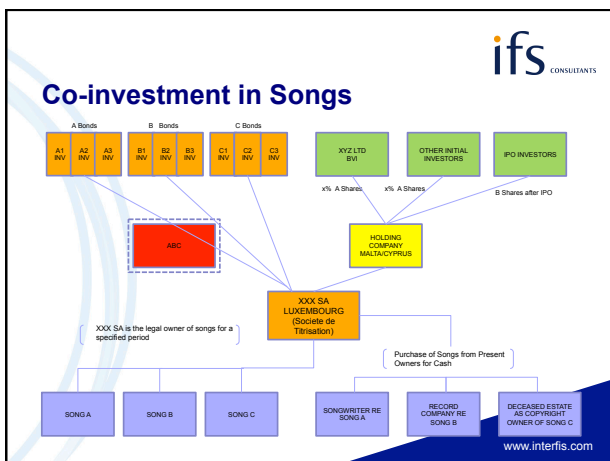
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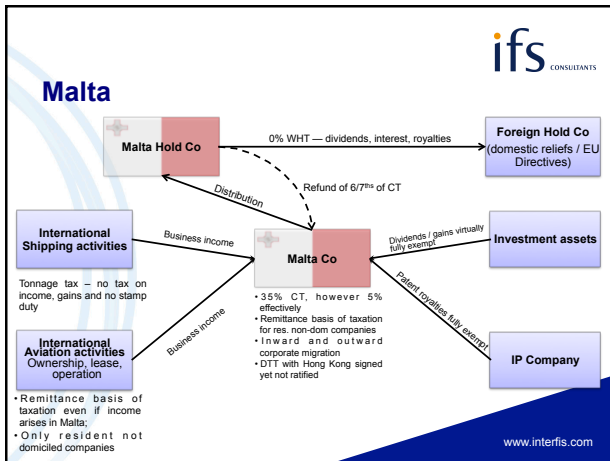
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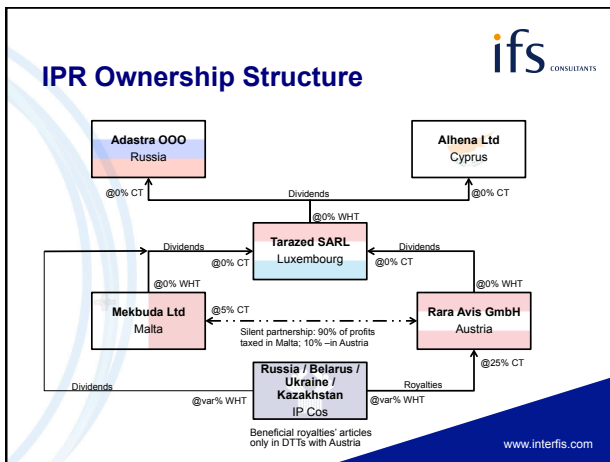
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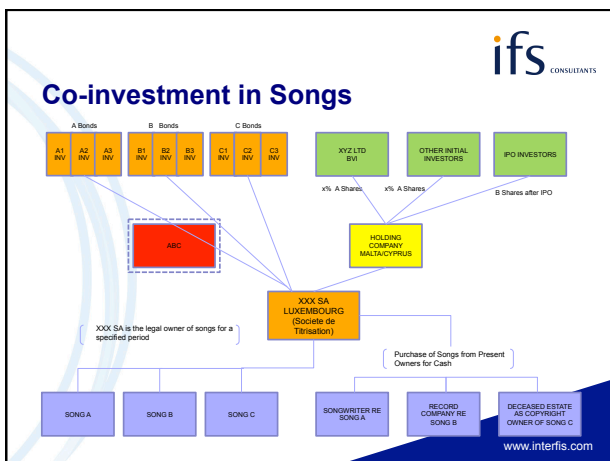
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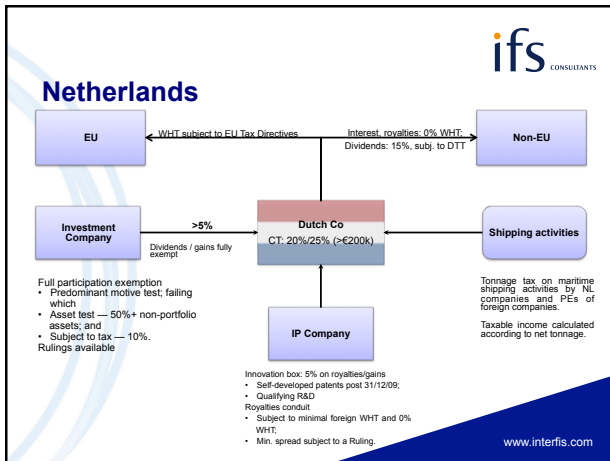
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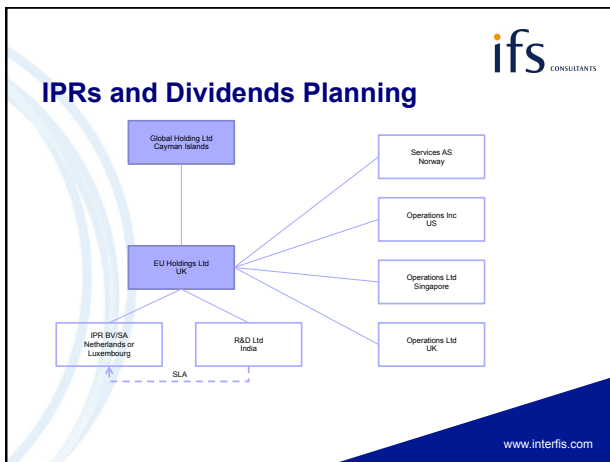
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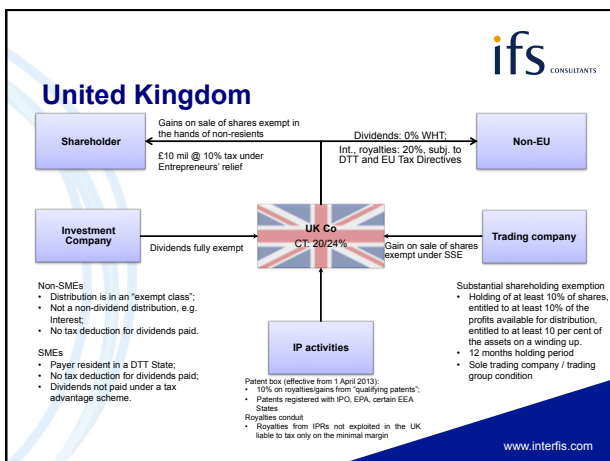
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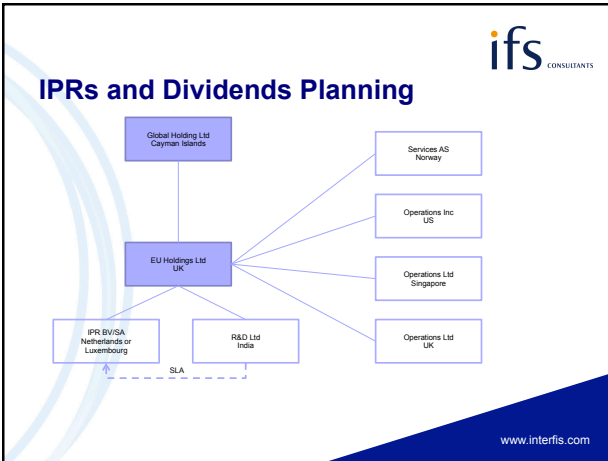
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**Avoiding falling into Treaty Shopping problems**

- Title of Double Tax Treaties
  - for the avoidance of double taxation
  - and the prevention of fiscal avoidance
- OECD MTC Arts. 10 (Dividends), 11 (Interest), 12 (Royalties) — source State has the right to tax; however, WHT limited if the beneficial owner is a **resident** of the other State
- Limitation on benefits provisions (second line of defence)
  - Russia-Cyprus DTT — a company incorporated outside of RU/CY but tax resident in either State may be denied DTT benefits if the main purpose or one of the main purposes of residence was to achieve the benefits
  - US Model Income Tax Convention: usual BO + broad LOB; however, see older US-Cy DTT (subject to the 'principal purpose' test)

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**Beneficial Ownership and Substance**

- Case law does not give conclusive definition
  - *Indofoods v JP Morgan, Prévost Car, MIL Investments*
  - *Velcro Canada Inc.*

Four necessary elements to consider: possession, use, risk, and control; the corporate veil is not to be pierced unless the corporation has "absolutely no discretion" with regard to the use of the funds. The recipient was the beneficial owner of the royalties because:

- the legal right to receive the royalties from the taxpayer;
- exclusive possession and control over the funds received as royalties in an account;
- such funds were commingled with other monies in its accounts and currency conversion exposed it to currency risk;
- the money earned interest belonging to the recipient;
- the recipient did not have to seek instructions in dealing with the funds; and
- the amount of the royalty payments received from the taxpayer differed from the amount paid out by the recipient (IBFD).

- Conduit companies must have proper degree of substance

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## Ensuring corporate management and control is where you want it



- **Article 4 OECD MTC — “place of effective management” (POEM)**
  - “The [POEM] is the place where key management and commercial decisions that are necessary for the conduct of the entity’s business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the POEM. An entity may have more than one place of management, but it can have only one [POEM] at any one time.” Para. 24, OECD MTC Comm. to art. 4
  - “various factors, such as where the meetings of its board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person’s headquarters are located, which country’s laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc” Para. 24.1 Ibid.
- **National treatment — the incorporation theory**
  - The UK, the US, Ireland, Switzerland, the Netherlands
  - A company is connected to the jurisdiction in which it has been incorporated
  - Mobile POEM
- **National treatment — the real seat theory (siège social, siège réel)**
  - France, Germany, Luxembourg
  - A company is connected to the state in which it has its centre of administration
  - Change of POEM leads to dissolution of the company

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## Purposes of Corporate Migration



- **Business continuity**
  - A migrating company may remain intact with unbroken corporate history
  - Shareholders do not need to crystallise gains and reinvest in assets
- **Streamlining corporate structure and operations**
- **Planning for changes in laws and tax treaties**
  - Protection of foreign investors
  - Corporate law regime
  - Tax law: CFC, WHT, participation exemption, thin capitalisation
  - Better treaty network and international agreements (including the EU Directives and ECJ case law)
- **Joining substance and the shell to gain treaty benefits**
- **Improving image** (e.g. in preparation for an IPO; anti-avoidance)
- **Personal reasons** (esp. owner-managed companies)

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## Methods of Migration



- **Winding up and reincorporation**
  - Most tax inefficient
- **Transfer of legal domicile**
  - Not universally accepted
- **Transfer of place of effective management (POEM)**
  - Subject to substance requirements, but the least complicated and achievable under double tax treaties
- **Share for share exchange**
  - May constitute a taxable disposal
- **Merger migration under EU law**
  - Migration into the EU is regulated by national laws
- **Societas Europaea**

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### Associated Risks

- Deemed realisation of gains
- Exit taxes
- Potential VAT
- Real estate transfer taxation
- Cancellation of losses
- Loss of limited liability
- Substance requirement in the host jurisdiction

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### Transfer of Legal Domicile from the BVI to Luxembourg

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graph LR; ZAO[ZAO Russia] -- "Dividends (No participation exemption)" --> A[A Ltd BVI]; France[SaRL France] -- "Rentals (Rent non-deductible expense)" --> A; Spain[SA Spain] -- "Property ownership (3% Special Tax on real estate owned)" --> A; Portugal[SA Portugal] -- "Property ownership (Higher rates of municipal real estate tax & stamp duty)" --> A; A -- "Redomiciliation" --> B[A Ltd Luxembourg];
```

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### Transfer of POEM from Cyprus to Malta

```
graph TD; Shareholder[Shareholder] --> B[B Ltd Cyprus]; B -- "Change of POEM" --> B_M[B Ltd Malta]; B --> C[C BV Netherlands]; C --> RE[Real Estate Netherlands];
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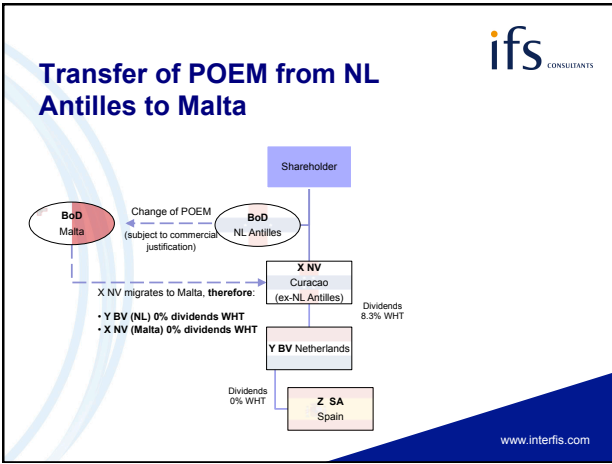
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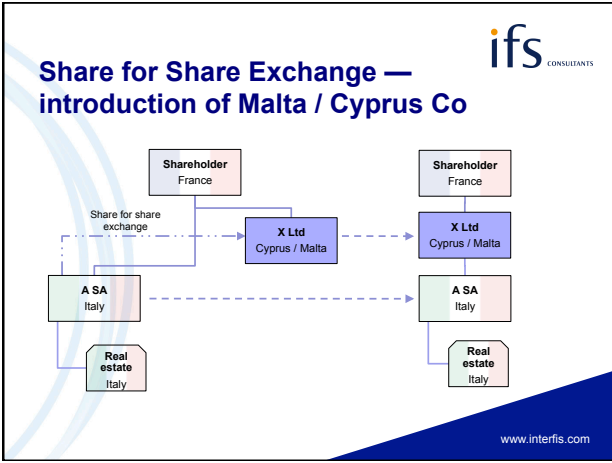
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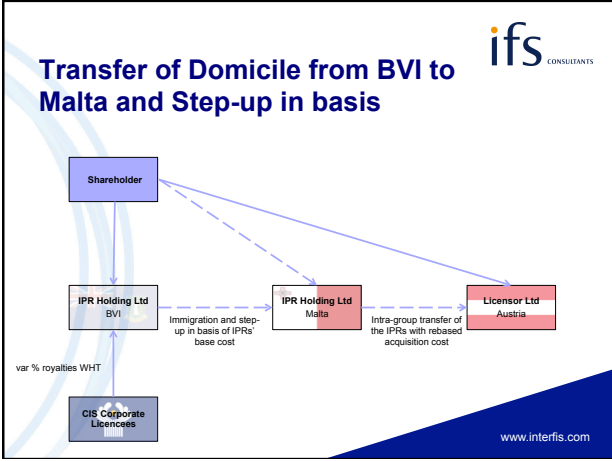
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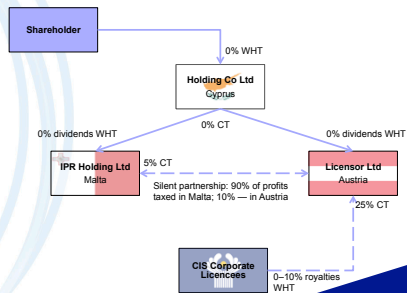
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## Transfer of Domicile from BVI to Malta and Step-up in basis

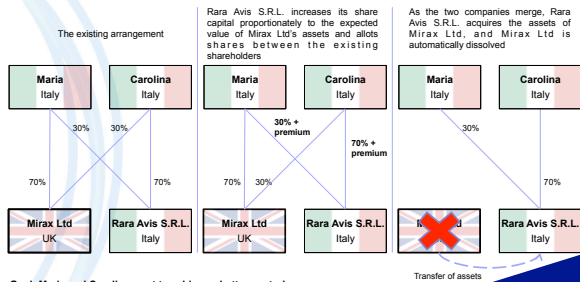
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## Migration through Merger — the Method

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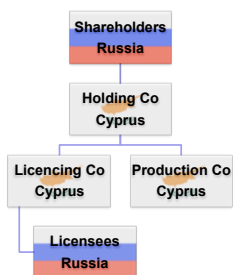


Goal: Maria and Carolina want to achieve a better control and involvement in the running of the core business in Italy through migrating Mirax Ltd and its assets to Italy

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## Pulling out of Cyprus — Current Structure

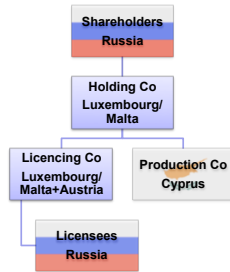
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## Pulling out of Cyprus — Migration to Luxembourg/Malta

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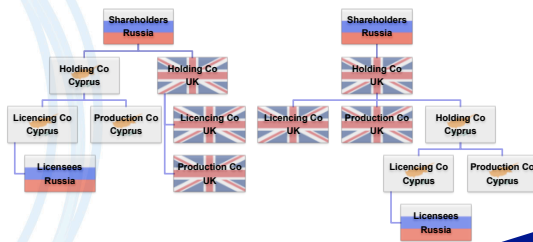
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## Pulling out of Cyprus — Migration to the UK

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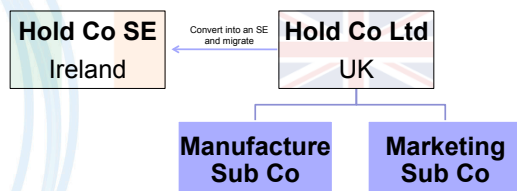
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## Migration of *Societas Europaea*

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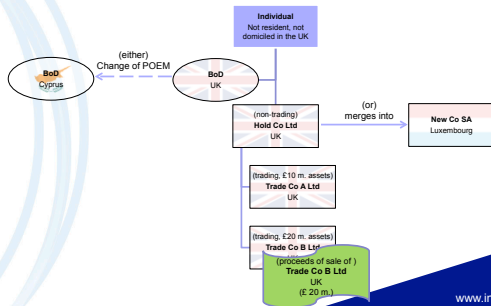
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## Migration through merger — capital gains and inheritance tax

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