



THE COMPETITIVE ADVANTAGES OF TAX REDUCTION STRATEGIES

Introduction

Effective tax planning is essential in an increasingly global market. Business should plan their:

- production;
- labour;
- place of provision of services; and
- corporate structure

in order to take advantage of tax differences in various jurisdictions. Tax planning is not just a tax issue and those businesses which undertake tax planning will increase their economic competitiveness.

Holding Company

In the current market it has become more common to separate product lines into subsidiary companies rather than having one holding company owning all of the assets in each jurisdiction.

The most favoured holding company jurisdictions in the EU are the Netherlands, Denmark and Spain. This is as a result of their favourable tax regimes. However, the most favourable jurisdiction ultimately depends upon the activities of the business concerned.

Tax and Transfer Pricing

Europe is beginning to harmonise its tax base regulations and transfer pricing regulations. The Parent Subsidiary Directive 94/435/EEC aims to harmonise the tax treatment for parent and subsidiary companies in different member states in order to ensure neutral tax rules across the EU. Transfer pricing regulations allow jurisdictions to tax profits which they consider to arise from activities in their jurisdiction. A starting point for the transfer pricing regime is that companies should charge and be charged prices that are justified on an arms length basis. However, despite problems with transfer pricing there are still ways in which a group structure can allow for high profits to be allocated to a lower tax jurisdiction, reducing the groups overall tax bill. In order to be effective a transfer of risk, core functions and decision making powers must be made to a group company in the low tax jurisdiction.

Contract Manufacturing

If a group company carries out manufacturing in a high tax jurisdiction the manufacturing can be ordered on a contract basis for a group company based in a low tax jurisdiction. The company in the low tax jurisdiction assumes entire responsibility and risk for production. Due to the transfer of risk and ownership the manufacturer can be compensated on a cost plus basis (with a low mark-up) thus concentrating taxable profits in the low tax group company.

Commissionaire Arrangements

The group company may be able to establish a sales company in a low tax jurisdiction then sell to customers in a high tax jurisdiction using a commissionaire (an independent agent acting in its own name for the account of a principal). As with contract manufacturing, the apportionment of risk away from the commissionaire allows taxable profits to be concentrated in the low tax jurisdiction. Properly structured there is a limited risk of commissionaire arrangements being classified as a permanent establishment in the jurisdiction.

Functional Analysis

Given the legal and regulatory complexities it may be necessary to conduct a functional analysis of the development, manufacturing and marketing chains in order to determine the profits which should be allocated particular functions in various jurisdictions.

Permanent Establishment and CFC Issues

Under most tax regimes a foreign company is liable to tax on the profit it derives from a permanent establishment in another jurisdiction. Effective structuring between the local operational functions and the principal functions should reduce this risk. Likewise, commissionaire arrangements should be structured such that the agent in the particular jurisdiction has no power to bind the principal (as this may be sufficient to establish a permanent establishment).



Most jurisdictions including the UK also have rules designed to ensure that companies can not shift profits to low tax jurisdictions by setting up controlled foreign companies (CFC). The rules allow the holding company's jurisdiction to tax the CFC profits. However, with careful assessment and planning such taxation risks can be minimised.

VAT

Value Added Tax rates of up to 25% apply across the EU.

Within the EU, VAT is charged at differing rates according to the products and services supplied. Generally speaking, electronically supplied goods attract VAT at the applicable local rate of the supplier whereas the sale and supply of physical goods (e.g. CD's, DVD's) attracts VAT at the applicable rate of the member state in which the consumer resides.

The VAT on e-commerce Directive (2002/38/EC) allows for the collection of taxes for the supply of 'digitised services' from suppliers outside of the EU. The Directive provides that supplies of 'digitised services' will be treated as supplied in the place where the recipient receives them and taxed according to the applicable local rate. The VAT Directive covers radio and television broadcasting and "electronically supplied services" (e.g. ISP, web-

hosting and the supply of digital software, music, film and games).

Non-EU suppliers of digitised services will have to register with a tax authority in the member state of their choice. That member state will collect the applicable VAT for all of the supplies made to consumers in each member state (at the applicable rates) and distribute them internally. Non-EU providers will therefore be subject to rates up to 25%, depending on the location of the consumer thus increasing the overall cost of supply. There are no lower threshold exceptions at EC level. In the UK, the threshold for mandatory registration for VAT applies to suppliers whose taxable supplies are greater than £55,000 per annum.

These VAT costs can be mitigated with suitable tax planning. For further information on such planning see *"The tax advantages of establishing an EU subsidiary"*.

VAT Waivers

There is a small packet VAT waiver operating within the EU. The effect of the waiver in the UK is that VAT is not charged on any consignment of goods (other than alcoholic beverages, tobacco products and perfumes) that do not exceed £15 in total value when imported, are not charged to VAT.

Contact information

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