International Tax Planning Newsletter

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ITP Newsletter: a quarterly journal of international tax planning by Broers & MacDonald (Tax Lawyers) and The ITPS Group (International Tax Planning and Structure Services)

ITPS opens Cyprus office

We are pleased to inform you that the ITPS Group has recently opened an office in Cyprus to meet customer needs for using Cyprus in international tax planning.

International Tax Planning Opportunities in Cyprus
Effective 1 January 2003, Cyprus introduced a new fiscal regime, which offers a range of very attractive tax advantages for structuring business through Cyprus.

One of these advantages is that Cyprus has the lowest corporate tax rate in the European Union, being 10%. This low tax rate coupled with an extensive network of tax treaties for the avoidance of double taxation and a mature legal, accounting and banking infrastructure places Cyprus high on the list of preferred jurisdictions to base a holding, finance or licensing company.

Below we will mention the key features of Cyprus and we will make some general comments regarding the taxation of dividends, interest, royalties and capital gains received by a Cyprus company. Subsequently, we will discuss the benefits of a Cyprus holding, whether or not with a Dutch sub-holding. Finally, we will discuss the Cyprus finance and licensing company.

Key features of Cyprus
The key features of Cyprus are the following:

- Member of the European Union since 1 January 2004.
- Lowest corporate tax rate in the European Union: 10% on the tax payer's worldwide income.
- An extensive network of tax treaties for the avoidance of double taxation, covering 40 countries.
- Full adoption of the EU Directives.
- Tax-exempt dividend income (subject to applicable criteria).
- Exemption of 50% of interest income (subject to applicable criteria).
- Tax-exempt business profits of non-resident companies.
- Tax-exempt gains on the trading and disposal of securities.
- Tax-neutral group reorganizations.
- Tax-relief for group losses.

Taxation on dividends
Dividend income received by a Cyprus company is exempt from taxation, unless:

1. The subsidiary is subject to tax at a rate which is significantly lower than the Cyprus corporate rate, i.e. lower than 5% and
2. Directly or indirectly more than 50% of the activities of the paying company result in investment income.

Note that the exemption is not applicable if both conditions are met.

No dividend withholding tax is levied when a Cyprus company distributes a dividend to a non-resident shareholder.

Taxation on interest
The tax legislation distinguishes between interest income on deposits and interest received in the ordinary course of business. Interest income on deposits is taxed at 15%, whereas interest income received in the ordinary course of business is taxed at 10%. Furthermore, there is no withholding tax on the payment of interest from Cyprus.

Taxation on royalties
Royalty income is subject to 10% corporate tax. However, royalty payments are deductible expenses in the computation of the taxable profits of a tax-resident company.

Royalties paid for the use of the intellectual property within Cyprus are subject to a withholding tax of 10%, whereas royalties paid for the use of the intellectual property outside Cyprus are not subject to any withholding tax.

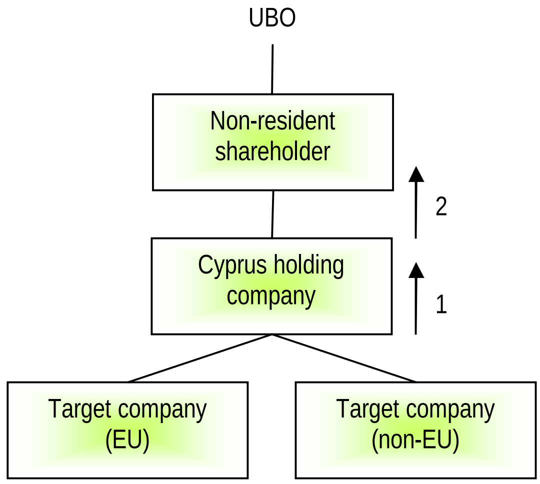
Taxation on capital gains
The gains from the disposal by a Cyprus company of the shares of a subsidiary are not subject to any tax in Cyprus, provided that the operating subsidiary does not own immovable property in Cyprus.

The benefits of a Cyprus holding company
Using a Cyprus holding company offers a number of significant benefits:

- Dividend income is received with low or zero rate of foreign withholding tax.
- Dividend income is subject to low or zero rate of tax in Cyprus.
- Dividend is distributed to the shareholders at a low or zero rate withholding tax.
- Proceeds from the disposal of a subsidiary are exempt from capital gains tax.
- Group reorganization can be effected tax free.
- Losses can be offset against taxable profits within the group indefinitely.

The Cyprus holding company with a foreign operating target company
A Cyprus company can act as the holding company for effectively consolidating the ownership of a number of foreign operating target companies.

This is visualized as follows:



If the target company is based within the European Union, dividends may be received by the Cyprus holding company from the target company (1) without any dividend withholding tax under the provisions of the EU Parent Subsidiary Directive.

If the target company is based outside the European Union, the dividend withholding tax levied on the dividends received by the Cyprus holding company (1) is subject to the tax treaty for the avoidance of double taxation between Cyprus and the country of residence of the target company.

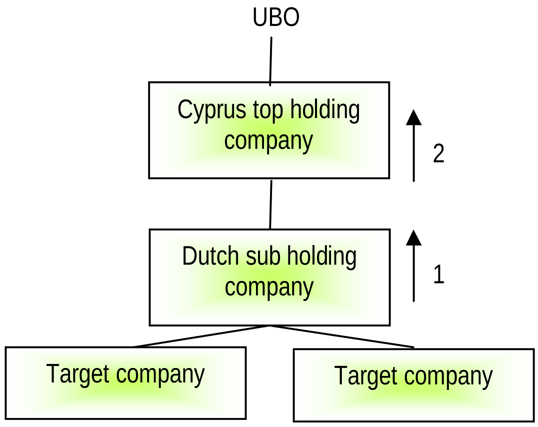
A dividend distributed by the Cyprus holding company to the non-resident shareholder (2) is not subject to Cyprus dividend withholding tax.

Therefore, by interposing for example a Cyprus intermediate holding company between a investor in Japan and a target company in Russia, the 10% Russian dividend withholding tax, which would be applicable if the investment were made directly, could be reduced to 5% when interposing a Cyprus intermediate holding company.

The gains from the disposal of the shares of the target company are not subject to any tax in Cyprus, provided that the operating subsidiary does not own immovable property in Cyprus.

A Cyprus top holding company with a Dutch sub holding
It can be very tax efficient to combine the benefits of Cyprus holding company with those of a Dutch sub holding. This is for example the case where dividends from the Dutch company to the ultimate beneficiary would be subject to Dutch dividend withholding tax. By interposing a Cyprus top holding between the ultimate beneficial owner and the Dutch sub holding company, the Dutch 15% dividend withholding tax (reduced from 25% as per 1 January 2007) could be reduced to nil.

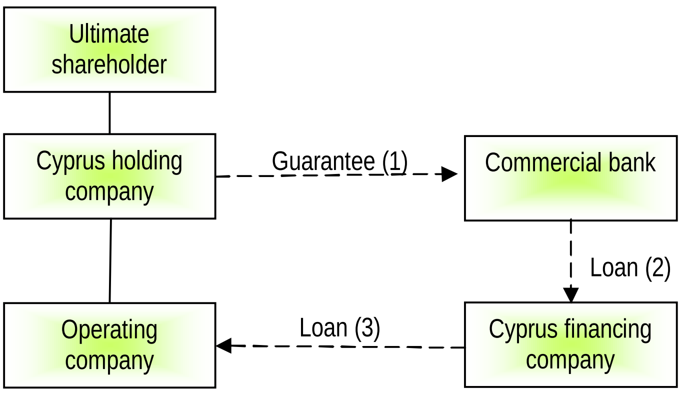
This is visualized as follows:



A dividend distributed by the Dutch sub holding to the Cyprus top holding (1) would not be subject to Dutch dividend withholding tax based on the EU Parent-Subsidiary Directive. However, please note that, since there does not exist a tax treaty for the avoidance of double taxation between the Netherlands and Cyprus, theoretically the Dutch tax authorities might take the position that the Cyprus holding company has a so-called "substantial participation" in the Dutch sub holding. They might tax the dividend received by the Cyprus holding company, or a capital gain realized on the alienation by the Cyprus holding company of the Dutch sub holding. To avoid this an advance tax ruling should be negotiated with the Dutch tax authorities.

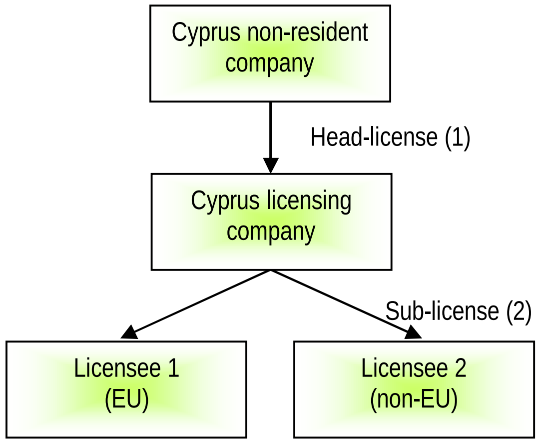
A dividend distributed by the Cyprus holding company to the non-resident ultimate beneficial owner (2) is not subject to Cyprus dividend withholding tax.

The Cyprus finance company
It may be very beneficial to use a Cyprus company as a group financing vehicle to achieve an overall tax reduction. The structure is usually set-up as follows:



The holding company guarantees (1) the granting of a loan by a Commercial bank (2) to the Cyprus financing company. The use of a Cyprus holding company avoids triggering of the thin capitalization rules that exist in countries like Germany, the U.K. and the Netherlands. The Cyprus financing company grants a loan to the operating company (3). Interest payable by the operating company reduces its taxable profits. Interest received in Cyprus is subject to tax at 10%. Any withholding tax levied in the country of the operating subsidiary is credited against tax payable in Cyprus.

The Cyprus licensing company
It may also be very beneficial to use a Cyprus company as a group licensing vehicle to achieve an overall tax reduction. The structure could be set-up as follows:



The owner of the intellectual property ("IP"), a Cyprus non-resident company, licenses all the rights for the use of the IP to a Cyprus resident licensing company (1), which in turn sub-licenses the IP rights to Licensee 1 in the EU and to Licensee 2 in a non-EU country (2).

Based on the EU Directive on Interest and Royalties, in case the sub-license is granted to an affiliated EU resident group company, or the double tax treaty between Cyprus and the country where the sub-licensee is resident, the foreign royalty withholding tax is substantially reduced.

The Cyprus licensing company receives royalty income and will pay royalty to the Cyprus non-resident company. The Cyprus license company normally retains a 5% spread, which is taxed at 10%. Hence the tax burden is reduced to 0.5%. Provided that the IP is not used in Cyprus, there is no withholding tax on the royalty payments under the head-license.

The Cyprus non-resident company can be resident in an offshore jurisdiction, such as the British Virgin Islands, where the royalty income would not be subject to tax. However, in stead of granting a head-license, it may also be very beneficial for a company based in a high tax jurisdiction, such as the Netherlands or Luxembourg, to set-up a subsidiary in Cyprus and to contribute its IP rights to a

Cyprus licensing company, for example in view of a future IPO. By doing that, the taxation on royalty income can be reduced substantially.

Services and Fees
As in all the other jurisdictions where ITPS is based, the Cyprus office renders international tax planning and structure services. The structure services comprise of domiciliation, management, accounting, audit and tax compliance services.

It goes without saying that ITPS (Cyprus) Ltd. only charges fixed incorporation and annual maintenance fees for standard companies.

Contact details
Should you have any questions, please do not hesitate to contact Jaap Broers or John W. MacDonald of ITPS (Netherlands) B.V. (telephone +31 70 3640900) and Andreas Athinodorou or Marina Zevedeou of ITPS (Cyprus) Ltd., Elia House, 77 Limassol Avenue, CY-2121 Nicosia, Cyprus (telephone +357 22677788; fax +357 22668111; e-mail: cyprus@itps-group.com). ■

Favorable Dutch tax reform into force effective 1 January 2007

The favorable Dutch tax reform bill, we have informed you about in our previous newsletters, was approved by the Dutch Upper House of Parliament on 28 November 2006.

Effective on 1 January 2007
The tax reform is aimed at keeping the Netherlands on the short list of top locations to base an (intermediate) holding company. Or, as the State Secretary said: "…improving the overall investment climate in the Netherlands and making the Dutch corporate income tax system more EU-proof".

The bill became effective on 1 January 2007. The measures include significant reductions of the corporate income tax and of the dividend withholding tax rates, beneficial changes to the participation exemption, relaxation of the rules relating to interest deduction and the introduction of a 5% "group interest box" and a 10% "patent royalty box".

Although the bill became effective on 1 January 2007, the Minister of Finance has requested the approval of the European Commission with respect to the compatibility of the interest box rules with EU state aid rules. These provisions will have retroactive effect from the beginning of the year in which Commission approval is granted.

The most important changes are summarized below.

Reduction of the corporate income tax rate
Since 1 January 2006, there were two brackets with a special tax rate: profits up to € 22,689 and profits exceeding that amount. Profits of up to € 22,689 are taxed at a rate of 25.5%, whereas profits exceeding that amount are taxed at a rate of 29.6%.

As per 1 January 2007, there are three brackets with a specific tax rate:

- Profits of up to € 25,000 are taxed a rate of 20%.
- Profits between € 25,000 and € 60,000 are taxed a rate of 23.5%.
- Profits exceeding € 60,000 are taxed a rate of 25.5%.

This reduction has reduced the rate to below that of the average for the EU-15 Member States and in line with the average for all current Member States (EU-15 and new Member States).

Reduction of the dividend withholding tax rate
As per 1 January 2007, the rate of the dividend withholding tax is reduced (from 25%) to 15%. Moreover, no dividend withholding tax is due when distributing a dividend to an EU-resident shareholder that holds an interest of at least 5%.

Major improvements to the Dutch participation exemption
Major improvements of the Dutch participation exemption regime have been introduced, including the abolishment of the "non-portfolio investment" condition, the abolishment of the subject-to-tax" condition and the introduction of a 5% minimum interest.

As from January 1, 2007, the Dutch participation exemption applies if the shareholding is at least 5% of the nominal paid-up capital of a company unless:

1. The subsidiary is a passive company and
2. This passive company is subject to a profit tax resulting in an effective tax rate less than 10% on a taxable profit which has been determined in accordance with rules that are acceptable by Dutch standards.

Ad 1. If the interest in the subsidiary, which is being held for a period of at least three years, drops below 5%, the participation exemption will remain effective for a period of three years, provided certain conditions are met. If an interest of less than 5% is being held on 1 January 2007, which qualified under the current rules of the participation exemption, the participation exemption will continue to be applicable for a period of another three years.

Ad 2. Whether a subsidiary is considered to be passive will be determined by the assets of the subsidiary, which includes the interest that the subsidiary may have in other companies.

The subsidiary is passive, if the consolidated assets (note: not assets less liabilities) of the subsidiary primarily (at least 50%) consist of so-called "free portfolio investments". This kind of investments are not linked with the business activity of the subsidiary and include passive group finance activities and passive licensing activities. Therefore, unlike under previous rules, the participation exemption can apply to an interest in a tax exempt holding company that in turn owns active investments.

If the consolidated assets (note: assets less liabilities) of a subsidiary consist of at least 90% investment in real estate, the participation exemption is applicable.

In case the participation exemption does not apply, the income received from the passive subsidiary will be fully subject to Dutch tax, but a tax credit will be available, i.e. the tax paid by the (grand-) daughter can be offset against the Dutch tax.

Introduction of an optional "group interest box"
The bill introduces a "group interest box" and a "patent royalty box." Both boxes provide for a significantly reduced corporate income tax rate on interest or royalty income, respectively, and are optional.

The group interest box is intended to replace the group finance company regime, which was classified by the European Union as a harmful tax regime and only applies until 31 December 2010 to companies that benefited from the regime on 11 July 2001 (the date on which the European Commission started the state aid investigation). A confirmation from the European Commission that the new measure is not incompatible state aid has been requested.

The group interest box, designed to retain capital and attract foreign capital, provides for an effective 5% tax rate on the balance of interest income and interest expense within a group ("the group interest balance"). The group interest balance is capped at the amount of the legal interest rate (applicable to the quarter of the year in which the book year ends; currently 4%) over the average equity of the tax payer in the relevant year.

The scope also includes foreign exchange results and costs incurred in connection with the loans. However, the box does not apply to changes in the valuation of the loans payable or receivable. This means that revaluations of loans are subject to tax at the normal rate of 25.5%, and devaluations are deductible at that rate.

All the Dutch group companies should join in the election of the group interest box for a period of at least three years. The threshold for a group company is generally set at an interest of more than 50%.

Introduction of an optional "patent royalty box"
Under the "patent royalty box", profits derived from intellectual property developed by the company after 31 December 2006, and for which a patent is granted, will be taxed at an effective rate of 10% if the patent for at least 30% contributes to the profits derived from the intangible asset.

The patent royalty box will be capped at four times the costs incurred to create the intellectual property. The excess will be taxed at the normal rate of 25.5%. The patent box is optional and does not apply to logos and trademarks.

Simplification of Dutch interest deduction limitation rules
Following the introduction of thin capitalization rules in the Netherlands per January 1, 2004, the Act streamlines a number of anti-abuse rules with respect to the deductibility of interest.

The deferral rule on interest deductions that apply to interest due to a group company with respect to a company acquired from outside the group that is included in a Dutch fiscal unity was abolished.

A new provision was introduced, similar to current rules on acquisitions of group companies, imposing limits on the deduction of interest on external acquisitions financed by a group company. The new rule may affect interest deductions on current loans related to previous acquisitions of external companies.

Hybrid Loans
As per 1 January 2007, the qualification of debt as equity will be determined based on existing case law, rather than statute. Under existing jurisprudence, a loan is qualified as a hybrid loan (i.e. equity) if the loan has no fixed redemption date or a redemption date of more than 50 years and the interest is almost entirely profit depending. In addition, a deduction is denied (both interest and decrease in value) with respect to loans with no redemption date or a redemption date of more than 10 years where the remuneration is substantially (i.e. 30% or more) lower than the arm's length remuneration.

The participation exemption will apply to a hybrid loan if the Dutch company (or a qualifying Dutch group company) holds a participation in the debtor. Any benefits derived from the hybrid loan, therefore, should be exempt from corporate income tax. The current provision, under which the benefits of a hybrid loan are only exempt if the interest expense on the hybrid is nondeductible at the level of the (foreign) debtor, was abolished. The new rules may allow for tax-efficient financing structures.

Tax Losses
The terms within which tax losses can be compensated are restricted. As per 1 January 2007 the loss carry-back is limited (from three years) to one year, whereas the loss carry-forward is limited (from an indefinite period) to nine years.

Under a transitional rule, tax losses incurred up to and including the taxable year 2002 can be used against taxable income realized in the taxable years up to and including 2011. ■

Loophole in French - Luxembourg tax treaty removed

On 24 November 2006, Luxembourg and France signed a second protocol to the Luxembourg - France tax treaty on income and capital of 1 April 1958.

Second protocol to the Luxembourg - France tax treaty on income and capital of 1 April 1958
The protocol removes the double non-taxation where a Luxembourg company owns French real estate without having a permanent establish in France. This double non-taxation existed because of court decisions in both countries.

French and Luxembourg Court cases
On 18 March 1994, the French Supreme Administration Court ruled that income derived from French real estate owned by a Luxembourg company must be characterized as business income, which would be taxable in France only if attributable to a permanent establishment there.

On 23 April 2002, the Administrative Court of Luxembourg ruled in the "*La Costa*" case that income derived by Luxembourg companies from French real estate, being characterized as income from immovable property, is taxable only in the situs country and exempt from tax in Luxembourg.

Income from immovable property taxable in the situs country
In accordance with the new protocol, income from immovable property will now be classified as income from immovable property taxable in the situs country and no longer as business income which requires the presents of a permanent establishment before it is taxable in the situs country.

The provisions of the new protocol authorize the state where immovable property is situated to tax profits, income and gains from the exploitation and transfer of immovable property, without distinction whether the owner of the immovable property is an individual, a company or a transparent entity and regardless of whether or not the immovable property is attributable to a permanent establishment in the situs country.

Applicable following the year in which the protocol enters into force
The protocol will be applicable to profits realized in the year following the year in which the protocol enters into force. It goes without saying that any existence structure involving Luxembourg companies owning French real estate should be reviewed. ■

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ITPS GROUP PROFILE

The International Tax Planning Newsletter is a quarterly newsletter of The ITPS Group, an independent provider of international tax planning and structure services. It provides these services in the Netherlands, the Netherlands Antilles, Aruba, the British Virgin Islands, Belgium and Luxembourg.

Needs of clients

As business is becoming more international, organizations are seeking ways to minimize the incidence of taxation linked to it. On the other hand, organizations as well as individuals are seeking international ways to optimize their profits and to protect their assets.

The increasing complexity of (tax) laws necessitates careful planning and consideration of the structure to be established and maintained. Customers require highly specialized professional services.

Mission

The purpose of ITPS is: doing the best the things that the customer values most. The focus is long term customer satisfaction.

The mission of the ITPS Group is to create value for it's customers through the provision of professional services in the field of international tax planning and structure, designed to optimize the customer's after tax profits.

Services

The objective of ITPS is to meet customer needs for international tax planning and structure by rendering "total offering" services with the highest standards of professional and personal service combined with complete confidentiality.

This comprehensive offering comprises not only the advice for international tax planning (i.e. for legal and tax questions), but also implementation to establish and maintain structures.

These services include, but are not limited to:

- § International tax planning;
- § Company formation, registered office facility, management, accounting and tax compliance;
- § Trust and foundation formation and administration;
- § Licensing and sub-licensing of intellectual property rights.

The services ITPS does not provide, but which we are rendered by correspondents, include auditing, legal opinions, litigation and portfolio investment.

Clients

The client base of ITPS consists of prominent individuals, including sportsmen and artists, small to large companies, including other professional firms, but also multinational (stock quoted) companies.

Why you should use ITPS

The ITPS Group holds an unique position in each of these jurisdictions for the following reasons:

1. Market oriented (and not product oriented):
ITPS focuses on meeting the needs of the clients;

2. Rendering international tax planning and structure (trust) services:
Tax planning and structure services are complementary. Planning is of no use if you do not structure it. Moreover you can not efficiently structure if you do not take the first step: plan the structure. Therefore, the services of ITPS are not restricted to trust services. Since ITPS has the combined skill and experience for more than ten years, high quality is ensured;

3. All included fixed fees for structure (trust) services:
In each jurisdiction, tax structure services are charged at annual fixed fees, generally payable in quarterly installments in advance. Tax planning services are charged at an hourly rate;

4. One contact person is possible for several jurisdictions;

5. Independent:
There is no conflict of interest. ITPS works with all other skilled professionals and (financial) institutions as the client deems appropriate;

6. Personal contact and continuity:
ITPS focuses on long-term customer satisfaction, providing proactive, personal, attentive and competent services;

7. Regular meetings:
Customers and correspondents are visited on a regular basis (three to four times a year) to touch base and to discuss opportunities and problems that may have arisen, without a fee being charged;

8. Tax sparring and education:
ITPS strives to built up a (tax) sparring relationship with customers and correspondents in order to keep each other abreast in a fast changing environment. A quarterly newsletter on international tax planning, the International Tax Planning Newsletter, is sent to inform customers and correspondents on the changes in legislation;

9. An excellent network:
Since ITPS is not part of an international network, it has built up a network of highly skilled professionals to work with.

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