LAW PUNDITS

CROSS BORDER JOINT VENTURES

COURSE MATERIAL

Cross Border Joint Ventures

In nearly all areas of commerce, businesses are looking beyond their own borders to compete in the international marketplace. Often this involves seeking out foreign partners to combine their commercial strengths and resources through strategic alliances.

For those involved in the technical aspects of structuring a joint venture the variety of form and objectives pose real difficulties in suggesting "off the shelf" solutions. Too often the choice of a corporate structure is made without a full analysis of other possibilities. When the joint venture proposed involves more than one jurisdiction, the options to be considered and the costs involved in getting it wrong increase significantly.

Where possible, technical support needs to be given at an earlier stage than in domestic joint ventures. A critical part in the process will be to translate each party's expectations as to form, documentation and fiscal structure into issues that the other parties can understand so that time is not spent negotiating and winning or conceding points which are wholly technical in nature. Many complex issues can arise in a cross-border transaction. Therefore, an understanding of the cultural, legal and fiscal background of the other parties and the locations in which business is to be done can be a very significant aid in removing misunderstanding and allaying suspicions.

While the differences between one joint venture and another are more pronounced than the similarities, it is possible to set out broad principles and offer ideas and solutions which are of general application.

Differences between domestic and cross-border joint ventures

Over and above all the legal and tax considerations raised in the context of domestic joint ventures, cross-border joint ventures raise additional issues as they involve parties from different legal and tax jurisdictions, and conduct business across international borders.

These issues include:

- The possibility of locating the joint venture in different jurisdictions.
- The possibility of using different legal vehicles in the different jurisdictions.
- Possible restrictions on foreign investment, ownership or control.
- "Overriding" concepts of local law rendering the provisions of an agreement void or unenforceable.
- Ensuring that fiscal transparency or neutrality is maintained across borders.
- The secondment or employment overseas of employees from the joint venture's participating companies.
- The need to choose an appropriate law and forum for the resolution of disputes.

An extended range of variables means a greater opportunity for planning (and for pitfalls) in structuring the joint venture.

Legal systems

Cross-border joint ventures involve different countries with different legal systems which operate differently from each other. This is particularly so when comparing civil law systems (the legal system prevalent in most of Europe, other than the UK and Ireland) and common law systems (for example, the US, UK and former dependent territories). Cultural differences in legal systems may cause problems or difficulties not always readily apparent.

The Anglo-American experience is based largely on the principles of contract law. If two parties agree to do something, it will be described and defined in detail with an attempt being made to document the rights and duties of the parties in most conceivable situations. The parties will expect their provisions to be fully enforceable and remedies clear. Under civil law, the approach and expectation is different.

Parties entering into joint ventures under civil law systems should be aware that their rights and duties may be affected by the general legal background.

Key commercial elements of a joint venture

It is essential to address fully the key commercial elements of the proposed arrangement. Cross-border joint ventures are not fundamentally different creatures in this regard from their domestic cousins. In each case, it is necessary to identify the critical elements which will shape the deal. Each involve the same basic issues:

- Agreeing on the commercial objectives, scope, duration, responsibilities (the "deal").
- Funding the joint venture ("money in").
- Extracting profit from the joint venture ("money out").
- Providing for management and control of the joint venture.
- Providing for divorce of the parties and dissolution of any joint venture vehicle.

Put more simply, joint ventures are about money in, money out and control.

The key commercial elements must be considered in the context of the following practical issues:

- **Are the proposals viable?** Clearly a number of matters must be addressed at this point. Business, financial, legal, regulatory and tax issues could all prevent the initial concept being implemented or dictate a particular form or structure to the venture that renders further investigation of the possibilities pointless.

- **Where should the joint venture be located?** There are a number of possible ways of combining operational and fiscal requirements.

- **What form should the joint venture take?** There are often a number of possibilities beyond the Anglo-American approach of choosing between a company, partnership or contractual arrangement.

- **Tax efficiency.** Tax planning for contributing assets, operating expenditure, financial expenses and profit extraction must be considered.

Viability

When considering the viability and shape of the deal, certain legal, regulatory and tax issues may be of such a nature that they become deal breakers.

Government regulation of foreign ownership

The location of a joint venture in many parts of the world will be heavily influenced by government regulation and foreign exchange controls. Care must be taken to check there are no regulations forbidding, restricting or regulating the size offoreign investment. In Australia, for example, foreign investment in Australian companies may be regulated by the Investment Review Board. Foreign exchange controls are an important feature of investing in South America, Africa and many parts ofAsia. Even countries which do not restrict foreign investment in general will often protect particular sectors (for example, the media, telecommunications and defence industries).

In many emerging economies foreign ownership, where permitted, is heavily regulated. Therefore, joint venture laws exist in Russia, Eastern Europe, China and other formerly protected or centrally controlled economies.

Foreign exchange controls

If the return from a joint venture is in a non-convertible currency or remittance is otherwise blocked, structuring the joint venture to access hard currency or otherwise avoid transfer risk becomes paramount. Tax efficiency, in particular, may take second place to an optimal structure which permits returns in a hard currency for joint ventures in South America, Africa and many parts of Asia.

Tax

In most joint venture deals, tax considerations will be key in deciding:

- The choice of the joint venture vehicle.
- Where it will be based.
- The manner in which it will be operated and terminated.

Although not identical, similar tax issues will arise in any proposed cross-border joint venture structure. Tax advisers should be involved at the earliest possible stage of the structuring process to identify any potential tax problems, offer solutions and ultimately to help the parties to achieve the optimal structure from a tax perspective.

In any jurisdiction the areas which will be the focus of most concern in the structuring process, and which may present possible deal breaking tax issues, will be those that are encountered at the three stages of the joint venture's life (setting up, operating and, in some cases, terminating).

Setting up

In many joint ventures, the parties will contribute assets (possibly including shares in subsidiaries) to the joint venture. It is important to assess the tax cost of contributions, as these can sometimes make the formation of the joint venture extremely expensive. A variety of taxes may be relevant:

- Capital gains taxes. The country in which the asset is located may charge tax, broadly, on the difference between the acquisition cost of the asset and the disposal value to the joint venture.

- Transfer taxes. Most countries charge transfer duties on the sale of certain assets such as shares and land. Notarisation fees may also be payable.

- The transfer of assets may be subject to value added tax or similar indirect taxes.

- Some jurisdictions (such as Switzerland), charge capital duty on the issue of shares. This will be relevant if the joint venture company issues shares in consideration for the transfer of assets to it.

In practice, it may often be the case that a joint venture party is unable or unwilling to transfer assets or a business to the joint venture because either its tax profile is such that it is unable to avoid incurring a tax charge in respect of its contribution, or for other commercial reasons. In this situation the parties may prefer to lease rather than sell the assets to the joint venture.

Operating

The following operational tax issues will invariably be raised during most joint venture negotiations:

- Minimising tax in the joint venture vehicle.

- Avoiding tax leakage on the distribution of profits or gains in the joint venture vehicle to the joint venture parties. So, for example, the parties will, if possible, want to obtain credit for any taxes paid by the joint venture vehicle and to avoid double taxation on any distribution.

- Obtaining relief for losses that the joint venture may sustain. Ideally, the parties will want the joint venture vehicle to be able to surrender losses to one or both of the joint venture parties or at least to carry them forward to offset against future profits of the venture.

Terminating

The nature of the joint venture vehicle will determine how assets can be transferred on termination. It may be the case, for example, that the termination of a joint venture in corporate form will involve the transfer of assets by the joint venture company back to the joint venture parties or a disposal by the joint venture parties of their interests in the joint venture company.

Both the transfer of assets and the disposal or deemed disposal of shares in a joint venture company may give rise to a tax liability, so it will be necessary to establish whether there may be any reliefs or exemptions available to offset this cost.

Optimal structures

Having dealt with any potential deal breakers, the parties should concentrate on considering optimisation techniques. As already mentioned above, the choice of structure is often, though not always, tax driven.

Optimisation techniques include:

- Making decisions on the location (or locations) for the joint venture.

- Deciding on the correct legal form.

- Investigating choices as to the capital structure of the joint venture vehicle.

- Establishing the current tax profile of the respective joint venture parties.

- Where the enterprises involved have operations in the same jurisdiction, considering the advantages of merging, grouping or consolidating those operations to ensure fiscal unity going forward or the ability to achieve a "step up" in tax basis for assets or business transferred.

- Considering and proposing the use of service entities which can provide financial, intellectual property, employment, headquarters or other services to the joint venture.

Locating the joint venture

If the joint venture is to be set up to operate from, or trade in, a particular territory, the location may be a commercial given. The operations may still however be structured in different ways. Operations may be in Country A but finance can be provided from Country B, technical know-how and intellectual property licensing from Country C, parent companies located in Country D. An operation carried on by a branch of a foreign incorporated company may be located for tax or regulatory purposes in both countries or only in the jurisdiction of the head office or principal place of management.

In other cases, several territories may be possible locations so that some positive planning is possible. This may be so if thebusiness is to be conducted across several jurisdictions or if the choice of location (for example, for a new factory) is dependent on the particular incentives offered by competing jurisdictions.

Some territories offer incentives for particular activities or for entities formed under the local law. However, over the last decade or so, the European Commission has investigated certain selective tax regimes (for example, in Ireland and Belgium), and has found that they constitute harmful tax competition between member states. In response, Belgium phased out the extremely attractive tax breaks which it had offered for the establishment of co-ordination centres and established a new regime under which Belgian companies are entitled to deduct a notional interest charge on equity capital. Ireland responded to the European Commission investigation by phasing out its special 10% tax rates (which applied to certain manufacturing activities and for foreigners investing in financial services located in the Dublin Docks) and replaced it with a general low rateof corporation tax (12.5%). For this reason, Ireland remains a fiscally attractive place to invest.

Even the UK, which is not renowned for offering tax breaks, participates in the intense competition in Europe to attract headoffices of multinationals. The exemption for capital gains on the disposal of substantial shareholdings, and the absence of UK withholding tax on dividends, makes the UK an increasingly attractive location for international joint ventures.

Form of undertaking

Form will be governed by a range of considerations:

- The desire to limit liability.

- The need to trade through a commercial entity acceptable to employees, customers and bankers.

- The need for the vehicle to own assets and incur liabilities that are not on the balance sheet of any parent joint venture party.

- The need for a structure where equity owners clearly understand their rights and liabilities.

- Tax.

As already mentioned above, the choice of vehicle should:

- Constitute an efficient medium for the flow of profits to the joint venture parties.

- Avoid unnecessary tax costs.

- Enable the parties to obtain tax value for any start up losses or other expenses.

A corporate vehicle is generally a preferred choice since its legal status is clear, its ability to contract (for example, borrow money) certain, and the accounting position for the vehicle and parents relatively straightforward. Companies have the advantages of legal personality and limited liability (though so do a number of other legal forms).

From a tax perspective, a corporate vehicle may be more advantageous where:

- The joint venture company is liable to a lower rate of tax or more favourable basis of taxation than the joint venture parties. However, it is worth bearing in mind that profits of a joint venture company in a low tax jurisdiction may, in certain circumstances, be imputed to a joint venture party in another jurisdiction under so-called controlled foreign company rules. These rules are intended to stop multinationals sheltering profits in low tax jurisdictions.

- The joint venture company may be better placed to benefit from double tax treaties than either of its parents if it is located in a jurisdiction with a wide range of double tax treaties such as the Netherlands or the UK.

- A holding company may be needed if there are operations in more than one country.

However, in a cross-border context a corporate vehicle may be disadvantageous where:

- There will be tax leakage on the distribution of profits from a joint venture company in one jurisdiction paid to a shareholder in another. Credit may not be available for underlying taxes paid by the joint venture company and there may be withholding tax on distributions that cannot be fully re-claimed.

- Losses of a joint venture company that is tax resident in one country are not capable of being surrendered to a joint venture party that is tax resident in another country. This is normally the case under domestic law and an EU losses directive seeking to mitigate this problem for companies formed in member states, remains in draft form with little prospectof adoption.

However, the treatment of losses is an area which has been considered by the Court of Justice of the European Union (ECJ) and in certain situations it may now be possible to surrender losses to and from companies in different EU jurisdictions.

In these circumstances there may be real economic advantages in not conducting the joint venture operations through a corporate entity. This may mean looking at a pure contractual arrangement or at a partnership. It may mean examining other local entities to determine whether or not they would be "transparent" from the standpoint of the tax authorities of the joint venture party while at the same time constituting a separate legal entity.

Hybrid vehicles

Conflicting objectives may sometimes be reconciled by the use of hybrid vehicles. Entities of one jurisdiction can be classified differently when viewed by the authorities of another. A company can be treated as a partnership for US federal income tax purposes by simple election under the US "check the box" regulations (at least unless it is a *per se* corporation, as is the case for a UK public limited company, a French *sociétéanonyme*, a Dutch *naamlozevennootschapor* and a German*aktiengesellschaft*). Various European partnership entities (for example, a Luxembourg SCA) may be treated as companies for UK tax purposes. A Delaware partnership can offer separate legal personality and limited liability yet be treated as transparent for tax purposes.

However, the UK's rules preventing the exploitation of differences between the tax systems of different jurisdictions in Part 6 ofthe Taxation (International and Other Provisions) Act 2010 (anti-arbitrage rules) can stop UK tax advantages arising to UK joint venture parties from, for example, the use of hybrid entities.

Hybrid vehicles

EEIGs (European Economic Interest Groupings) may have a useful, though limited, role to play.

Contractual arrangement versus corporate partnership

The choice of hybrid may be between different forms of unincorporated joint ventures, for example, between a simple contractual arrangement and a partnership.

In pure legal terms, the simplest form of association for a joint venture is an arrangement under which the participants agree to associate as independent contractors, rather than as shareholders in a company or partners in a legal partnership. This type of agreement is often referred to as a consortium or co-operation agreement. Here the rights and duties of the participants as between themselves and third parties, and the duration of their legal relationship, will basically derive from the provisions of the joint venture agreement and the associated agreements, and general common or civil law rules.

If the participants in a contractual joint venture wish to avoid joint and several liability for business debts, they can do so by avoiding carrying on any business "in common" and ensuring that the different businesses that make up the joint venture are kept separate.

If the businesses that make up the contractual joint venture are separately owned and controlled and each joint venture party bears its own costs, it will usually follow that the net profits of the contractual joint venture are not shared, but rather accrue separately to the participants. There is, however, no objection to the participants sharing the gross returns of the joint venture.

Whether or not particular joint venture arrangements constitute a legal partnership is a mixed question of fact and law. Under UK law, a "partnership" is defined as the "relation which subsists between persons carrying on a business in common with a view of profit". Various rules are laid down for determining whether or not a partnership exists.

Unlike the participants in a contractual joint venture, an enterprise formed as a partnership may involve joint and several liability. This factor may, depending on the circumstances, make this a less attractive choice as the joint venture vehicle. Also, the tax treatment of partnerships varies from country to country. In some countries like the UK, partnerships are normally tax transparent so that profits and losses accrue directly to the joint venture parties in proportion to their share of the partnership. In other jurisdictions, a partnership may be taxed as a separate legal entity and special rules may apply where there are limited partners.

In addition to the above, a UK joint venture party considering the use of a partnership may need to consider the following:

- Whether the partnership is UK or foreign, offset of losses from non-UK based activities will generally not be available against other profits of a UK partner. No such restrictions on the use of losses should apply to a contractual joint venture.

- Where a partnership is taxed as a separate legal entity in its own right, it may sometimes be treated as a resident of a country under tax treaties which follow the Organisation of Economic Co-operation and Development model and may, therefore, be entitled to treaty benefits. Where it is not taxable as such, it may not be eligible for treaty benefits. Some treaties (for example, the UK/US or the France/US Treaty) deal expressly with partnerships. Others (for example, the US/Dutch) are silent and the extent to which a US limited partnership is eligible for Dutch treaty benefits (if at all) will be determined by reference to Dutch domestic law provisions.

Reconciling conflicting objectives

If there is a conflict between an operational desire for the venture to be conducted through a company and optimal tax planning, it may be possible to reconcile both aims by using an agency or nominee arrangement. This might be a solution where the transfer of assets to a newly formed joint venture company would carry a prohibitive tax cost, but where it is essential for the new venture to be seen to have a distinct personality. For example, the joint venture entity can take a corporate form, trade with the outside world in its own right and have a clear management structure but be structured so that its profits and losses are earned by it as nominee or agent for its parents. Such an arrangement will be effective where the need for a separate identity is organisational but not where the new entity must establish its own balance sheet and trading record.

If the conflict cannot be reconciled in this way, it is then necessary for a tax adviser to consider each constituent element ofthe joint venture to see whether efficiency can be achieved not through the legal form of the joint venture but through effective structuring of money in/money out.

Money in/money out

Financing a cross-border joint venture is, in principle, the same as for a domestic joint venture. Choices include:

- Equity.
- Debt.
- Retained earnings.
- Leasing.
- Debt factoring arrangements.

However, although the cross-border element can raise potential problems (for example, withholding taxes and non-deductibility of payments), it can also in certain jurisdictions create tax planning opportunities. Payments, deductible in a high tax country where operations or sales are located, may legitimately be made to a low taxed company in another jurisdiction. Even better, money may be borrowed in the parent company's high tax home (any interest paid is tax deductible) and used to subscribe for shares in an overseas company which in turn lends to the joint venture (interest again may, depending on the jurisdiction, be deductible). A financing instrument may be regarded as debt in the country where the borrower resides (allowing a deduction for interest), but equity in the country where the lender is located (giving the lender a credit for taxes paid by the borrower). Activities can be conducted through a branch or dual resident (that is, an entity treated as tax resident in more than one jurisdiction) and therefore expenses may fall to be deducted against income in two jurisdictions.

However, the anti-arbitrage rules can stop UK tax advantages arising to UK joint venture parties from, for example, hybrid financing instruments.

Payments and tax

Interest

In addition to the basic commercial issues as to the desirability or otherwise of debt financing, loans from shareholders are a common method of financing joint ventures (principally because of perceived flexibility, simplicity of procedure and tax efficiency).

In regard to tax efficiency, there is a fundamental difference between the tax treatment of dividends and interest: interest payments are generally tax deductible and dividends are not. If this is the case, the joint venture parties may try to take advantage of this by giving a joint venture company a large loan capital and a small share capital.

The taxable profits of the joint venture company are thereby reduced, although it should be noted that many jurisdictions have anti-avoidance legislation to prevent this highly geared structure. Such structures are "thinly capitalised" and can often be attacked under either thin capitalisation or transfer pricing rules. Broadly, the way these rules generally operate is to treat interest incurred on "excessive" debt as non-deductible for tax purposes.

Also, the tax laws of many jurisdictions seek to penalise interest payments cross-border to affiliates. For example, interest paid by German partnerships to its partners can be treated as an allocation of profit and be non-deductible. Interest payments by French entities will in general qualify for deduction but restrictions may apply if interest payments are set at a non-commercial rate, or, in some cases, on payments to equity holders in the joint venture. Assuming that the interest payable is likely to be deductible, the next consideration is whether the joint venture company or, as the case may be, the joint venture parties have sufficient tax capacity to benefit from the deductions.

Many countries impose withholding tax on interest. Rates of withholding tax are commonly around 20% to 25%. The current rate of UK withholding tax is 20% although, in common with withholding tax in many jurisdictions, this liability is often reduced or eliminated under the provisions of a double tax treaty.

Within Europe, withholding tax on interest (and royalties) may also be avoided under the terms of the European Council adopted Council Directive 2003/49/EC on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states (the Directive). The Directive came into effect on 1 January 2004 and effectively abolishes withholding taxes on payments of interest and royalties between companies in different member states where the recipient owns more than 25% of the payer. On 24 August 2010, the European Commission launched a consultation on extending the Directive.

UK withholding tax will only need to be considered if a UK joint venture company is paying interest to a non-resident UK joint venture party.

Planning for losses

Losses, in a tax sense, may arise because of start up operating deficits of the joint venture or in capital intensive joint ventures, particularly infrastructure projects, where tax depreciation and investment deductibility rules in the parent companies' home territories permit an accelerated deduction for tax purposes. It may also, for example, be possible to obtain a deduction for purchased goodwill (see, for example, Belgium, Germany, Italy, Netherlands, Norway and Sweden and more recently the UK) which could result in tax deductions becoming available.

If this type of loss is anticipated, the parties should consider a number of options as follows:

- It may be possible to establish a structure which is "tax transparent" (where income and expense flow directly back to the joint venture parties) so that the losses can be offset against other taxable revenues.

- An alternative structure, which may work in certain jurisdictions, is to establish the joint venture entity as a corporate entity but dually resident, therefore treated as a domestic corporation in more than one jurisdiction. This may enable losses to be grouped or consolidated for tax purposes with one or more of the joint venture parties.

- In regard to using UK group/consortium relief as a method of relieving losses, it is worth noting that, until relatively recently, it was not possible for a non-UK resident company to either surrender or claim UK group relief in respect of its losses, unless it carried on a trade in the UK through a permanent establishment. However, the law was amended following the ECJ decision in the case of *Marks & Spencer PLC v. David Halsey (HM Inspector of Taxes)*, Case C-446/03, and a group litigation order (made in the High Court on 23 May 2003), which claimed that the UK group relief provisions were in breach of European law and/or the non-discrimination article of various double tax treaties.

The changes introduced by the Finance Act 2006 as a result of the *Marks & Spencer* litigation, include the extension of the group relief regime to allow for surrenders by a non-UK resident company acting other than through a UK permanent establishment subject to the satisfaction of certain conditions and an anti-avoidance provision.

In 2010, changes were also made to the UK's consortium relief rules principally to correct an abuse of the Community law principle of freedom of establishment, identified by the Tax Chamber of the First-tier Tribunal in *Philips Electronics UK Ltd v HMRC [2009] UKFTT 266*. In that case, the tribunal determined that the UK's consortium relief rules were contrary to EU law insofar as the rules denied consortium relief in cases where a "link" company was not resident in the UK or carrying on a trade in the UK through a permanent establishment.

Section 12 and Schedule6 to, the Finance Act 2010 contain the amending legislation. Relief through "link" companies is now available so long as the holding company holds at least 75% of the subsidiary's ordinary shares through a company established in the EEA.

On 11 December 2012, draft legislation for Finance Bill 2013 was published to ensure that a non-UK resident company that is resident in the EEA may surrender as group relief losses made by its UK resident permanent establishment provided the loss is not deducted from or otherwise allowed against the non-UK profits of any person. The amendment follows the ECJ's ruling in *HMRC* v *Philips Electronics UK Ltd* (Case C-18/11) that the UK's group relief rules are incompatible with Article 49of the Treaty for the Functioning of the European Union. The Finance Act 2013 legislation, which amends Section 107 of the Corporation Tax Act 2010, is identical to the December 2012 draft. The amendments take effect for losses arising in accounting periods beginning on or after 1 April 2013. Losses that arise in accounting periods that straddle that date must generally be apportioned on time basis.

On 24 October 2013, the ECJ's Advocate General Jääskinen (AG) gave his opinion on two questions referred by the First-tier Tribunal in a case concerning consortium relief surrender when the link company is resident in Luxembourg. On the question of whether Articles 49 and 54 of the TFEU (formerly Articles 43 and 48 of the EC Treaty) (freedom of establishment) preclude the requirement that the link company be either resident in the UK or carrying on a trade in the UK through a permanent establishment there, the AG considered that, as far as countries resident in the EU/EEA were concerned, this was the case. On the second question, whether the UK could preclude link companies whose ultimate parent was resident in a third country from benefiting, the AG's view was that restrictions could legitimately be imposed to restrict relief to companies whose lowest common parent was resident in the EU/EEA.

Where losses are likely and where they would not otherwise be used directly by the joint venture parties, it is worth considering leasing or consortium type arrangements with outside investors. Though the details vary, these arrangements essentially permit tax-paying third parties in the jurisdiction where the joint venture is based to provide capital to the joint venture in such a way as enables them to benefit from depreciation or other reliefs. This is a significant activity for many structured finance departments of international banks. It may even be possible for tax capacity in other jurisdictions to be accessed in this way although tax authorities around the world have become more hostile to granting tax relief for expenditure incurred on assets outside the jurisdiction.

In wholly domestic joint ventures, use of losses is generally a timing game. In other words, efficient use is about getting tax relief sooner rather than later. This may also be true in cross-border situations but, more fundamentally, efficiency may be about absolute benefits: where relief is obtained for expenditure which is not allowable in one jurisdiction or where relief is obtained at higher marginal rates of tax.

People

People are likely to be a critical factor to any joint venture. One or more of the joint venture parties are likely to wish to second or assign personnel to the joint venture.

A basic choice to be made in cross-border joint ventures, as with domestic joint ventures, is between seconding employees to the joint venture and employing them directly from the joint venture.

It is frequently more advantageous for employees to be seconded. This is usually where secondment maintains the employee's continuity of employment for the purposes of social security; pension or other benefit schemes (for example, share option schemes).

However, the secondment of staff to an EU company may attract a VAT charge. While this may, in any event, not be a significant issue for a fully taxable business, in other situations, particularly for groups engaged in financial services, VAT is a major cost item.

If VAT would be a problem there should be a solution. One is to group the employer and secondee entity into a single VAT group. Groups can sometimes be established across EU boundaries for VAT purposes with much greater ease than for other tax purposes. Another option is to consider the payment arrangements (that is, how salaries are paid by the joint venture). Direct payments by the joint venture to the employee can in practice be accepted by HMRC as not having any VAT effect.

A third option may be to formalise arrangements by dual contracts of employment so that the employees maintain their original employment contracts but are also employed by the joint venture. There may, in any event, be other commercial reasons (for example, enforceability of restrictive covenants) or tax reasons (for example, favourable benefits for income derived from offshore) for considering dual contracts. However, it should be noted here that HMRC will look closely at dual contracts and it has stated that:

"[a] dual contract arrangement based solely or mainly on a geographical split of employment duties without commercial underpinning is vulnerable to challenge on the grounds that there is in reality a single employment with duties in and outside the UK. When we come across such cases, we intend to fully investigate the facts and circumstances including the commercial rationale and context and to assess an employee to tax where the evidence shows that there is in fact a single employment. If necessary, we will defend such an assessment in formal appeal proceedings."

Choice of law

This fundamental issue is sometimes determined almost casually. Clearly, where the joint venture is a creature of the domestic legislation of the territory in which it is based, there may be compelling reasons for the regulation of matters between the joint venture parties to be governed by the same law. However, very often this is inappropriate, for example, where the joint venture touches on a number of different jurisdictions or where the parties positively wish to regulate their relations beyond the narrow constraints of a particular joint venture. In these cases there may be a tension between the dominant parties behind the joint venture, each of whom is likely to wish to have its home law as the governing law.

Factors that are relevant in making a choice for a neutral governing law include:

- The preferred method of dispute resolution. Though there is no difficulty in choosing the law of one territory and electing for ***arbitration*** in another, if arbitration is not seen as the appropriate dispute mechanism, the parties will clearly need to be comfortable about the court system in the jurisdiction whose law is chosen. Issues here include:

- the perceived independence of the judiciary (particularly if one party is domiciled there or if another comes from a "politically incorrect" state, such as South Africa or Israel before recent reforms);
- the efficiency of the litigation process; and
- whether appropriate recognition of judgments is given in any territory where enforcement may be necessary.

- The flexibility of the law in permitting the partners to regulate their affairs precisely as they wish (rather than leave matters to uncertain notions of fairness) and also in providing appropriate remedies if necessary. For example, the ability to obtain an injunction to stop damaging behaviour rather than be left to seek financial redress afterwards.

- The chosen language of the documentation. If the parties wish to regulate their legal relations in one particular language there is likely to be some logic in adopting the governing law of the territory where that is the mother tongue.

In any event, there will normally be good reasons for the parties to settle on a single choice of law and elect for this to be exclusive to any other.

The importance of expert advice

Joint ventures are fraught with difficulties. Joint ventures which bring together parties from different backgrounds and which span the legal and fiscal regimes of more than one jurisdiction are even more difficult. However, many businesses are discovering that joint venture arrangements are essential to share costly development programmes, to gain access to larger markets or to expand into more rapidly developing economies.

The adviser's role is to create the right technical structure which meets commercial, operational, accounting, regulatory, legal and tax needs. Establishing an efficient and practicable operating and financial structure will not create success but it can get matters off to the best possible start.

Corporate structures

Corporate structures and shareholders' agreements are generally more regulated under civil law systems than in common law jurisdictions. This can be illustrated by the following examples:

Italy

- Shareholders' agreements may be invalid if they deprive shareholders of fundamental rights.
- Clauses which subject transfers of shares to the discretionary consent of corporate bodies are invalid.
- If you have a deadlock board and a director dies, the remaining majority may appoint a replacement.
- A director cannot be bound to vote in a certain way.
- There are restrictions on distribution of profits until reserves have reached a certain level.
- You cannot have a shareholder participating in the gains but not the losses of the company.

Germany

The two most common forms of German corporate entity are AGs and GmbH. In each case, the composition of the board is regulated:

- **AGs.** If there are more than 500 employees there must be a supervisory board. If there are 2000 employees, half the supervisory board must be appointed by the employees.

- **GmbH.** If there are more than 500 employees there must be a supervisory board. Depending on the number ofemployees, a third or one half of the supervisory board must be appointed by the employees.

France

It is unclear whether shareholders' agreements outside the constitutional documents of a French company are enforceable.

Pros and cons of the UK

In fiscal terms, the UK has become a more attractive location for a headquarters company. The main advantages of the UK tax system are that:

- The rate of corporation tax for the 2013-14 financial year is 23%, which compares favourably with corporation tax rates elsewhere in Europe (section 6, Finance Act 2012). The rate will fall to 21% for the financial year 2014-15 and to 20% from 2015-16 (sections 4 *and* 6, Finance Act 2013).

- The UK does not impose withholding tax (or any other charge) on outgoing dividends irrespective of the location ofthe shareholders.

- Under the Finance Act 2009, dividends paid on or after 1 July 2009 are subject to a new regime that applies equally to dividends paid by both UK and non-UK companies. Under the new regime, overseas source dividends received by large and medium-sized groups on ordinary shares and most non-ordinary shares are exempt from UK tax. This is subject to a targeted anti-avoidance rule to protect against avoidance activity seeking to exploit the dividend exemption.

- The UK has an extensive double taxation treaty network which supplements its system of unilateral relief.

- The tax rules for deducting debt funding costs are generous, although see recent anti-avoidance changes to the deductibility of interest discussed further below.

- There is no capital duty or other tax cost arising from establishing and/or capitalising a UK company.

- The EU PSD can further reduce dividend or withholding taxes on income distributed through the UK.

- UK withholding tax on royalty payments is no longer a concern where the payments are to certain categories of UK tax resident entities.

- The UK has a substantial shareholdings exemption which effectively exempts companies from UK corporation tax on capital gains on the sale of shares which satisfy the conditions of the exemption. However, it is worth noting here that the conditions that must be satisfied for the exemption to apply are more onerous than those required under the participation exemptions in other EU countries like Belgium, Luxembourg and the Netherlands.

- The UK provides tax relief for accounting amortisation of the price paid for goodwill, intellectual property and other intangible assets.

The primary disadvantages of the UK tax system are that:

- Careful planning is required in order to secure effective offset of funding costs and use of foreign tax credits particularly in the light of the FA 2005 changes which affected the deductibility for tax purposes of interest on non-arm's length loans made to UK borrowers, and also the timing of the deduction on certain loans made by lenders (outside the charge to corporation tax) with an equity or contingent equity interest where the interest is not current pay. However, changes enacted in the Finance Act 2009, which took effect for accounting periods beginning on or after 1 April 2009 (subject to an election to defer effect until the second accounting period after that date) mean that a deferral of the tax deduction for interest and discount only applies if the creditor is a company resident or effectively managed in, broadly, a tax haven. HMRC has issued guidance on the new measure.

- A worldwide cap on interest deductions (tax deductions for interest claimed by UK members of a multi-national group will be restricted by reference to the group's consolidated external finance costs) applies to amounts payable in accounting periods beginning on or after 1 January 2010. Legislation affecting this has been included in Section 35of, and Schedule 15 to, the Finance Act 2009.

- There is no reduced corporation tax rate for particular types of company, such as the Netherlands regime for treasury activities. (However, there is an optional reduced rate of corporation tax (10%) for companies exploiting patents and medicinal and botanical innovations from 1 April 2013.

- The tax rules for depreciation (capital allowances) are not as generous as several other jurisdictions and became less generous from 2012. However, the capital allowances annual investment allowance increased from £25,000 to £250,000 for qualifying investment in plant and machinery for two years from 1 January 2013 (section 7, Finance Act 2013).

- The UK has Controlled Foreign Company (CFC) rules which can subject low tax profits of subsidiaries of a UK parent to UK corporation tax. However, in the wake of recent decisions of the Court of Justice of the European Union, the UK High Court and the European Commission that the rules contravene the principle of freedom of establishmentand in the light of the package of measure for reforming the tax treatment of foreign income, the government:

- has legislated for full reform of the CFC rules for accounting periods of CFCs beginning on or after 1 January 2013; and

- introduced legislation (in section 47 of, and Schedule 12 to, the Finance Act 2011) improving the regime on an interim basis before full reform.