

INFRASTRUCTURE INVESTMENT

Continental European tax aspects

Bart Rubbens and Matthijs Vogel, Loyens & Loeff

Infrastructure Conference 2008

Sydney, 6 February 2008

Overview

Next 90 minutes

- Introduction: infrastructure investment in continental Europe
- Overview of tax issues
- Structuring into Europe/ funds

Introduction (1)

- Classical procurement: public funds, public servants
- Infrastructure deficit
 - EU: trillions of dollars
 - New EU member States!
 - Germany: annual need US \$ 90 billion
- Government budget deficits

Introduction (2)

- Closing the gap? PPP's: private sector participation
- Developing towards capital investment by the private sector on the strength of a government contract
- Pioneered and matured in UK
- Catching on in continental Europe
- Mainly used in transport sector

Introduction (3)

Varying market maturity

- Most jurisdictions ambitious, but in stage one
=> e.g. Eastern Europe
- Some maturity in:
 - Italy and Spain: roads and rail
 - France: roads, waste water and prisons
 - The Netherlands

Introduction (4)

The Netherlands

- Tradition in PPP for social housing and urban regeneration
- Late starter with PPP in transport, but quickly developing – Know How Centre Ministry of Finance
- Moving into other infrastructure areas – schools, housing
- Also using newer PPP-models e.g. Zuidas

Introduction (5)

Taxes in Europe

- Not one system: 27 Member States, 3 candidates and 19 other European States
- Little harmonisation of direct taxes
- VAT harmonisation, but differing interpretations
- However, several common tax issues for infrastructure investments

Common tax issues

- Contract qualification (tax accounting)
- Interest deduction (thin cap. + double dip)
- Loss carry back/ carry forward
- Real estate transfer tax and value added tax
- Withholding taxes on dividends, interest and royalties

Contract qualification

- Crucial to deciding when profit/loss is realised
- Risk that CIT must be pre-financed
- Does tax accounting follow commercial accounting?
- Many European jurisdictions have independent tax accounting rules, e.g. the Netherlands
- Example: Dutch discussions on DBFM-contracts (Design, Build, Finance and Maintain)

Example: Dutch DBFM-discussions (1)

- Bifurcate contract in separate components?
- Work-in-progress or fixed business asset?
- Tax treatment:
 - Work-in-progress (until 2007): immediate deduction of financing cost and overhead costs + profit realization upon finalisation of building
 - Fixed business asset: capitalization of costs + no profit realization upon finalisation of building

Example: Dutch DBFM-discussions (2)

Starting point Dutch tax authorities:

- If payment from public contractor, then work-in-progress
- Example: building three years, after that 10 year operation, payments in ten equal instalments during operation:
 - Losses during building phase (interest + overhead costs)
 - Taxable gain realised upon start of operation
=>Pay tax before any cash received
 - Service element eliminated
 - Discounted value of instalments is transfer price
 - In later years decreasing interest component of instalments plus service fees taxed

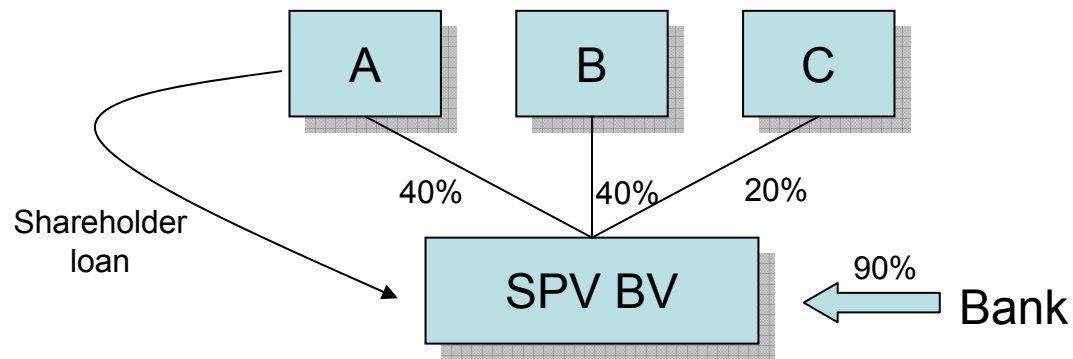
Example: Dutch DBFM-discussions (3)

- New rules on work-in-progress (2007): Percentage of Completion
- Consequence: tax due even earlier
- Arguments against qualification as work-in-progress:
 - Private contractor builds to exploit project itself
 - No payments received during building period
 - Project risks are for private contractor

Interest deduction (thin cap.)

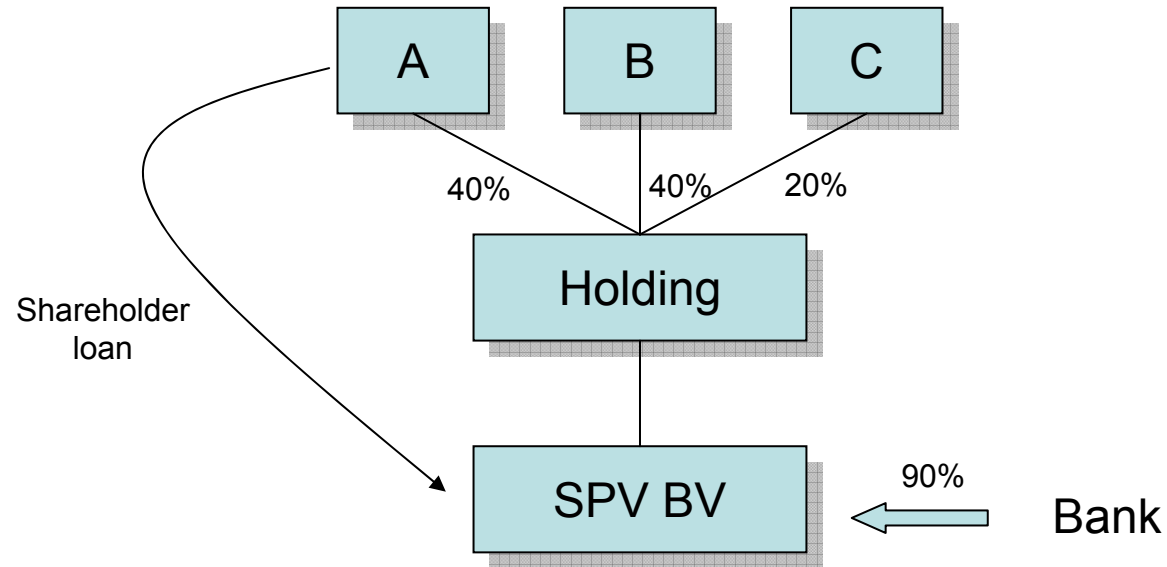
- Pivotal issue, because high gearing (>90%)
- In some jurisdictions no issue in building phase
=> interest costs added to tax basis
- In most jurisdictions no issue for third party financing if no sponsor guarantee
- Even if related party debt, many thin cap. systems have loop holes
- Recent development: some jurisdiction introduce rules that also cover third party debt (Germany and Czech Republic)

Thin cap. examples – the Netherlands (1)



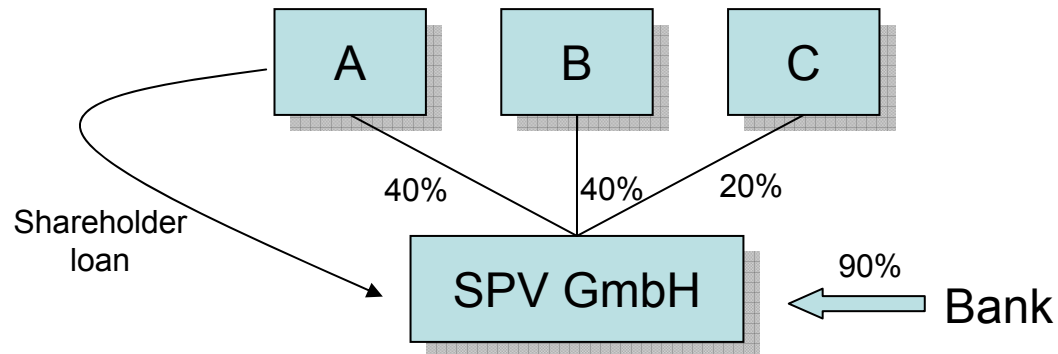
- Debt/equity ratio 3 : 1 max. exceeded
- Limitations apply only if BV is part of a “group” for accounting purposes
- Neither A, B nor C has control over SPV BV
=> No group, no thin cap. limitations

Thin cap. examples – the Netherlands (2)



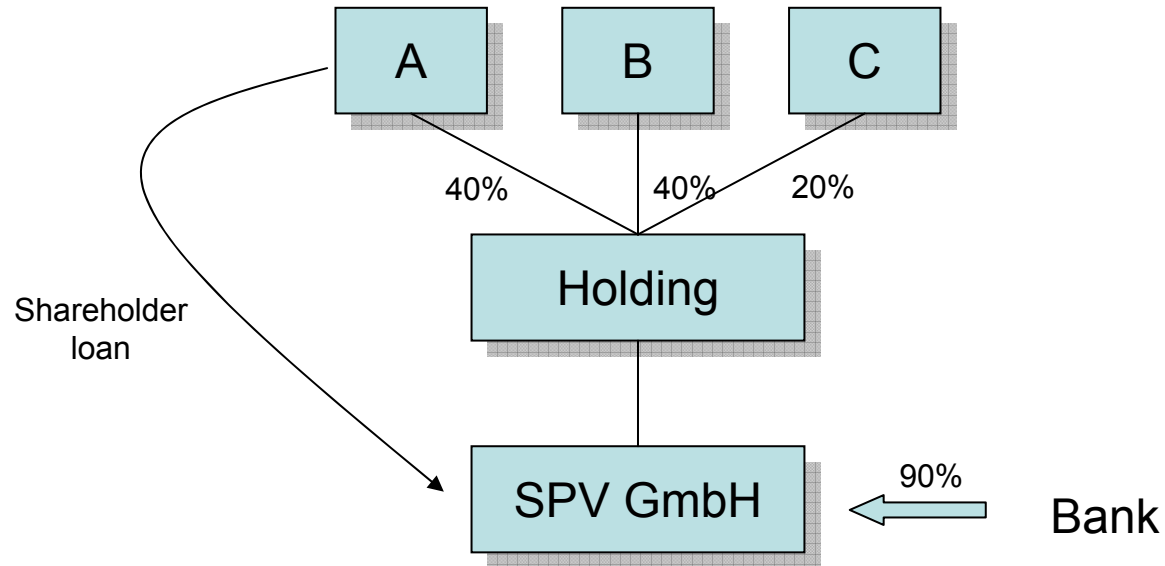
- Holding and SPV BV form a “group” for accounting purposes
- Thin cap. rules apply and 3 : 1 ratio exceeded
- Interest deduction on shareholder loan limited, however:
 - Possibly no limitation during construction phase
 - No limitation if Holding and SPV BV form a Dutch fiscal unity
 - No limitation on the basis of commercial group debt/equity ratio (assuming Holding’s only asset is SPV)

Thin cap. examples – Germany (1)



- No limitation during construction phase for capitalised interest
- Thereafter, earning stripping rule applies: deduction of (net) interest only up to 30% of EBITDA, however:
 - No limitation if total (net) interest expenses < € 1 million per annum
 - No limitation if SPV GmbH is not part of a group (= neither A, B of C has control over SPV GmbH) + interest expenses on loan from A do not exceed 10% of the total interest expenses

Thin cap. examples – Germany (2)



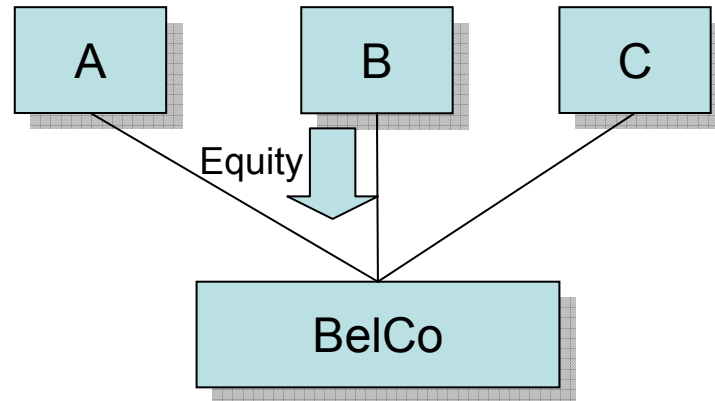
- No limitation during constructing phase for capitalised interest
- Thereafter, earning stripping rule applies: deduction of (net) interest expenses only up to 30% of EBITDA, however,
 - No limitation if total (net) interest expenses < € 1 million per annum
 - No limitation if SPV GmbH's commercial debt/equity ratio is equal to (or deviates with only 1% of) the commercial debt/equity ratio of the group (= Holding + SPV GmbH assuming that neither A, B or C control Holding) + the interest expenses on loan from A do not exceed 10% of the total interest expenses

Double dip concepts (1)

- Notional interest deduction
- Hybrid loans
- Hybrid entities

Double dip concepts (2)

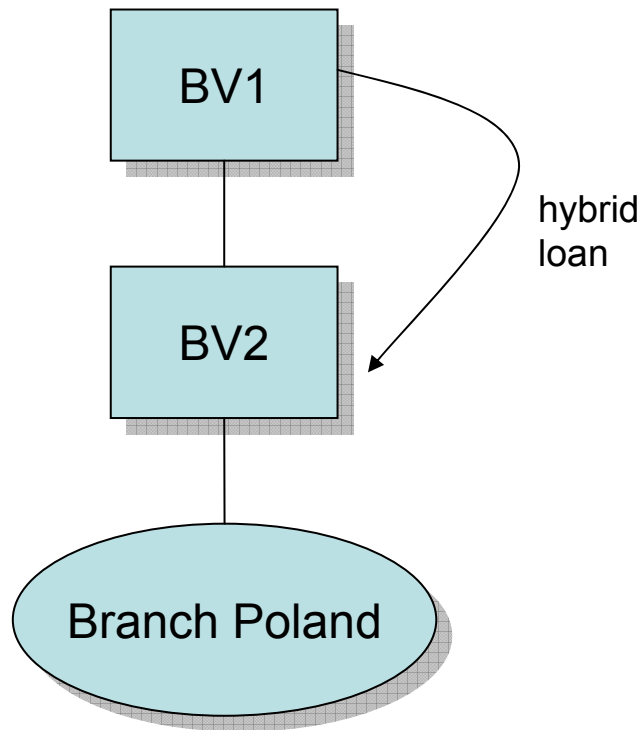
- Notional interest deduction Belgium



Deemed interest deduction of approx. 4.3% on equity of BelCo

Double dip concepts (3)

Hybrid loan (1)



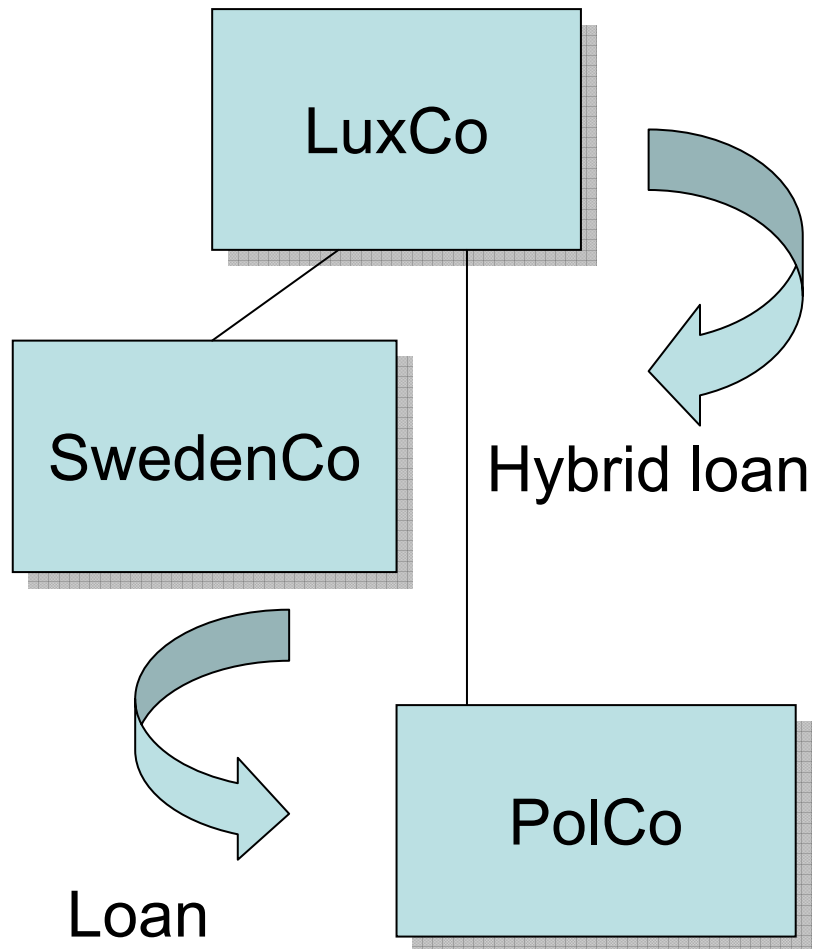
- Tax benefits in Poland
 - No Polish capital duty
 - No withholding tax on interest
 - Arguably no thin cap. restrictions
 - Interest deductibility at 19% rate
- No Dutch corporate income taxation if hybrid loan between BV1 and BV2

Comparison corporate income tax rates

Country	Corporate income tax rate (2007)
• Cyprus	10% (15% on passive income)
• Latvia	15%
• Lithuania	15%
• Hungary	16% + 4%
• Poland	19%
• Slovakia	19%
• Estonia	23% (upon distribution)
• Czech Republic	24% (2010: 19%)
• Slovenia	23%
• Malta	35% (0% IHC, 5%-10% interest/royalties)
• Bulgaria	10%
• Romania	16%

Double dip concepts (4)

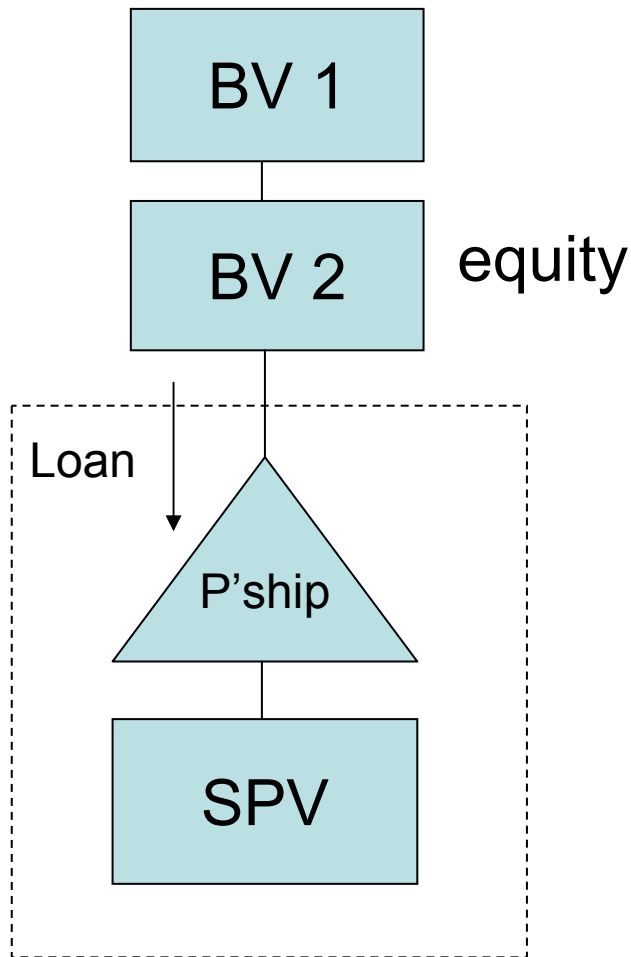
Hybrid loan (2)



- Luxembourg
 - Participation exemption
 - Investment in SwedenCo and PolCo
 - Hybrid loan
- Sweden
 - Taxed on margin (borrowing and on-lending)
- Poland
 - Interest deductible (thin cap. rules apply)
 - No withholding tax (treaty Sweden – Poland)

Double dip concepts (5)

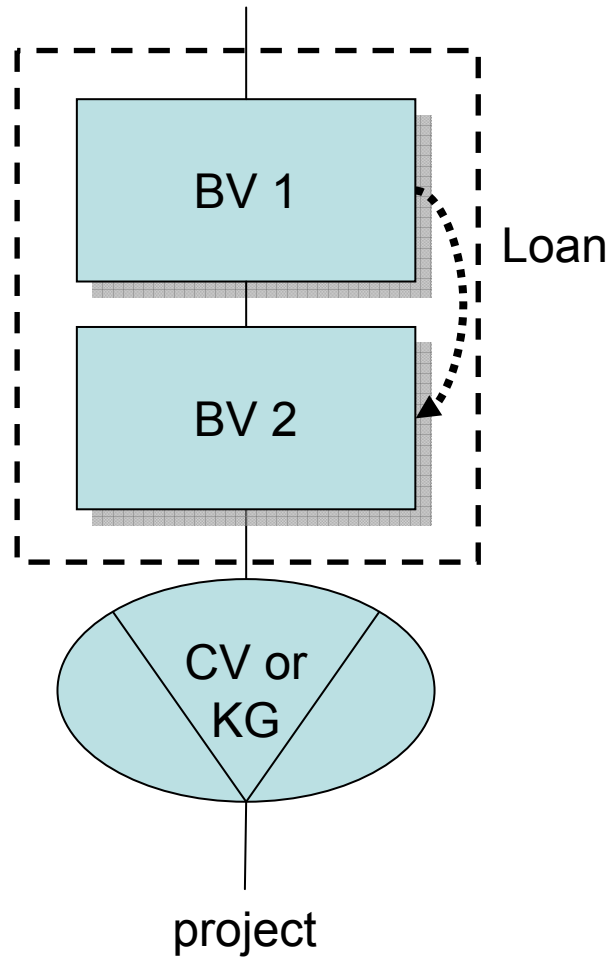
Hybrid entity (1)



- BV 1 contributes equity into BV 2 (participation exemption)
- BV 2 grants loan to Slovenian partnership
- Loan is disregarded in the Netherlands and recognised in Slovenia
- Slovenia levies no interest WHT
- Partnership and 100% SPV form a fiscal unity and deduct interest

Double dip concepts (6)

Hybrid entity (2)



- Deduction of interest in Germany (within restrictions of earning stripping rule), no taxation of interest in the Netherlands

Loss carry back/ carry forward

- Start-up losses? Depends a.o. on tax qualification of contract
- Most jurisdictions have no carry back (or very limited) and a limited carry forward
=> E.g. Eastern Europe normally 5 years
- Minimum taxation rules in some jurisdictions.
=> E.g. Germany: only 60% of annual profit above € 1 million can be offset with carry forward losses
- Note: most jurisdictions have rules that limit the carry forward of losses of a company in case shares in it are transferred

RETT and VAT

- RETT and VAT planning major part of infrastructure planning
- RETT systems not harmonised; rates up to 12%
- Many jurisdictions also tax transfer of economic ownership
- VAT EU harmonised
- But substantial interpretation differences DBFM contracts
- Possible issues:
 - Separate taxable transactions or one taxable transaction sui generis?
 - Supply of goods or delivery of services?
 - Timing of VAT payment => date of invoice or payment of cash
 - VAT-compensation fund for a.o. municipalities and provinces
 - In practice VAT position cleared upfront

Withholding taxes on dividends, interest and royalties (1)

- Source taxes in most European jurisdictions
- European Directives for intra-EU dividends, interest and royalties
- Directives apply also for new accession States
- But transitional rules, in particular for new accession States
- Important: anti-abuse rules (substance requirements)!

Withholding taxes on dividends, interest and royalties (2)

Example transitional rules for new accession States for interest and royalties

- Interest:
 - Latvia, Poland, Bulgaria: 8 years (4 years max. 10% / last 4 year max. 5%)
 - Lithuania: 6 years (4 years max. 10% / last 2 years max. 5%)
 - Romania: 4 years (max. 10%)
- Royalties:
 - Latvia, Poland, Bulgaria: 8 years (4 years max. 10% / last 4 years max. 5%)
 - Lithuania and Czech Republic: 6 years (max. 10%)
 - Slovakia: until 1 May 2006 full WHT – transitional period ended
- Transitional period started on 1/7/2005, for Bulgaria/Romania: 1/1/07
- Until start transitional period, right to levy full WHT
- Withholding tax may be reduced under tax treaties

Structuring into Europe (1)

Ideal EU holding from a tax perspective:

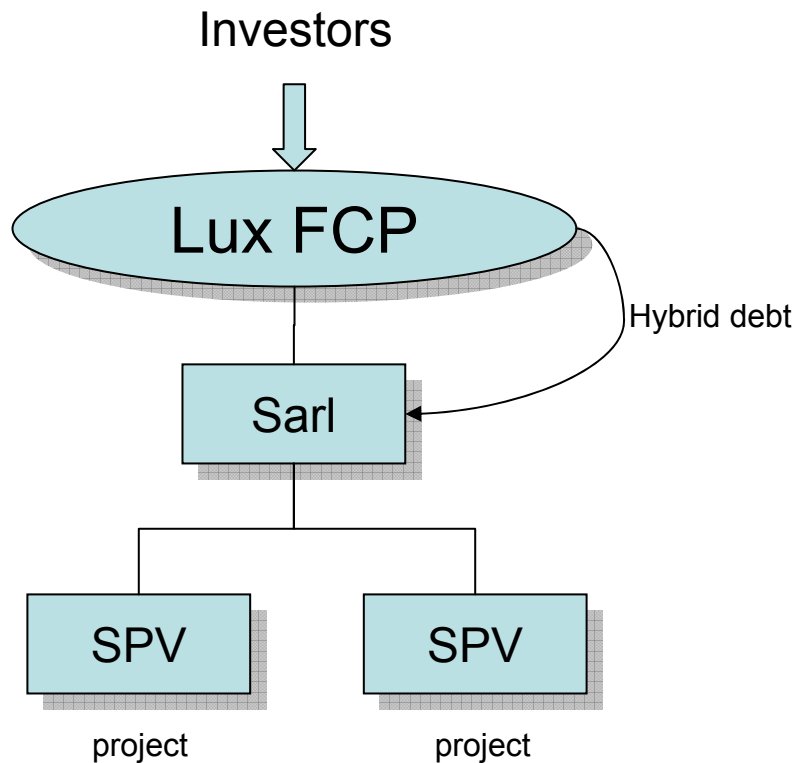
- Flexible and full participation exemption for dividends/capital gains
- Entitlement to EU Directives and tax treaties
- No source tax on dividends, interest and royalties
- No capital duty or stamp duty
- No thin cap. rules
- No CFC rules
- Ruling practice

Structuring into Europe (2)

Common holding countries:

- Luxembourg
- Malta
- Cyprus

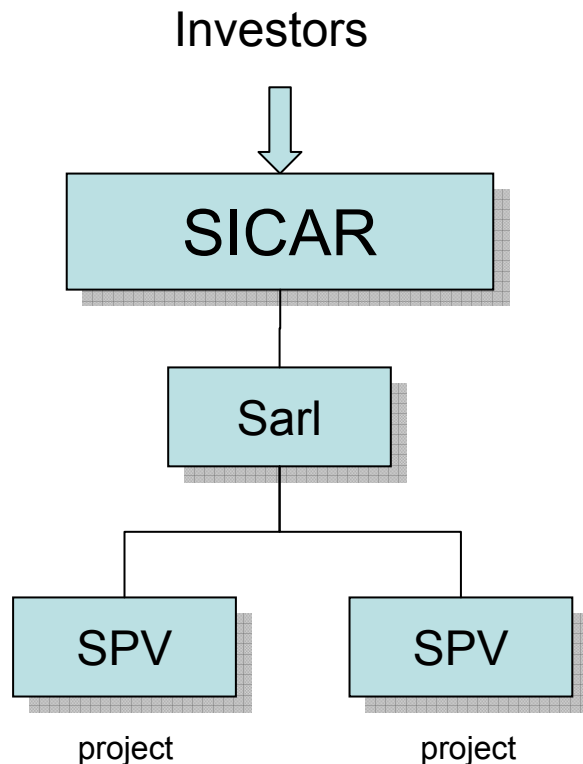
Funds (1) – FCP



- Both management of fund and legal ownership of assets with a management company
- Contractual arrangement
- Limited liability for unit holders
- No legal personality
- Several compartments possible (umbrella)
- Regulated

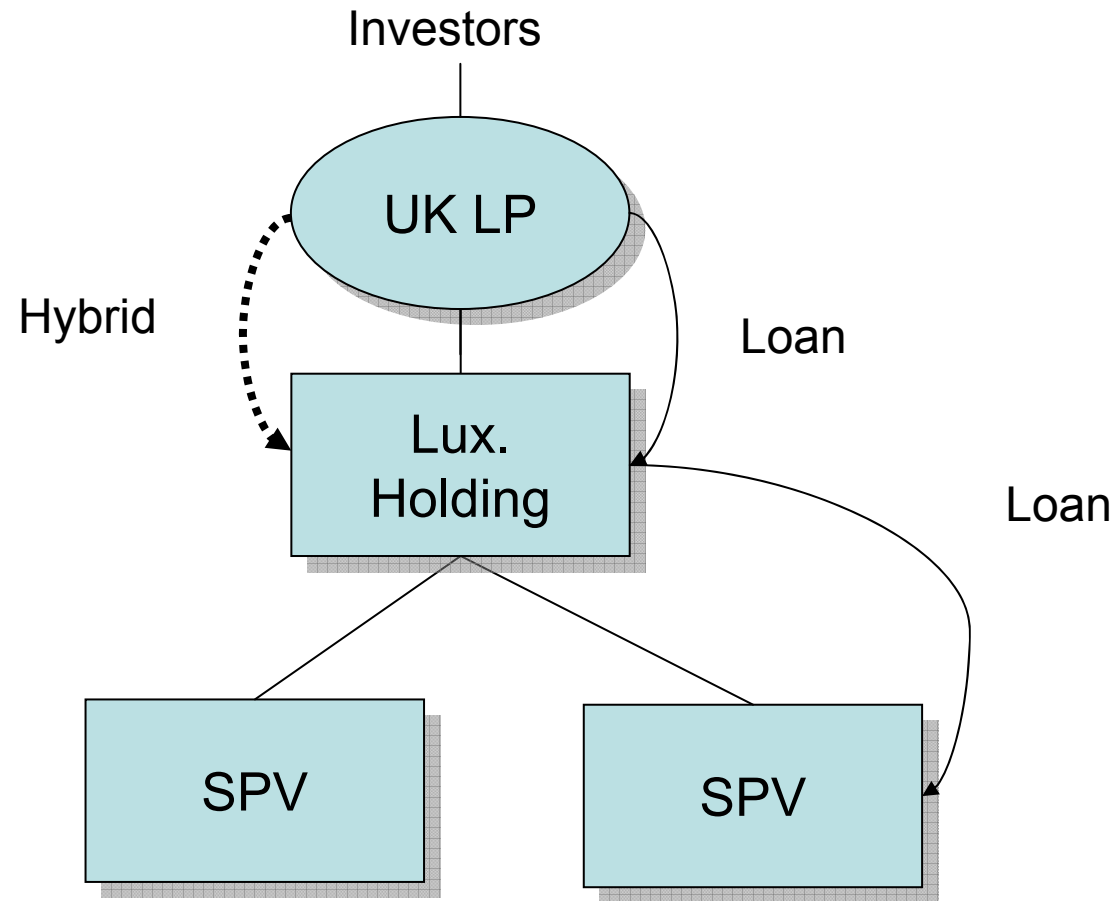
- Exempt from all Luxembourg taxes, except:
 - Annual levy of 0.05% or 0.01% over net asset value
 - € 1,250 capital duty upon set up

Funds (2) – SICAR

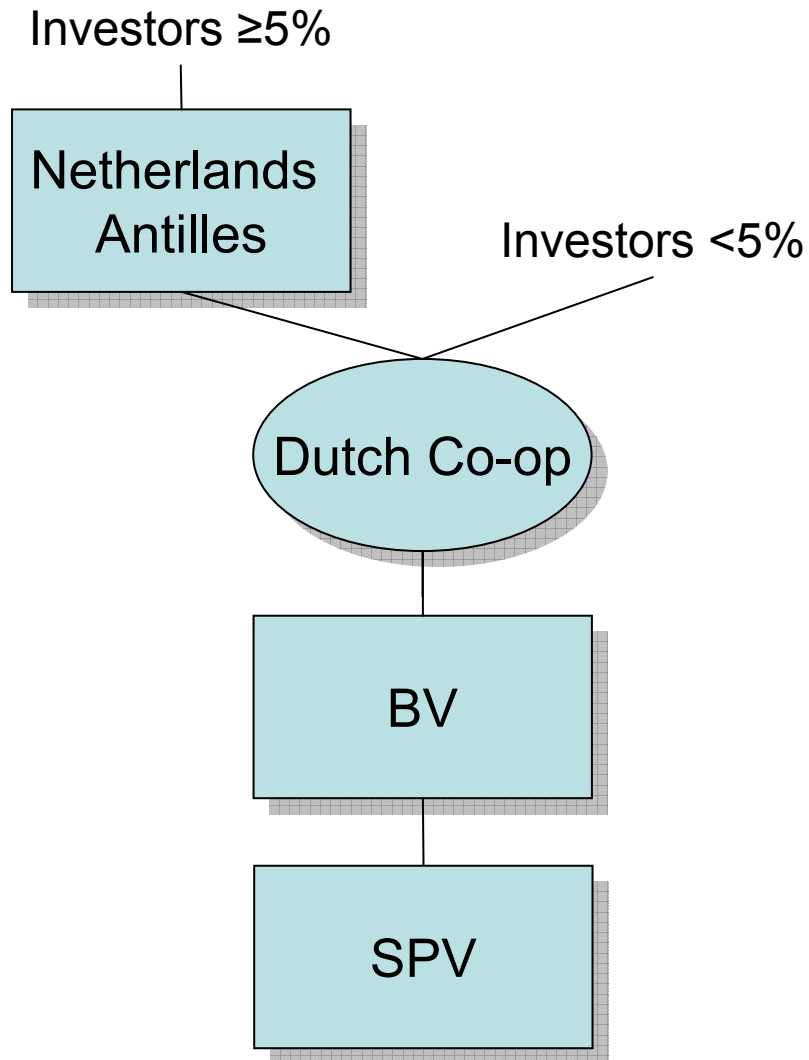


- Investment company in risk capital (SICAR)
- Intermediate between SICAV and normal limited liability company
- Lightly regulated
- Subject to corporate income tax, but: risk capital income is exempt
- Exempt from net wealth tax
- Exempt from dividend withholding tax
- € 1,250 capital duty on set up only
- No exit taxation for its investors

Funds (3) – partnership and Luxembourg holding



Funds (4) – Dutch Co-op



- No Dutch dividend WHT if Co-op has no capital divided by shares
- Netherlands Antilles to avoid Dutch CIT on substantial shareholding (dividends and capital gains)
- Fiscal unity possible between Co-op and BV
- Functional currency possible
- Participation exemption
- Large tax treaty network