



www.economic-substance.com/organise-substance.html

How can economic substance be organised?

Organising a sufficient level of substance for your international structure is extremely relevant. In this respect it could be stated that there are two levels of substance for you to consider. We refer to these different levels as objective economic substance and subjective economic substance. Below we address both.

Objective economic substance

With objective economic substance we refer to the level of economic activity and the actual set-up of the foreign corporate entity. Does the company have its own staff (one or more people) and equipment? Does it have its own office space and/or are business premises available? What is the turnover and how many costs are incurred locally? Are there actual activities and functions established locally and which decisions can local staff take independently?

There is not a set minimum level in this respect, but based on the latest international developments it is clear that you run a serious risk when you use individuals which are directors in dozens of other companies and when your office is located at the same address as a couple of hundred other “empty” conduit companies. As this is the standard set-up currently used by all trust companies that offer corporate services, you easily end up in this situation.

It is therefore clear that in case you want to minimise the risk of your carefully contemplated and well advised international tax optimisation structure being considered a sham, you should refrain from using a cheap trust service provider which only sets up an empty shell for you. This does not mean that you cannot use (some of) the services provided by trust companies, but you should carefully consider which services you need and correctly instruct the trust company on how to act and operate.

The extent to which substance needs to be organised in the jurisdiction of your foreign subsidiary depends on its actual function; however, an own ‘real’ office and one or more ‘real’ employee(s) are definitely not a luxury. Additionally, the staff in that jurisdiction should ‘at least’ have a basic level of own decision power. A good example of what you want to avoid is for example a set-up in which certain directors of the corporate structure in your home country (the parent company) are ‘by incident’ also directors in the foreign subsidiary. In that case tax authorities will easily take the position that all decisions are in practice taken in your home country and not in the foreign subsidiary, resulting in a lack of economic substance.

In the end you have to make sure that the foreign entity has (at least) such a set-up that you can ‘objectively’ defend that it is a company operating in reality.

Subjective economic substance

With subjective economic substance we refer to the specific activities of the foreign corporate entity in combination with the legal framework in the countries involved. Subjective economic substance depends on the specific situation of your company (are there holding, IP or finance activities etc.), the actual international corporate structure, the applicable anti-avoidance tax regulations in your home country, jurisprudence on this issue in the jurisdictions involved and the rules of the applicable treaty for the avoidance of double taxation. It could very well be that in your home jurisdiction the law describes clearly in which situation CFC rules apply, or, based on existing jurisprudence, it could be clear what level of substance needs to be present in the foreign jurisdiction in order to be considered sufficient. Additionally, limitation of benefits clauses incorporated in the applicable double taxation treaty could give a lot of clarity on the economic substance necessary. For an example in this respect, we refer you to the page 'Why is economic substance important'.

It is the tax authorities that judge on the structure in the end, basing themselves on a thorough analysis of the actual fiscal situation and the existing jurisprudence in both your home country and the foreign target jurisdiction; however, the necessary level of substance for the corporate structure could very well be determined before the actual structure is even established.

We look forward to [assisting you](#) in this process.