Thematic report on atypical entities and the personal scope of the corporate income tax ("CIT")

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Studying atypical entities, I found it difficult to talk about the personal scope of the CIT. Some entities raise the question of their status as an independent taxpayer. However this question should be kept separate, in my view, with that of the CIT's personal scope. First of all, this former issue is common to different taxes and is not specific to CIT. Secondly, this question has consequences that go beyond CIT, for example the application of tax treaties. These considerations do not constitute any impediments to the definition of the CIT's personal scope, namely that covering any entity considered as a separate taxpayer.

Other entities raise the question of which revenues should be subject to the CIT. This question made me wonder if the CIT should be seen as a tax on all revenues of specific entities (it has been indeed created, in many countries, as a specific tax for the corporations). But in such cases many – if not all –atypical entities actually taxed to CIT would not even fall within its personal scope. CIT can also be seen as a tax on certain types of revenues (from commercial or for-profit activities). In such case, subjecting certain entities to the CIT on the criterion of their form is only possible in light of the presumption according to which entities of a certain form always exercise commercial or for-profit activities. However this would mean that the CIT's personal scope should be opened up and cover any entity considered as a separate taxpayer. In this context, the CIT's material scope would acquire a greater importance with the definition of revenues that shall be taxed to the CIT.

I will now illustrate these ideas with my comparative study of atypical entities. I have divided this in two parts: first, the study of domestic atypical entities and second the study of foreign entities, most of which will be considered atypical. There are two reasons behind this division. The first reason is that in most countries foreign entities are treated in comparison with domestic entities. It seems therefore appropriate to study domestic entities first and then foreign ones. The second reason is that these two groups of entities raise different questions.

I/ Analysis of tax treatment of atypical domestic entities

The comparative study revealed that entities with a public (non-profit) goal raise different questions than entities with a private (for-profit) goal.

A. Entities with a goal of public (non-profit) interest

1. I have assembled in this group, maybe in a rather daring way, public entities and private non-profit entities. Indeed, the comparative study of different legislations revealed that these entities are treated in a very similar way and according to a similar logic, as it will be demonstrated below. Few differences that exist in their respective tax treatment do not seem to have a particular justification. This way of assembling entities according to their goal has the advantage of avoiding difficulties in determining entities considered as public or as charities in different legislations.

2. The first interesting observation about this group of entities is that it does not raise an issue about whom shall be taxed to the CIT. Their status as separate taxpayers seems to be assumed. I found two possible explanations for this: either one can consider that the legal personality usually recognised by civil or commercial or public law implies their status of a separate taxpayer. This explanation is however insufficient. Some entities of this group have no legal personality (that is often the case for public entities. For example in France, only financial independence is required for public entities to be considered as separate taxpayers) and many legislations do not grant a status of separate taxpayer to all legal persons. Therefore, it seems that the simple fact that these entities are

mentioned in legal provisions on CIT's scope implicitly grants them a status of legal taxpayer. A wide variety of entities thus become separate taxpayers without any explicit or even implicit criteria and without any discussion. It is an interesting observation, as we will see that for other entities there are many issues on the choice of criteria before a possible recognition of their status as taxpayer.

3. The real issue about this group of entities is all about what should be subject to the CIT and in particular what kind of revenues?

3.1. There are three possible criterion of selection of revenues subject to CIT .

- The broadest one will lead to tax revenues from **any for-profit activity** exercised by this type of entities (thus in Russia and in Greece private and public non-profit entities are exempt from CIT if they exercise no for-profit activity. In Portugal and Denmark similar rules exist for private non-profit entities).
    - Some countries (German legislation on private non-profit entities, Finland legislation on the business income tax) use the notion of "business activity" rather than for-profit ones. Both notions seem rather close, even though the notion of "business" activity makes more reference to a professional (regular) character of an activity than a "for-profit" one.

- The narrowest one consists in taxing only **revenues from commercial activities** (as in the Netherlands, where CIT is only due on – specifically defined - commercial activities of public bodies)

- An intermediate, rather sensible solution, consists in taxing only **revenues from activities exercised in competition with private entities** (as under German legislation on public entities. France being an interesting case where the official legislative criterion of CIT subjecting – for private as well as for public non profit entities – is the exercise of for-profit activity. The assessment of the for-profit nature of an activity is however focused on a possible competition with for-profit entities). This approach is based on the protection of competition and market rules (in accordance, in particular, with EU law on competition and on public aids) and seems to be a minimum rule which can be difficult to derogate from (even though Italy seems to exclude all public entities from CIT scope).
    - The notion of an activity "exercised in competition with private entities" raises some questions.
        - Is a non-profit entity promoting for-profit activities in competition with other for-profit entities? For example, in France, the activity of organisations who have a non profit goal for themselves but seek to promote the goods and services of their members, is subject to CIT. It seems in particular justified by the competition protection. Creating such entities would otherwise allow for-profit entities to develop a marketing and advertising activity tax-free. One can wonder if the same logic should not apply to public entities with similar activities, such as entities promoting trading in specific geographical or professional areas. However, in France, revenues of chambers of trade and industry from their activity of representing the interests of members of trading and industrial professions are not subject to CIT.
        - Does "in competition" mean that the activity shall be exercised in the same conditions for public and private entities? What about, for example, an association of scuba diving (whether it is a private association or an entity managed by a local authority) proposing its activities for prices, proportional to revenues of its clients? This would give a possibility to the less fortunate

members to practice these activities for a price significantly lower than that practised by its colleagues? (In France, the conditions in which an activity is exercised are taken into account. I could not find this information in other countries legislation)

3.2. The choice of criteria should be consistent with the general CIT logic, whether it is seen as a tax on revenues from commercial, economic or any for-profit (business?) activity. One should then bear in mind that these activities can be defined differently in different legislations and even for different purposes of the same legislation. Thus in France, commercial activities are defined differently in civil and in tax legislations. In a similar way, the notion of for-profit activities has no legal definition but several judicial definitions, depending on the legal and tax context this notion is used in. Only the definition of economic activity can be rather harmonized between legislations of EU members, through definitions given in the VAT directives.

3.3. In many countries (France, Austria, Greece, Norway) one of the above-mentioned main criteria of CIT subjecting is supplemented by additional provisions subjecting to CIT any investment revenues, sometimes only from financial investments, sometimes from any kind of investment made by non-profit entities. French legislation offers an example of a difference in treatment of public and private non-profit entities, which seems unjustified. Indeed I could see no reason why private non-profit entities are taxed only on revenues from their financial investment, whereas public non-profit entities are taxed on all kind of estate revenues.

4. There are however few differences between private and public non-profit entities that take into account differences in the organisation of these entities and thus are justified. Both differences concern the use of a possible profit made by this type of entities. In this regard private for-profit entities are subject to additional conditions in order to be exempt from CIT. First condition is the prohibition of any gain for the management of the entity. Second condition can be a form of thresholds for the entity's profits. These additional conditions are simply not relevant for public entities.

- Thus in Portugal, for the CIT exemption, 50% of any taxable income shall be used for the statutory purpose activity where there shall be no gain for the entity's managers.
- In France a “disinterested management” requirement is a necessary precondition for the CIT exemption. Once this condition is satisfied, entities whose principal activity is the non-profit one are exempt from CIT, as long as their profits from incidental for-profit activities do not exceed 60.000 euros per year.
- In Netherlands, entities that are not authorised, by law, to distribute its profits to its members or other parties are exempt from CIT if their profits do not exceed 15.000 or 75.000 euros per year
- in Poland, the exemption of public benefit organizations is subject to the use of all income earned only for the statutory's activity objectives.

5. My final remark will be about legal techniques used to define the CIT application to this group of entities. The comparative study of these techniques reveal the confusion about the two main issues : that of a status of taxpayer and that of revenues falling within the CIT scope (not really personal, but rather material scope). Thus, in many countries, a legislator can make all or a part of non-profit entities (in most cases through a list of entities subject to CIT) fall within the scope of the CIT and then exempt the ones that do not exercise any commercial or for-profit activities. It is however difficult to see on what ground or according to what criterion these entities fall within the scope of what is supposed to be a tax on corporations or at least on business entities? Even though this technique of exemptions – particularly when they are granted by a decision of a relevant authority, as it is the case for charitable organisations in Portugal and in Poland – gives a better way for the Government to control revenues that would escape CIT.

B. Entities with a goal of private (for-profit) interest

In most countries most for-profit private entities are subject to CIT, as long as they can be considered as a separate taxpayer. I found no issues on the selection of taxable revenues, but different issues on granting the status of a separate taxpayer. This observation makes me think that in most countries the material scope of the CIT covers any for-profit activities.

To sum up, I found three main groups of atypical private for-profit entities, one of which is that of entities used for investment purposes and is treated in my colleague's topic. I shall thus concentrate my analysis on entities that are atypical in their activities and/or their organisation (1) and atypical entities used for the estate management purposes (2).

1. Entities atypical regarding conditions of exercise of their activities and/or their organisation

6. I included in this group entities such as cooperatives, mutual banks and insurances, housing associations, funds for mutual accounts. Some of these entities can take any form available under local civil or commercial law (as it is the case for cooperatives in France). Others will take a specific form, but their main difference comparing with other private for-profit entities resides in the conditions of exercise of their activities. Whatever the form of these entities, they do not seem to raise any issue about their status as a separate taxpayer (which seems to be once again implicitly granted by the legislator mentioning them in provisions on CIT) or about their revenues that are taxed to the CIT (even though they can be covered by some exemptions).

7. National reports revealed some other specific cases, like the ones on entities whose members exercise liberal professional activities. The interesting thing about these cases is that the liberal nature of its activities has no impact on their taxation. On the contrary it can have an impact on their status as independent taxpayers, as it will be illustrated by two following examples.

- in France, companies exercising a liberal professional activity (lawyers) through their shareholders can take any legal corporate form and will be subject to CIT according to rules applicable to the chosen form of companies. Therefore, it looks as though under French legislation, the status of taxpayer depends only on the form of the entity and not on its activity or conditions in which it is exercised.
- However in Austria if a company (with a legal form usually subject to CIT) is controlled only by 1 person, it has no personnel and its activity consists of rendering services usually rendered by individuals (artistic scientific, lecturers etc), it will be subject to tax transparency. In Austria, it seems that a status of independent taxpayer depends not only on the form of the entity but also on its activity and conditions in which it is exercised. It does also look as a measure aimed to prevent natural persons from benefiting from CIT's more favourable taxation. However, one can wonder if the simple fact for a natural person of creating a separate taxpayer can be viewed as tax evasion. For me, it is another illustration of the confusion between the status of a separate taxpayer and the personal scope of different taxes.

2. Entities used for the private estate management

8. I included in this group entities such as trust (UK, US), fiducies (France), asset pool (Luxembourg) and the estate of the deceased (Austria, Norway). Distinctive features of all these entities are, firstly, the absence of legal personality (that does constitute an impediment to the CIT taxation in certain countries) and secondly, the difficult identification of the owner or of any person exercising all the owner's usual powers. One can deduce from these features that the main difficulty about these entities is to determine who should be taxed.

9. Sometimes, the legislator overcomes difficulties due to the absence of legal personality and treats these entities as separate taxpayers for, mainly, practical reasons. National reports of these countries mention that it is impossible from a legal or purely practical point of view to tax anyone else on these entities' revenues:

- examples of practical difficulties :
    - tax treatment of trusts under Italian legislation : in Italy, trusts are tax transparent and their revenues are taxed once in the hands of its beneficiaries if the latter can be identified. If this cannot be done, the trust would be considered as a separate tax entity.
    - Tax treatment of death estates: death estates are usually not treated as separate taxpayers, as their beneficiaries are usually easy to identify. Thus, in Sweden, the estate of a deceased person has legal personality under civil law, but is not recognised as a separate taxpayer under tax law. However, specific situations can create difficulties in identifying beneficiaries of these estates. These latter will then become separate taxpayers.
        - Thus in Finland, foreign death estates are considered as separate taxpayers. One can presume that the justification of this specific treatment can be at least partly explained by a more jeopardized identification of its beneficiaries.
        - In a similar way, in the absence of heirs, a deceased estate becomes taxable entity under Austrian law, even though under the tax legislation of this country a legal personality is a precondition to the CIT liability.
        - In Norway, deceased's, bankruptcy and administration estates are considered as separate tax entities until distribution. They are however usually exempt from CIT.
- Examples of legal difficulties concern legal forms of collection of assets, whose legal owner can be difficult to identify. Thus, in Luxembourg, ring-fenced asset pools are taxed as separate tax entities, even though they have no LP under civil law. The reason for this is due to legal difficulties to identify the owner of its revenues.

10. Sometimes, the legislator will favour a similar tax treatment for similar situations, where the creation of a specific entity is simply a mode of organization of one's estate management. Thus in Anglo-Saxon countries, trusts are considered as tax transparent entities as it is also the case for French fiducies. The choice of the taxpayer behind these entities can be explained as follows[1] :

- legal characteristics of the entity: when the settlor keeps some form of control over these structures, its revenues are taxed in his hands, as it is the case for Anglo-Saxon revocable trusts or for the French fiducie
- practical reasons: the trustee can be taxed if the settlor has no more power over the trust and its beneficiaries are unknown
- anti-avoidance rules: in UK, a trustee is taxed first and then beneficiaries have a tax credit for the amount already paid by the trustee. Such a taxation counter a possible temptation for the trust to accumulate revenues and not distribute them to avoid taxation.

Another example is the one of the French limited-liability individual entrepreneur (“EIRL”) gives a possibility to a natural person to separate his personal and professional estate and to limit his professional liability to the latter without creating a separate legal person. These entities without legal personality are normally tax transparent. However, as the natural person here is in a situation similar to a one-person limited liability company, he can opt for a similar tax treatment, including being subject to CIT.

1 See on a comparative study of taxation of trusts V. Thuronyi, Comparative Tax Law, Kluwer Law International, 2003, p. 286 and following.

II/ Analysis of tax treatment of foreign entities

11. Foreign entities are all – or certainly most of them – atypical from the domestic point of view. Even companies with similar names can have very different characteristics under different legislations. Such entities give rise to two separate questions : first about their status of independent taxpayer (who shall be taxed?) and second about the nature of their activity (what shall be taxed?). These questions are however often treated in a confused way and the choice of legal techniques does also give rise to some difficulties.

12. Most countries use the resemblance test to compare the foreign entity to the domestic ones. Once a comparison is established, tax treatment of the selected domestic entity is applied to the foreign one. This technique generates three major difficulties: the one about the foundation of the foreign entity's taxation, the one about legal certainty and the one about the equal treatment of domestic and foreign entities.

12.1. Indeed, most Constitutions in Europe and all over the world, establish a principle of legality, according to which tax must be imposed by law[2]. However, in some countries, the tax treatment of foreign entities is not regulated by law at all (France) and the choice of the resemblance test technique is the one made by judges. But even in countries, where the resemblance test is recommended by law, if this law does not establish specific criteria of comparison, the foreign entity's taxation will still lack a clear legal foundation.

12.2. Furthermore, this – very common – lack of clearly established criteria for comparison (exceptions exist. In Austria for example criterion for comparison are provided by law) leads to legal uncertainty, contrary to case-law of national constitutional courts and CJEU. A foreign entity has no mean to know what will be its tax treatment prior to the judge's decision.

12.3. A last possible problem is the one on the equal treatment of national and foreign entities regarding non-discrimination articles of tax treaties and non-discrimination provisions of the European treaties. Indeed, the lack of criteria of comparison can lead to a different treatment of similar entities. Thus in France, under the article 206 of the GTC, a public limited corporation, with limited liability members, exercising a civil non commercial activity is subject to CIT. Whereas under French case-law, a foreign public limited corporation, with limited liability members, exercising a civil non commercial activity is not subject to CIT[3]. This example actually illustrates a double difficulty of the resemblance test : first, to determine what are the domestic legal criteria for the CIT's personal scope. Indeed these criteria can be implied in a provision establishing a list of entities and do not appear expressly in national legislation. In my French example judges considered that the legal domestic criterion was that of the commercial activity, whereas in reality it was the criterion of limited liability. The second difficulty is that of eventually determining a hierarchy between different criteria. This difficulty is linked with the confusion between the status of taxpayer and CIT personal and material scope. Indeed, one shall take into account personal characteristics of an entity (such as its legal personality or the limited liability of its members) to know if it can be considered as a separate taxpayer. But one shall also consider the nature of its activity (for-profit or not, commercial or not) to know if it does fall within the CIT scope. If both questions are not clearly distinguished, they can lead to a conflict between personal characteristics of an entity and the nature of its activity. These conflicts are another potential source of discrimination between national and foreign entities.

Furthermore, as it has been underlined by Professor Van Raad, in his 1988 general report for the IFA congress on recognition of foreign enterprises as taxable entities, domestic entities do have a

2 French Constitution, art. 34, Belgium Constitution, art. 170; Italian Constitution, art. 23.

3 Council of State, 24 May 2006, n°278737, Société immobilière Saint-Charles.

choice between tax transparent and tax opaque forms. Foreign entities do not have such a choice, particularly regarding the above-mentioned problem of legal uncertainty. According to Professor Van Raad this difference does not seem to constitute a form of differential treatment to which the tax treaty non-discrimination clause could apply, but should nevertheless be taken into account. This observation of Pr. Van Raad is even more true today, for some legal systems, as the French one, where most national entities, once they have chosen their legal form, have a separate tax choice between transparency and independent taxpayer status. Foreign entities do not, even if they are similar to French entities for whom such choice is available.

13. To avoid these difficulties Pr. Van Raad recommends granting – at least to some extent – a right to choose their tax regime to foreign entities, as it is already the case in the US. However, no European country – to our knowledge – has yet accepted such a possibility.

14. Another possible legal technique is that of the reference to foreign law, even though it only answers the question about the status of independent taxpayer, but not that about the nature of activity and its subjecting to CIT. The reference to foreign law can be made in order to know if according to the national law of the entity it is considered as tax transparent or not. The major problem with such use of foreign law is the differential treatment it creates between domestic and foreign entities, as it has already been underlined by Pr. Van Raad in his 1988 report. Foreign law can also be used to determine if the main domestic criterion of the status of independent taxpayer (a legal personality, for example) is satisfied under the national law of the entity. Two problems can then arise: first, the access to foreign law is rather difficult. If the domestic criteria of the status of independent taxpayer are more sophisticated than simply a legal personality, they can be rather difficult to verify under foreign law. Second problem is a traditional problem for international law : the domestic criterion of the status of independent taxpayer can have completely different goals under foreign law. As underlined by Pr. Van Raad, the choice of whether an entity has a legal personality and what is the extent of the liability of its members can be based on different material aspects under the national law of the entity.

15. The last possible technique consists in specific legal provisions on the tax treatment of foreign entities. This technique can be particularly interesting with a view to harmonize the CIT personal scope at a European level. Thus can be avoided any problem of differential treatment within, at least, the European Union. This technique does respect a principle of legality and thus avoids any criticism about the lack of legal foundation of the taxation of foreign entities. It would be particularly appropriate to fix criteria for the status of independent taxpayer and, on the other hand, the criterion of the nature of activity falling within CIT scope.

This technique, in its simplest form is already used in some countries, when considering that any foreign entity with a legal personality falls within the CIT scope, as it is the case in Greece or in Germany. In a similar way, all foreign entities exercising an activity in Russia shall register. In this procedure they acquire a legal personality under Russian law and thus become separate taxpayers.

However such provisions do not deal with the question of the nature of activity and a non-profit foreign association can fall within the scope of the CIT only because it has a legal personality. Thus in Greece, foreign non-profit entities – whether private or public) are subject to CIT as long as they have a legal personality. In a similar way, in Russia, exemption for non-profit entities does not apply to foreign non-profit entities. In Germany only non-profit entities established in EU or EEA, or in countries who have signed a Tax treaty covering non-profit entities can be covered by CIT exemptions.

Conclusion. The comparative study of atypical entities enriches our understanding of the following three questions: the one of the status of independent taxpayer (question concerning not only CIT, but many other areas of taxation), the one of the personal scope of the CIT (should all independent taxpayers fall within the CIT personal scope? Or should it be a tax for corporations only?) and the one of the nature of revenues that should be subject to CIT. In the light of these three questions, one can understand that the treatment of atypical entities depends very much on the general logics of the CIT chosen by national legislations. The more this general logic will be clear and consistent, the easier the choices about the tax treatment of atypical entities.