Report "Non-resident entities and CIT"

Professor Stefan Olsson

Countries	**Resemblance test?**	**Place of management?**	**Opt in?**	**CTA?**	**Diversity?**
Austria	Yes	No	No	Yes	No
Belgium	-	-	-	-	
Denmark	Yes	-	-	Yes	Yes?
Finland	Yes	No	No	Yes	No
France	Kolla	?	Yes	No	Yes
Germany	Yes	?	?	Yes	Yes
Greece	No	No?	No	No	No
Hungary	No	Yes	?	Yes	Yes?
Italy	No	Yes	Yes	No	Yes
Luxembourg	Yes	No	No	No	Yes
Netherlands	Yes	No	No	Yes	Yes?
Norway	Yes	?	?	No	No
Poland	No	?	No	Yes	?
Portugal	No	Yes	No	Yes	Yes?
Russia	No	?	?	No	Yes?
Spain	Yes	?	No	Yes	Yes?
Sweden	Yes	No	No	No	No
Switzerland	Yes	Yes	No	Yes	?
Turkey	Yes	No?	No	Yes	Yes?
UK	-	-	-	-	-
US	Yes?	No?	Yes	No	Yes!

Questions:

Whether a non-resident entity is subject to CIT is a matter solved in very different ways by domestic legislations: while some adopt a mutual recognition method, others implement a resemblance test with domestic entities or other kinds of tests. A survey of comparative law in this respect should point out the main differences between tax systems. It should also try to answer the question whether some systems are "more" or "less" compatible with EU freedoms.

1. Unlimited or limited tax liability?

Although it is described in different ways in some of the national reports, it is quite obvious that all states make a division between the notions of unlimited or limited tax liability. These notions are depending on different main principles of international taxation. That a natural person or a legal entity should be regarded as liable to pay tax for all income, regardless in what country it has occurred, in the country of residence is of course an example of application of the principle of residence. On the other hand, the taxation of a foreign legal entity only for income that derives from the country where the permanent establishment is seated or where the entity owns real estate is an example of application of the principle of source. It must however be remembered that the division between unlimited or unlimited tax liability is in fact a question of defining the tax base in the specific country and not so much a matter of defining the subjects liable to pay tax.

2. Domestic legal entity?

The point of departure in all countries is that domestic companies are unlimited liable for company income tax. In general, a company is considered to be domestic if it is established and registered under nation law. Some countries complete this rule with also mentioning companies being under registration or companies that for another reason should be regarded as legal entities in the country. This is the case for example in Poland and Sweden. Since the principle of residence regarding legal entities in general is depending on the nationality of the entity, it might also be appropriate to see the rule of unlimited tax liability for legal entities also as an example of the principle of nationality. This stands in contrast to the treatment of natural persons, where the principle of residence normally is applicable regardless of nationality. It should however be noticed that some of the examined countries also apply the principle from international tax law regarding the place of management for a legal entity.[1] This is the case regarding at least Germany, Hungary, Italy and Switzerland. Since this principle normally is applicable due to the double taxation treaties, the difference between countries which have implemented the principle in national legislation and those who have not implemented the principle will probably not be of great importance.

3. Foreign legal entity?

Regarding foreign legal entities, subject to company income taxes, two main approaches can be seen. One is that foreign civil law is overlooked and that only entities that bear a resemblance to domestic entities are considered to be foreign legal entities. This approach leads to the conclusion that some kind of resemblance test is necessary in order to determine which foreign entities that could be regarded as foreign legal entities. The other approach is that all foreign entities also are considered to be legal entities and such as treated according to domestic tax law.

There could be various reasons why a country has chosen the first or the latter legislative solution. At first, the company law background differs between the examined countries. A

[1] OECD art. 4.3.

group of "minimalist" countries could be identified, in which the company law only admits the establishment of limited companies, usually separated into smaller "private" companies and larger "public" companies, partnerships and limited partnerships.[2] This "minimalistic" approach could be found for example in Finland, Norway and Sweden. On the other hand, Germany is the typical example of a country, where the civil law offers a broad variety of different types of companies for business purposes. Nowadays also France and Italy could be included in this category. However, several countries could be classified as "in between", since their civil law, a part from the above mentioned entities in the "minimalistic" approach also covers limited partnerships with shares. This seems to be the case regarding for example Denmark, Hungary, the Netherlands, Portugal, Russia and Spain.

A suggestion would be that a country with a more "complicated" company law would need a resemblance test in order to establish which kind of domestic entity a foreign entity resembles. This is obvious not the case, since for example Germany is relaying on a resemblance test, while Italy is not. Also countries like Finland, Norway and Sweden, who has "uncomplicated" company law systems uses resemblance tests.

Another reason for a country to practice a resemblance test is that there is an important difference between the treatment of foreign companies and of other foreign legal entities than foreign companies. Other foreign legal entities might be for example partnerships or limited partnerships. Partnerships are considered to be legal entities in some countries, for example Sweden, or lack legal personality in for example Germany. Nevertheless, they are usually regarded as transparent for taxation purposes. The division between foreign companies and other foreign legal entities seems to be of importance regarding the taxation of Controlled Foreign Companies. This appears to be the case at least in France, Hungary and Sweden. However, the transparent taxation of CFC is mainly a different question compared to the question of foreign companies being subjects to domestic CIT. CFC's do normally conduct their activities in low tax regimes and the issue in for example an European country is instead how to tax an owner of the CFC living in the country. This issue is not in focus in the questionnaire, but may be an answer to way some countries has chosen the resemblance model. Countries were CFC's are defined in by a different method might have easier to equal other non-CFC foreign partnerships and limited partnerships to domestic limited companies.

As far as can be seen, the issue of EU freedoms has only been discussed in this context in Germany. The implementation of the Parent Subsidiary Directive has only been seen as a problem in few of the reporting countries. Some of the reports are from non EU-members. As far as can be seen from the reports, it is mainly in Luxembourg and Portugal where problems have been reported. In Luxembourg, it concerns the treatment of a Belgian SICAV as a foreign company according to the directive.[3] The Portuguese discussion has been if corporations located in the Madeira International Business Center would be subject to the directive.

[2] I am in this respect overlooking other forms of legal entities as savings banks, mutual insurance companies and cooperatives, which usually are liable for CIT in all countries.

[3] SICAV stands for Société d'Investissement à Capital Variable.

4. Conclusions

The taxation of foreign companies seems to be similar in the reporting countries. A foreign company is normally regarded as subject to limited tax liability, based on the principle of taxation of the source. The difference lays instead in how to define a foreign company.

Based on the reports, it is difficult to see a pattern that can explain why some countries has chosen a resemblance test between foreign and domestic entities and why other countries has chosen to equal all foreign entities as companies liable to company tax. It has been suggested that there might be explanations that are not visible in the reports, for example the definitions of Controlled Foreign Companies.