

Edited by Daniel Gutmann

CORPORATE INCOME TAX SUBJECTS

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Corporate Income Tax Subjects

Why this book?

Tax harmonization or coordination of corporate taxation in the European Union is usually considered from two complementary points of view: tax base and tax rate. These two perspectives structure the debate on whether EU Member States, and more broadly states belonging to the same economic area, should harmonize or coordinate their policies on tax matters.

However, little attention has been paid so far to a more basic question which is at the core of tax theory: who are corporate taxpayers? Are they defined in the same way throughout Europe?

Comparative law shows that the conditions that must be met in order to be subject to corporate income tax are very different from one country to another. The way tax systems define foreign entities that fall under their corporate income tax may also vary significantly, which may in practice give rise to interesting tax planning opportunities.

Against this background, the 2013 EATLP Congress devoted to corporate income tax subjects was designed to enhance the main similarities and differences that exist between many countries (European countries and the United States). It is the first time that such joint research has been conducted on an international scale on this fundamental topic and it has given rise to an ambitious publication.

This book therefore provides a basis for tax policy decisions at a national and European level. It also constitutes a starting point for academic reflection on a core issue affecting the structure of corporate income taxation.

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General Report

Daniel Gutmann

1.1. Introduction

In terms of tax policy, tax harmonization or coordination of corporate taxation in the European Union is usually considered from two complementary points of view: tax base and tax rate. These two perspectives structure the debate on whether EU Member States, and more broadly states belonging to the same economic area, should harmonize or coordinate their policies on tax matters.

However, little attention has been paid so far to a more basic question which is at the core of tax theory: who are corporate taxpayers? Are they defined in the same way throughout Europe?

This may be explained by the fact that the vast majority of tax systems accept the same fundamental idea: while companies limited by shares and limited liability companies should be subject to corporate income tax (CIT), partnerships should be considered fully or partly transparent for tax purposes.

This general statement is nevertheless an oversimplification of reality. Comparative law indeed shows that the conditions which must be met in order to be subject to CIT are very different from one country to another. The way tax systems define foreign entities which fall under their CIT may also vary in a significant way, which may in practice give rise to interesting tax planning opportunities.

Against this background, the 2013 EATLP Congress devoted to CIT subjects was designed to highlight the main similarities and differences which exist between many countries (European countries and the United States). To the best of my knowledge, it is the first time that such joint research has been conducted on this fundamental topic.

The outcome of this collective research is very interesting in many respects, all of which cannot be tackled in this brief general report. I would however

like to thank all the national and thematic reporters whose accurate and insightful reflections have truly helped us to reach a better understanding of the historical background to and the current state of the law in many different countries.

That said, it seems that the comparative research underlying the question “why do some entities fall within the scope of CIT whereas others do not?” leads to mixed results both in terms of tax theory and in terms of tax policy. While no general theory seems to explain why and to what extent some entities are actually subject to CIT, little justification exists for an ambitious process of harmonization at a European level in this field.

1.2. Tax theory

Those who believe in the existence of a rational explanation for the personal scope of corporate income tax should not read the output of this conference. Comparative law indeed shows that it is extremely difficult, if not impossible, to build a systematic theory in this respect. The criteria for CIT liability differ from one country to another; even within one legal system, several criteria may coexist and not be consistent with each other; finally, structural reasons may explain why theory cannot account for positive law in this field.

1.2.1. Diversity of criteria of CIT liability

National and thematic reports display a wide variety of criteria for CIT liability.¹ These criteria fall under two basic categories: abstract criteria (which are drawn from general legal principles or concepts) and concrete criteria (which rely on individual characteristics of entities).

Abstract criteria seem to be far more important than concrete ones. In several countries, legal personality is presented as a condition of CIT liability.² In other countries (which are less numerous), limited liability is considered to

1. Please *see* national reports in this book for accurate information on each legal system examined. Please note that in order to avoid overlap with the thematic reports, this general report does not always refer to individual national reports when it deals with topics already tackled by thematic reports. Neither does this general report quote exhaustive lists of countries as examples of the statements which it contains.

2. For details, *see* the thematic report written by D. J. Jiménez-Valladolid de l'Hotellerie-Fallois and F. A. Vega Borrego.

be the prevailing criterion.³ Sometimes also (albeit very rarely) the dividing line between CIT subjects and other entities builds upon existing distinctions of company law,⁴ such as the distinction between capital companies and partnerships.

Concrete criteria stem from a more fact-sensitive approach. The Luxembourg report provides an example of a system where the guiding criterion for determining CIT liability relies on the entrepreneurial risk of the partner combined with the collegial running of the undertaking. This combination may rely on abstract distinctions imported from company law but it also serves as an *in-concreto* tool to recharacterize entities whose legal form would normally exclude them from its scope. It is therefore interesting to see how the actual features of the entity's organization may impact its tax status.

Another example of a concrete criterion may be found in the French legislation where the nature of the activity performed by the entity is closely connected to the CIT liability. A civil partnership which should normally be subject to personal income tax becomes a CIT subject if it performs a commercial activity. Non-resident companies may also be subject to CIT where they perform a for-profit activity.⁵

Lastly, it is worth noting that a limited number of countries give some leeway to taxpayers by offering them a choice between CIT and personal income tax under generally narrow conditions. This is the case for domestic entities⁶ as well as for non-resident entities in very limited cases.⁷ Individual will therefore becomes a material criterion for determining CIT liability – which does not go without saying from the constitutional perspective of the ability-to-pay principle.

At first glance, it therefore appears that many different criteria exist in comparative law for determining CIT liability. This is a major hurdle for the building of a general theory ... but it is certainly less important than the obstacle which the internal inconsistency of most tax systems presents.

3. For details, *see* the thematic report written by D. J. Jiménez-Valladolid de l'Hotellerie-Fallois and F. A. Vega Borrego.

4. *See* for instance the Greek national report.

5. *See also* case law in the national report on Spain.

6. *See* the French national report. *See also* the Belgian national report which describes such a system which is however no longer in force.

7. *See* for instance the check-the-box rules in the United States.

1.2.2. Relativity of criteria of CIT liability

It is striking to note that domestic tax systems almost never rely on a single criterion of CIT liability for domestic entities. In systems where legal personality is the prevailing driver for CIT liability, some entities deprived of legal personality are nevertheless obliged to pay CIT.⁸ Even pools of assets can be recognized as CIT “subjects” for practical reasons relating mainly to the need to prevent tax avoidance.⁹ The same kind of observation can be made for other systems which favour other abstract or concrete criteria in principle. This conclusion, drawn from comparative research, teaches that CIT liability is certainly not connected to one general criterion but rather to several criteria which coexist in domestic law in order to reach the different kinds of entities which the legislator has decided to include in the scope of CIT for budgetary and economic purposes.

Whether the addition of unrelated criteria relating to CIT liability should be considered as a sign of inconsistency of tax systems is a matter for discussion. The fact remains that this juxtaposition of criteria makes it nearly impossible to identify a theoretical rationale for most domestic systems.

The same may be said about the criteria for determining CIT liability of non-resident entities. Here again, comparative law shows a great diversity of criteria but also and more importantly, a possibly different approach regarding the criteria for CIT liability within the same tax system, depending on whether the entity in question is a resident or a non-resident one.¹⁰ Horizontal comparison of tax systems moreover shows that systems which are greatly comparable when it comes to defining CIT liability for domestic entities (relying for instance on legal personality) may diverge significantly when it comes to defining the CIT liability of non-resident entities: while some systems extend the domestic criterion to cross-border situations, others prefer a “resemblance test” which departs from the domestic criterion¹¹ (although some discussion remains open as to whether the adoption of a resemblance test is or is not a way to extend the domestic approach in a cross-border

8. See for instance the Dutch national report.

9. See for instance the Portuguese, Swedish and Norwegian national reports.

10. See for instance the French and Greek national reports.

11. For instance, the German and Polish systems consider legal personality as the key condition for CIT liability of domestic entities. However, while Poland extends this criterion to foreign entities, Germany rather relies on a resemblance test. For a synthesis of legislations on this matter, see Stefan Olsson’s thematic report.

situation). Whether this difference is legitimate from an EU point of view is an interesting question which is tackled in several reports.¹²

1.2.3. Structural limits to general theory

This great diversity and inconsistency of domestic systems is certainly not surprising. Economic actors perform their activities through many different legal forms: traditional forms prescribed in company law, non-profit entities such as associations, charities or foundations, investment structures etc. This diversity of legal forms mirrors the variety of needs and goals which are intrinsically connected to the complexity of contemporary societies.¹³

Moreover, the personal scope of CIT is closely dependent upon domestic policy considerations, some of which are of a budgetary nature. Not only does the legislator wish to include as many entities as possible in the scope of CIT in order to make sure that every economic actor contributes its share to the global tax burden, it also pursues specific anti-avoidance goals. Several reports illustrate that general rules regarding CIT liability may actually be inspired by the need to fight tax planning schemes: in some countries, CIT is more advantageous for taxpayers than personal income tax, which explains why partnerships, albeit outside the scope of CIT, are nevertheless subject to a level of taxation which mirrors CIT, or why some companies which would normally be subject to CIT are subject to personal income tax to prevent tax planning behaviour (in order to avoid shelter companies, closely held passive companies, transformation of labour income into corporate income etc.);¹⁴ conversely, several countries wish to prevent abuse of facilities offered by personal income tax (in particular by way of loss imputation) and have designed or drafted CIT liability rules to prevent this from occurring.¹⁵

Other aspects relating to policy considerations may be illustrated by the existence of regimes providing exceptions to CIT liability as a way to offer tax facilities to specific taxpayers: in some countries, family units may either opt out of CIT or be excluded from its scope;¹⁶ start-up companies

12. See the German national report as well as Bart Peeter's thematic report on the classification of foreign entities for CIT purposes and Ruben Martini and Ekkehart Reimer's report on CIT subjects and EU harmonization.

13. See in this respect Hein Vermeulen's thematic report on investment structures and P. Kouraleva-Cazals' thematic report on atypical entities and the personal scope of CIT.

14. See for instance the Danish, Portuguese and Belgian national reports.

15. See for instance the Polish national report.

16. See the French and Portuguese national reports.

may enjoy a personal income tax treatment for a limited duration,¹⁷ small and medium-sized companies are subject to special carve-out measures¹⁸ etc. Needless to say, when anti-avoidance or expediency considerations impact the design of general rules of CIT liability, pure theory becomes even more complex.

Against this background, the easiest way to define the scope of CIT is certainly to give up the ideal of an overarching theory of CIT liability and to establish lists of CIT subjects. In most countries, legal drafting techniques are therefore analogous: the scope of CIT is not defined by way of general principles, but rather by way of enumeration of specific types of entities. Whenever a general principle does exist (such as “persons enjoying legal personality are subject to CIT”), it frequently appears as one of the items in the list of entities falling within the scope of CIT and serves as a tool to close potential tax gaps rather than as a principle statement intended to reflect the real nature of CIT subjects. Consequently, the natural inclination of academics to build theory on the basis of positive law should be analysed as an ex post rationalization of reality but in most cases does not reflect an intentional will of the legislator to derive the scope of CIT from general principles.

This somewhat pessimistic theoretical conclusion should not hide the important fact that comparable economic entities are generally subject to comparable kinds of taxes within Europe and the United States. However, as comparative law often shows, comparable results may rely on very different theoretical grounds.

1.3. Tax policy

Facing such a diverse and somewhat chaotic environment, is there room for any tax policy recommendations in this area?

1.3.1. Domestic tax policy

It is certainly not the goal of this general report to advise individual states on what they should do in the future. However, one might wish to pay attention to two fundamental policy issues.

17. See the French national report.

18. See the Hungarian, Russian, Italian, US and French national reports. See also the thematic report by J. van de Streek, *Does Company Size Matter in Defining the Scope of a CIT?*

1.3.1.1. Clarity

The need for clarity in tax legislation is not specific to the topic of this report but it nevertheless deserves some attention. While tax systems generally establish clearly which domestic entities fall within the scope of CIT, the same is not true for non-resident entities. In some countries, tax statutes and administrative statements of practice are either silent or vague on this matter. Case law is ambiguous. This situation may be inspired by a reluctance to provide classifications which would in the end prove to be too rigid.¹⁹ However, it is well-known that legal certainty is demanded by taxpayers generally, and perhaps even more of foreign investors who need to know in advance the tax framework which applies to them.

1.3.1.2. Neutrality

Another important policy issue which has been widely discussed during the conference is neutrality. Although this concept still possesses its dark side of uncertainty, there seems to be a wide agreement among scholars and even in the current legislation of some states regarding the need to ensure that CIT subjects and non-CIT subjects should bear a comparable – if not identical – tax burden, account taken of the sum of CIT and personal income tax. It is however striking to observe that the tools used to reach the goal of neutrality are significantly different from one country to another. Some States have established specific rules of taxation of partnerships in order to approximate their taxation to that of CIT,²⁰ some have enacted opt-in and/or opt-out rules while others have reformed dividend taxation.²¹ Scholars also disagree on the best possible ways to achieve neutrality: in this book, some advocate a strong move towards full transparency²² while others urge countries to adopt a uniform business tax.²³

Several observations may be made in this respect. First of all, it is questionable whether the same ready-made solution can be proposed for all countries. The debate on neutrality varies widely depending on the features of each tax system insofar as the respective rules governing CIT and personal income tax are different in every system. Within a single system,

19. See the UK national report, however quoting detailed HRMC guidance on this topic.

20. See for instance the Greek national report.

21. See the thematic reports written by G. Marino and P. Selicato.

22. See Henry Ordower's thematic report.

23. See Johannes Heinrich's thematic report.

the respective advantages of CIT and personal income may also vary over time.²⁴ It is therefore up to each country to decide whether neutrality can be achieved in a satisfactory way through specific anti-abuse rules or if it requires a structural reconstruction of the system itself.

Secondly, the ultimate legal status of neutrality still seems to be very ambiguous. Is neutrality a mere policy goal or is it a consequence of the constitutional principle of equality? If neutrality is a policy goal, it is desirable. If it stems from the equality principle, it is compulsory, in which case it entails that comparable situations should legally be treated equally. Here again, though, the question of whether neutrality is a policy or a legal issue may receive very different answers from one country to another!

Assuming however that neutrality is a constitutional constraint on the legislator, it remains to be seen what comparable situations consist of. Are partnerships (and their partners) and corporations (and their shareholders) intrinsically comparable? To what extent should this comparison take into account the size of the entity, its governance, etc.? Should the comparison factors include other economic factors such as the identity of the shareholders and their activity in the company? One may for instance take the view that an individual owning a substantial interest in a company where he or she performs his or her activity is comparable to an individual entrepreneur and should be taxed accordingly. By contrast, another shareholder in the same company may legitimately not enjoy the same tax treatment because he or she merely acts as an investor. Along this line, several ways to achieve neutrality could be conceived: one could consist in not applying CIT up to the portion of the company's profits corresponding to the interest owned by the "entrepreneur-shareholder"; another one could consist in keeping CIT liability at the level of the company and in reintroducing the currently obsolete imputation system for this category of shareholders (i.e. in granting shareholders a tax credit corresponding to the upstream CIT) and making it EU-compliant by extending it to foreign-source dividends.

Once again, the latter proposal should not be taken as a ready-made tool to achieve tax neutrality. It nevertheless shows that many possible understandings of this concept may exist in academic literature.

24. See for instance the interesting evolution described in the Austrian national report.

1.3.2. Cross-border situations and tax policy

Policy issues related to cross-border situations may arise to the extent that differences in tax systems create undesirable effects for taxpayers and/or tax administrations. Some of these effects are well-known: where a state considers that an entity is a CIT subject while another state takes the opposite approach, double taxation or double non-taxation may occur. This problem arises notably in connection with hybrid entities, which are subject to close scrutiny both at the OECD level and at the EU level and do not require particular comment in this general report. Other issues may also arise in cross-border situations in the event that some countries consider that specific entities such as investment structures may claim the protection of tax treaties while other countries take a different view. These practical problems call for coordination between EU and OECD states in order to avoid mismatches between domestic tax systems.

The reports prepared for the EATLP conference on CIT subjects shed a more original light on other aspects of interest, in particular with respect to EU law. In particular, they allow some reflections on the opportunity for harmonizing tax systems regarding the personal scope of CIT as well as on the way tax directives deal with CIT liability.

1.3.2.1. General reflections on EU harmonization

As Ruben Martini and Ekkehart Reimer point out in their report (*see* section 12.3.3.), “diversity does not affect the fundamental freedoms (...). As a result, the fundamental freedoms do not promote a harmonization of the personal scope of corporate income taxes within the EU”. This statement seems to be perfectly correct insofar as no legal obligation exists for EU Member States to harmonize their legislation in this field.

Let us add that in any event, harmonization of domestic legislation in this respect appears to be nearly impossible. Even if EU Member States agreed on the need for such harmonization, they would have difficulty finding appropriate criteria in this respect. This may be explained by the fact that abstract criteria do not provide an adequate basis for harmonization while concrete criteria are too imperfect by nature.

For instance, “legal personality” cannot be used for harmonization purposes because its connection to CIT liability is too deeply anchored in the specific legal culture of each country to allow any generalization. Indeed, the link

between legal personality and CIT liability relies on a strong relationship between private law and tax law, which is far from being accepted by all EU Member States where the never-ending debate on the autonomy of tax law is often not closed.

Moreover, the very concept of “legal personality” does not have the same meaning throughout the world: in some countries, legal personality means that a person enjoys rights and obligations under civil law; in others, a person may enjoy rights and obligations without being a “legal person”. This is the mechanical outcome of the absence of harmonization of civil and company legislations.

To complicate the whole issue further, let us underline that any reference to civil law to decide whether a non-resident entity enjoys legal personality would lead to even more diversity, since the rules governing conflicts of laws differ in every state: the *lex societatis* may either be the law of the state where the company is incorporated or the law of the state where it has its effective place of management.²⁵

In the end, the generalization of legal personality as a criterion of CIT liability would produce undesirable effects insofar as it would make tax systems even more different from one another than they are today! Let us indeed recall that private law varies substantially in this respect: while partnerships enjoy legal personality in some countries, they do not in others. Incidentally, this difference in the private law status of partnerships explains why article 3 of the OECD Model on Income and Capital defines the term “company” as “any body corporate or any entity that is treated as a body corporate for tax purposes”.²⁶ At present, the different civil law approach of partnerships among countries does not produce wide-scale problems since most Member States end up with comparable tax systems through different means: while countries which accept the connection to legal personality and believe that

25. See for instance the contrast between the Swiss and Belgian systems in this respect: while both systems consider that the *lex societatis* should provide an answer to the question of whether an entity enjoys legal personality, they do not retain the same connecting factor to determine which is the *lex societatis*. Belgian law refers to the law of the principal establishment, Swiss law refers to the incorporation theory.

26. As the preparatory work of the Model recalls, “in most Member countries of the O.E.E.C. differences exist between the provisions of civil law and those of tax laws as to the treatment of different kinds of entities. Thus, e.g., a partnership is frequently treated for tax purposes as a body corporate whereas this form of business undertaking has no legal personality under civil law. The term “company” has been defined with a view to eliminate difficulties originating from such differences between the national tax laws and the civil law” (FC/WP14(61)1).

partnerships do not enjoy such a personality logically exclude partnerships from the scope of CIT, other countries which attribute legal personality to partnerships reach the same conclusion spontaneously by introducing exceptions to the personal scope of CIT in order to exclude partnerships. In other words, most tax systems are globally convergent despite their different civil or company law culture; harmonization by means of referral to civil or company law would therefore lead to the paradoxical outcome of making systems less aligned than they are today.

Could these problems be overcome by using concrete criteria of CIT liability such as the nature of the activity conducted by an entity or the way its governance is organized? One may have doubts in this respect, since these criteria are not only shared by a minority of EU Member States; they also contain a great deal of semantic uncertainty, which explains why they always play a marginal role in the tax systems where they exist.

These general considerations on EU harmonization do not mean, however, that no reflection deserves to be conducted when it comes to assessing the personal scope of EU tax directives.

1.3.2.2. The personal scope of EU tax directives

EU directives in direct tax matters (the Parent-Subsidiary Directive, the Interest and Royalties Directive and the Merger Directive) as well as the Draft CCCTB Directive do not pursue the same goals. This is the reason why the personal scope of these directives should be dealt with in separate ways.

The Parent-Subsidiary Directive and the Interest and Royalties Directive mainly aim at eliminating juridical double taxation on specific cross-border financial payments. This is the reason why Ruben Martini and Ekkehart Reimer rightly observe that the different methods which are used in the annex to these Directives in order to determine whether an entity is eligible for their benefits are not satisfactory insofar as they leave some domestic CIT subjects outside their scope although these entities are exposed to the same risk of double juridical taxation as other entities falling within the scope of the Directive (*see* section 12.2 of their thematic report). National reports also reveal cases of inconsistency between the list of entities covered by the Parent-Subsidiary Directive and other directives: these differences are hardly understandable from a theoretical and practical standpoint.²⁷

27. *See* for instance France, the Netherlands and Spain.

An extension and a harmonization of the personal scope of these directives therefore seems to deserve a new discussion at a European level. Let us recall in this respect that the Ruding Report²⁸ had already called for an evolution of the current situation through an extension of the scope of both the Parent-Subsidiary Directive and the Merger Directive in order to include any undertaking subject to CIT irrespective of its legal form. This proposal had even been endorsed by a European Commission Proposal in 1993²⁹ and later been approved by the European Parliament,³⁰ but was withdrawn in 2003, with the regrettable effect that the Directives still do not apply to certain entities which are subject to CIT in their country of residence.

The case of the Draft CCCTB Directive³¹ is slightly different as its objective is not to prevent double juridical taxation but rather to define new tax rules applying on a harmonized basis to groups of companies operating across the European Union. It is however interesting to see that the legal drafting technique used by the Draft Directive does not innovate when it comes to defining personal scope and merely duplicates the listing system which exists in current directives. Thus, it does not have as an ambition to create entirely new criteria for CIT liability: those continue to derive from national tax law.

This approach is certainly pragmatic, since I have already explained above why a substantive harmonization of the criteria for defining CIT liability appears not only unnecessary but also very difficult. However, one may wonder whether the reflection on the CCCTB draft does not provide for an opportunity to re-think the somewhat chaotic methodology reflected in the existing directives on direct tax matters and to resist the temptation to duplicate a tool which is not entirely satisfactory in substance. Moreover, the question of whether the scope of the CCCTB Directive should be identical to that of other tax directives must remain open. The European Commission was aware of this issue, as is demonstrated by a working document which suggests that more detailed reflection should still be conducted on this matter. This document states the following: “as the main goal of the CCCTB is to remove obstacles created by existence of 25 different corporate tax systems, it would probably make sense to cover in CCCTB only entities doing business, whereas some corporate tax systems cover a wider group

28. *Report of the Committee of Independent Experts on Company Taxation, Commission of the European Communities*, Official Publications of the EC, March 1992.

29. COM (93) 293 final.

30. EP 1994-1995, minutes of the sitting of 19 April 1995, p. 69-71, O.J. No C 128 of 9 May 1994, p. 91.

31. COM (2011) 121/4.

of entities”.³² The Commission therefore seems to have plead in favour of a restriction of the scope of the CCCTB by taking into account concrete criteria in addition to a mere referral to domestic tax legislations. Whether such a restriction based on “business or profit making activities”³³ is the proper way to approach this topic may be discussed, but it has the merit of opening a debate which does not yet seem to have taken place.

32. CCCTB/WP/040/doc/en, 26 July 2006, § 5.

33. Ibid, § 16.

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