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Report from Prof. Wim Wijnen, IBFD Chief Editor Case Law

Seminar L: Corporate emigration and immigration

Summary of discussion

The Seminar examined and compared the exit and entrance tax regimes of several jurisdictions with respect to the transfer of corporate residence. Conducted in an interactive format, the Seminar investigated what emigration taxes and immigration rules are designed to accomplish, and the extent to which they are successful in achieving their goals.

Chair: Ronald K. Durand (Canada)

Participants: Prof. Jaap Bellingwout (Netherlands), Kim Blanchard (United States), Prof. Daniel Gutmann (France), Ricardo Rendon (Mexico)

Secretary: Jill Pinkus (Canada)

Ronald K. Durand commenced the Seminar by introducing the Panel members and the subject matter of Seminar L, "Corporate emigration and immigration". He explained that it will be subdivided into 7 parts.

What are the basic connecting factors that individual states use to establish the right to tax an entity as a domestic corporation that is liable to tax on the most comprehensive basis adopted by that state?

(a) United States.

Kim Blanchard noted that the United States distinguishes between domestic and foreign corporations based solely on the jurisdiction of incorporation, i.e. the place where the corporate charter is filed. Corporations formed in the United States are treated as domestic and are subject to tax on a worldwide income basis, whereas corporations formed under the jurisdiction of a foreign country are treated as foreign and subject to tax, in general, on their US source income. The speaker noted that place of management, seat, and similar criteria are not relevant in the United States.

Two exceptions to these rules were mentioned where a corporation may be treated as domestic even though incorporated in a foreign jurisdiction:

- the US rules dealing with offshore "inverted" corporations; and
- the US rules dealing with foreign corporations whose stock is "stapled" to that of a US corporation, both of which provisions are anti-abusive in nature.

Recent legislation proposed in the United States was also referred to, which is entitled Stop Tax Haven Abuse, and which would treat certain types of foreign corporations, specifically offshore funds and inverted entities, as domestic corporations. The legislation would operate on the basis of the place of management. This would be determined on where the managers carry out the day-to-day business activities of the corporation, and not on the place where directors meetings are held. This rule is based on the 2004 protocol to the US-Netherlands tax treaty which denies treaty benefits to Dutch corporations managed in the United States.

(b) Mexico.

The only relevant factor is the place of effective management, i.e. day-to-day decisions of control, administration, operation or management.

(c) Netherlands.

The connecting factor in the Netherlands for taxation on worldwide income is tax residency. Entities incorporated in the Netherlands are deemed to be resident in the Netherlands during their entire existence. Entities incorporated abroad are resident if they have their place of effective management in the Netherlands.

(d) France.

The corporate income tax is based on the principle of territoriality. It means that the location of the seat should have little impact on the tax base. However, worldwide passive income of French companies is taxable in France and non-resident companies are subject to specific tax rules. Therefore, the definition of the seat is important. Tax authorities refer to the statutory seat in case of a fictitious statutory seat and place of effective management, which is broadly defined.

How does an existing corporation acquire or relinquish a domestic status?

(a) Netherlands.

A company acquires domestic tax status by either incorporating as a Dutch entity, or relocating its place of effective management, i.e. head office, to the Netherlands.

A Dutch company relinquishes its domestic status by ceasing to exist through liquidation or merger. Dutch companies cannot lose their domestic status. However, a Dutch company migrating its head office to another country may no longer be taxed on its worldwide income subject to the tiebreaker rule in the tax treaty. Foreign companies can lose their domestic status by migrating their place of effective management to another country.

(b) Mexico.

A company acquires or relinquishes its domestic status by setting up its place of effective management either outside Mexico, or in Mexico

(c) France.

From a tax perspective, a company acquires or relinquishes its domestic status by setting up its statutory seat or place of effective management either outside France, or in France.

From a legal perspective, any foreign company may incorporate in France and enjoy legal personality.

(d) United States.

Kim Blanchard noted that status as a US domestic corporation is acquired or lost depending on the acquisition or loss the US corporate charter, which is a matter of US state law since the United States does not have corporate legislation at the federal level. It was noted that the movement by a corporation from one US state to another US state generally has no federal tax effect, and that state level tax effects are largely irrelevant since most US states determine tax liability using worldwide formulary apportionment. It was noted that the reason for the place of incorporation rule at the federal level was based on the fact that there are 50 US states and that corporations often conduct business in more than one state.

The methods of immigration and emigration recognized by the US states varies, but the primary method is a legal merger or consolidation from the emigrant state to the immigrant state. It was noted that the laws of the US states often permit foreign corporations to immigrate by filing documents with the Secretary of State of the immigrant state.

What are the tax consequences of acquiring or relinquishing the relevant connecting factors?

– Migration between two states, where not more than one of the states is a member of the European Union

(a) United States.

Kim Blanchard noted that corporate emigration from the United States may be carried as a merger or conversion which is treated as a Type F reorganization. It was noted that US Internal Revenue Code gives deemed liquidation treatment to the transaction, i.e. the old corporation is deemed to have transferred its assets to a new corporation, followed by a liquidation of the old corporation and the distribution of the new stock to the shareholders. Corporate level gain is generally required to be recognized given the US-outbound character of the transaction. Unlike some of the other countries included on the Panel, it is not relevant whether the assets continue to be used as part of a PE located in the United States. An additional option discussed for emigration was a taxable liquidation of the old corporation, followed by a contribution of the assets to a new corporation on a "fresh start" basis.

The US inversion regime was also summarized in this context, whereby an emigrating US corporation may continue to be treated as a US domestic corporation unless it has a substantial presence in the immigrant state. Under the inversion rules, a corporation that continues to have an 80% or more overlap in the shareholders of the emigrating entity will continue to be treated as a US domestic corporation and thus as a dually chartered entity. This provision may not be overridden by US treaties.

With respect to corporate immigration, if a foreign corporation becomes a US domestic corporation by reason of a merger of conversion, without a change of business or ownership, the transaction is again treated as a Type F reorganization and as a deemed liquidation, i.e. a transfer of assets followed by a liquidation of the old corporation. The tax results are that no gain or loss is recognized by the old corporation and the tax basis of the assets carryover to the new corporation. The net operating losses (NOLs) and tax accounts of the old corporation are also carried over, which may be problematic for the foreign corporation since such accounts must be computed using US tax principles. The deemed liquidation may be taxable to the US shareholders to the extent of the untaxed earnings that are repatriated to the United States. It was pointed out that corporations that immigrate to the United States are not permitted a step-up in basis by US domestic law, but that techniques are available to provide a step-up if the transaction is properly structured.

(b) Mexico.

Emigration is a deemed liquidation. It is a deemed sale of assets at fair market value. Thus any gain is taxable. It is not clear whether other untaxed retained earnings resulting from PEs will be taxed upon deemed liquidation. There are no rules regarding assets used in a PE that the migrating company may keep in Mexico.

There are no specific rules for immigration. Therefore, diverging interpretations are possible in respect of

- asset cost basis – no step-up;
- goodwill non-deductible by definition;
- capital contributions account;
- NOLs; and
- previously taxed earnings.

Thus, double taxation may arise.

(c) France.

In respect of emigration, the transfer of seat is regarded as a winding up of the company and the creation of a new company. It has an impact on corporate income tax and transfer duties. There is no concept of corporate inversion. There is an immediate taxation of all untaxed profits and capital gains (which is laid down in the Code) except to the extent that a real or deemed PE remains in France (which is not regulated in the Code). It is a deemed sale of assets at fair market value.

In respect of immigration, no written rules exist. It is regarded as the creation of a new tax entity in France. The assets of the new French company should be recorded at fair market value. However, to the extent that there is already a PE in France, it would be logical for the transfer of seat to be tax

neutral for corporate income tax purposes.

(d) Netherlands.

In respect of emigration, there is an exit tax on those assets (including goodwill) that no longer contribute to the Dutch tax base. It is a deemed disposal at fair market value. In other words, there is no exit tax on assets that stay behind in a Dutch PE or on real property located in the Netherlands.

In respect of immigration, there is a step-up in the opening balance sheet on an asset cost basis. Existing (pre-migration) NOLs are not taken into account.

Step-up mirrors exit tax upon emigration.

– Specific issues relating to migration within the European Union

Under EU law, exit taxation plays only a role in the Merger Directive 90/434/EEC. Migration of a SE or SCE from one member state to another will not result in exit taxation to the extent that the assets remain in a PE. A pending issue is whether exit tax is allowed on assets that do not remain connected to a PE in the state of departure. The position of the EU Commission is that the exit tax should be in line with the fundamental freedoms.

The following questions were raised:

- whether the Merger Directive only applies to SE and SCE (and no harmonization exists for other entities); and
- whether the PE requirement is in line with the EC Treaty.

The Panel then observed that the Cartesio case seems to have opened the door to apply the EC Treaty to exit tax on corporations. The Panel also observed that the principles of De Lasteyrie case also apply to exit taxes on corporations.

Three criteria were mentioned by the Panel for complying with the principle of freedom of movement contained in the EU Treaty:

- Member state of departure may not impose tax upon migration but must defer until gain is recognized post-migration;
- Member state of departure must grant "reverse credit" for taxes imposed by new host state on gain present at time of migration (or vice versa, the new host state must grant a credit for the taxes imposed by the member state of departure); and
- Member state of departure must recognize post-migration losses.

What are the tax consequences of transferring assets to a foreign establishment?

Due to time constraints, this issue was not discussed.

Effect of tax treaties

– On connecting factors

– On the principle of exit taxation

Due to time constraints, this issue was not discussed.

If the source state taxes foreign resident companies on the disposition of certain assets, what are the consequences where such foreign companies migrate from a non-treaty protected foreign jurisdiction to a treaty protected jurisdiction?

On the basis of an example, the most salient aspects were briefly indicated by the Panel.

If a shareholder that is subject to tax in your home jurisdiction owns shares in a corporation that migrates, in what situations, if any, would such shareholder be subject to tax as a consequence of the migration?

On the basis of an example, the most salient aspects were briefly indicated by the Panel.

Concluding remarks

Prof. Jaap Bellingwout concluded that exit taxation is essentially a matter of double taxation that should be solved within the framework of capital gains under Art. 13 of the OECD Model Convention.

Ronald K. Durand closed the Seminar by thanking the Panel members for their work and expressing his appreciation to the audience for their attention.

IBFD Reporter: Prof. Wim Wijnen

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Noot

Op pagina 5 van het verslag is sprake van een kennelijk verschrijving door de auteur. Voor artikel 13 van het OESO-Modelverdrag dient gelezen te worden artikel 7.