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Other Flow-Through Entities **Automatic Flow-Through Treatment**

Joint Ventures • The term "joint venture" can be a confusing one, because it can cover a variety of legal

forms. A distinction is commonly made between "equity joint ventures," in which the parties incorporate a separate joint subsidiary corporation, and "contractual joint ventures," which are closer in nature to partnerships and are generally taxed on a flowthrough basis. For example, when two companies establish a joint venture for a particular purpose, the normal practice is to tax each of the companies upon its share of the profits from the venture rather than to tax the venture as a separate entity. • A special form of joint venture—the European Economic Interest Grouping (EEIG)— was introduced in the member states in 1985. • The EEIG is formed by contract and established by registration, which confers on it legal

personality. It is intended as a means of cooperation between individuals or entities that otherwise wish to maintain their independence. The profits from the grouping's activities are treated as the profits of the members themselves and are taxed only in their hands.

Other Entities Given Flow-Through Treatment • It is frequently considered appropriate to tax various other types of business or investment entity on a flow-through basis. For example, in Spain, the impuesto sobre sociedades (corporate income tax) generally applies to all legal entities, but an exception is made for unquoted portfolio investment entities and for certain family-owned investment-holding companies. • In the United States, flow-through treatment is given to investment vehicles such as real estate investment trusts and real estate mortgage investment conduits.

• In civil law countries, trust agreements, whereby assets are entrusted to a trustee for the

carrying on of business, are typically taxed on a flow-through basis.

 These are similar to joint ventures and do not involve the complexities of taxing common law trusts because the shares of the beneficiaries are specified. Certain types of companies are also taxed on a flow-through basis. Sometimes this is done in recognition of their essentially personal nature, as in the case of the one-person company (entreprise unipersonelle à responsabilité limitée) in France, or their resemblance to a partnership, as with the limited liability company in the United States. • Flow- through taxation of companies may also be adopted as a method of counteracting tax avoidance, for example, when the income of a controlled foreign corporation is

allocated among resident shareholders and taxed in their hands whether or not dividends are paid. • This treatment may also be appropriate to prevent undue tax deferral through the use of personal holding companies, where the standard corporate tax rate is substantially lower than the top rate of individual income tax.

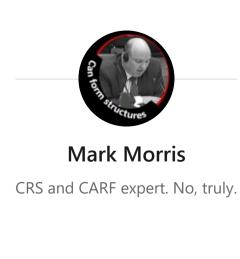
Elective Flow-Through Treatment

• Depending on tax rates and the system of taxing corporations, incorporation either may confer a tax advantage (as noted in the preceding paragraph) or result in a heavier tax • The latter is particularly likely to occur when the "classical" system is adopted. Relief from economic double taxation may be given by permitting certain corporations to elect to be taxed on a flow-through basis. For fairly obvious reasons, this solution is appropriate only in the case of relatively small corporations. A well-known example is the United States "S Corporation" rules, under which a corporation that has 35 or fewer shareholders, all of whom are individuals resident in or citizens of the United States, may elect to be taxed as

a flow-through entity. • The flow-through taxation of S corporations is simpler than that of partnerships, in part because S corporations are allowed to have only one class of stock. • Thus, the allocation of corporate income among the shareholders is straightforward because it can be allocated in proportion to share ownership. Elective flow-through

treatment may also be granted to other types of entities that are otherwise normally

taxed as legal entities. • For example, in Spain, professional partnerships and certain joint ventures may elect to be taxed as flow-through entities. • Elections can also work in the other direction. For example, in France, partnerships, joint ventures, and one-person companies may elect to be subject to corporate income tax.



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