

## Legal entities, Registration, Update, & Deregistration

### 1. What you must be aware of, 'before' your Board Resolution to establish a Foreign Legal Entity

According to most of applicable corporation and value added tax laws, offices of foreign companies, aiming to supply commercial or technical assistance or productive activities in other countries, are subject to corporation and value added taxes in accordance with local taxation rates in each country; in or out of the European Community, apart from some exceptions in certain countries.

Often companies controlling foreign legal entities rely on avoiding corporation taxes by declaring that the activity in the foreign country does not fall under the concept of a '**Permanent Establishment**'. This approach implies a considerable risk; the foreign direct investment strategy must include an analysis of statutory requirements.

Providing technical or administrative assistance activity, even to simply coordinate local dealers, is often considered to be indirect assistance to the Parent Company marketing and commercial department, although no direct sales are taking place through the local country entity and no commercial invoices are issued locally or payment locally collected. The activity infers local support generation.

In some countries the concept of 'diffusion of information' helps identify a Permanent Establishment, while 'collecting' information activities (public relations, market or technical researches, business planning, buyer offices) are often considered as acceptable activities for a representative/ liaison office (R.O.). The R.O. connotation not only negates the imputation of corporate and VAT tax obligations, it additionally mitigates local reporting needs (filing of financial statements) (ex. Italy). In some other countries it is true that a representative/ liaison office may not have corporation taxes obligations, however accounting obligations need to still be segregated and prepared (ex. India). Careful analysis of local requirements needs to be performed.

Local tax authorities do not purely rely on assertive registrations (PE or branch office registrations). Other means of identification of a Permanent Establishment have been used such as the request of probationary documents of the kind of activity undertaken, or interviews with employees and local customers, in some cases they are corroboratory supported by having the two parties read each others' statements and certifying/signing as to their truthfulness after private interviews.

The procedure of the tax authority in case of inspection and eventual claim is in most countries to simply estimate a taxable company profit (often not allowing a full cost deduction - and usually also estimating the turnover of the foreign company in the local country, between the date of registration of the R.O. and the date of the inspection), send a tax payment due notice, and wait for the company to produce material of evidence of the opposite case within 30-60 days from the receipt of the inspection notice.

Pure administrative penalties for the lack of statutory accounting may also be added in case of negative response from the inquiring authority related to the taxes avoided.

The registration of a Representative or Branch Office is the simplest and cheapest way for a Foreign Company to extend its presence abroad. The functions of a R.O. are although limited to information gathering, promotion, market and scientific research, public relations (no information diffusion, no technical assistance, no sales coordination, no marketing). In fact a R.O. cannot engage in any productive or commercial activity. This kind of entity is also often used in case of preliminary business planning activities. The activity of the representative office should be, at least in part, reflected in the employees' job description in the employment contract, which cannot therefore include any mention to the items in brackets above, and possible should 'not' include reference to 'variable salaries' related to sales or other economic results, in order to be reasonably in line with the activity declared for the legal entity itself.

A R.O. is simply a "cost center", it is not qualified to give rise to any kind of income.

For this reason it does not have any fiscal relevance and VAT / corporation taxes are avoided, the R.O. should not have any fiscal duty for filing corporate and VAT tax returns or bookkeeping/ accounting reporting obligations.

Company registration will be required to open an R.O., useful to receive invoices from any supplier with application of VAT., which will be considered as a full cost (may want to explain not sure I understand?). In some countries there is a possibility to recover VAT, supplying original invoices copies, but this might not be advisable as it could infer crossing the business activity threshold. This kind of request will often lead the VAT office to an inspection in which it might be checked in detail the kind of company activity, asking for any document or witness report.

In summary, should the Company produce any income in the local country of new registration, the local tax authorities could assess a Permanent Establishment, which would be subject to corporation taxes.

Missing payment of stat obligations, the CEO or Managing Director, and any person legally representing the company in the local country is completely liable and the amounts could be recovered also through an international legal action. For US companies, this creates additional considerations under FIN 48 disclosures and accruals.

There is no need of share/ quota capital in Representative and Branch Offices.

## **2. If you choose to declare a 'Permanent Establishment', how can you organize cost and revenues transfers between Parent company and foreign entity?**

In The case of registration/ existence of a branch office (B.O.) with Permanent Establishment, accounting (reporting) and corporation taxes obligations are created. It is possible to use an intercompany 'Cost Plus Agreement' (where the invoicing from the local branch office to the Parent Company of periodic amounts for service/ technical/ commercial activity are reimbursed with a markup by the parent company to the B.O.) to avoid inference of unjust profits by the local tax authority, however these agreements need to be written and executed as contemporaneous (in-place) before the start of the billing activity by registered letter. This fixes the profits of the local subsidiary to the efforts expended, and it should be avoided to have the local office issue invoices to customers and/or collect money on behalf of the Parent as this implies direct sales changing the intercompany understanding and profit basis of the subsidiary. Under transfer pricing regulations by country, there are specific documentation requirements when transacting business between affiliates. These agreements are subject to local and international regulations concerning '**transfer pricing**'. A study should be conducted before an agreement is executed to ensure operating results fall within acceptable ranges - unless your business falls under an exemption rule.

An alternative way to fund your organizational costs could be represented with an intercompany loan. The loan can subsequently be forgiven (with a formal act of renouncing to the credits/ debits accumulated), and both the loan and the renouncement must be written and sent in advance by registered letter to the proper authorities. The difference is arranging for either technical service to be provided by the subsidiary controlling the profits through transfer pricing, or funding via intercompany loans. It should be noted on the latter, that should the loan(s) be outstanding for more than one year, interest need be imputed.

It is important to organize each funding in advance. Each transfer needs to be fully justified with the above agreements in order to mitigate tax office inspection risk.

## **3. Which are the administrative steps to proceed with a Representative or Branch Office registration?**

- **Board resolution** : this document must be originally, signed at least from the company legal representative, notarized and depending on the country of origin, apostilled (example: not necessary for Belgium, France, Denmark, Ireland).
  - This document should include at least :
    - Parent Company letterhead/ paper (including legal address and company tax code/ enterprises registrar/ Chamber of Commerce company code, and contacts)
    - Name and qualification of the meeting chairman;
    - Date and place of the resolution;
    - Local entity name and kind (R.O. or B.O.);
    - Extensive name and surname and updated residence address of the Parent Company legal representative, nationality, place and date of birth, number and kind of identity document ; should these have already individual tax codes in the

local country, this should also be added, or should they not, a local attorney should be nominated to proceed with such registration and a local fiscal domiciliation;

- Legal / administrative address of the local entity (it is advisable for this to choose an address which could be reasonably considered as permanent, as in some cases electing the employee home office address can be cheaper, but subject to higher risk of change, ex. In case of employment resolution during probationary period);
- Declaration of the Parent Company and local entity activity;
- Name, individual data and powers of the local entity legal representative;
- Possible attorneys for any action which any local representative might be-

-allowed to do on behalf of the mother company board (ex. registration of

-remote banking, payments of salaries, social contributions, company and employees taxes, registration of local entity by any public office, signature

-of employment / self employment contracts, relationships with suppliers or third parties etc.).

- **Identity documents:** of the Parent Company and local entity legal representatives, in most of countries, required to be recently authenticated by a foreign notary, and should be including updated residence address; should passports not be included, an additional 'official' document including it would be necessary.
- **Parent Company foreign certificate of registration:** public office ensures the Parent Company is a legal entity properly registered abroad. It is necessary to enclose in the local entity registration procedure an original copy of the Parent Company registration certificate. This states the updated name of the company, a registration number, the updated name of the legal representative and the company activity. In many countries, the certificate of registration is simply a company name, and it is important to check that these are included and notarized in the board resolution; the lack of this official information might stop and delay the process.
- **Legal translations:** documents need to be legally translated.
- **Local notary deposit:** documents are often required to be deposited by a local notary, before proceeding with registrations by local public offices. This is subject to a notary fee.
- **B.O./ R.O. registration by local public offices:** all the documents must be copied several times in order to allow the local legal entity existence to be notified to all the necessary local offices (ex. Chamber of Commerce, tax offices, national insurance and national work accident insurance, integrative medical care, integrative pension funds, employment office etc.), in addition to the local forms submission requirements.

#### **4. Which consequence in case of change of legal/administrative address, change of local representative, change of mother company name and/or address, delegated powers etc.?**

Unfortunately in case of corporate changes, authorities must be notified through the proper legal documents; therefore all the procedures above must be repeated. Forecast pending changes in the first board resolution, the appointment of attorneys and addresses which could grant a reasonable duration of acceptance of the charge and domiciliation.

**5. Given a choice of permanent establishment, which difference between a Branch Office and a Limited Liability Company registered in compliance with local country legislation?**

Limited Liability Company	Branch
Exempt from capital duty on paid-in capital	Exempt from capital duty on paid-in capital
Taxable on worldwide income; specific country income tax rules apply	Taxable on income related to the activity of the local branch only
Corporation tax rates applicable as from local country legislation	Corporation tax rates applicable as from local country legislation
Interest paid to parent company is tax deductible, unless disallowed under anti-abuse regulations	Interest paid to head office is tax deductible (in principle), but a case-by-case analysis is required
Withholding tax on dividends; treaties apply; it can be reduced to 0% if paid to EU parent company and certain conditions are met; or to the lower treaty rate	No tax on remittance of branch profits to head office
Payment of royalties and management fees to the foreign parent can be deducted from corporation tax in most of cases	Payment of royalties and management fees to the foreign parent can be deducted in most of cases from corporation tax though some issues may arise, particularly for royalties
Local subsidiary can invoke treaty protection	Branch cannot invoke treaty protection

<p>Disposal of shares: capital gains realized by shareholders qualified for treaty purposes are generally tax exempt in Italy</p>	<p>Disposal of Permanent Establishment is a disposal of assets, and capital gains are taxable locally. Possible tax free restructuring may be available, if branch belongs to EU company</p>
<p>Carry forward for start-up losses might be applicable; check country specific tax law</p>	<p>Carry forward for start-up losses might be applicable; check country specific tax law</p>
<p>Liquidation of subsidiary = realization of capital gains, if any</p>	<p>Closing of branch = realization of capital gains, if any</p>
<p style="text-align: center;"><b><u>Formation steps:</u></b></p> <ol style="list-style-type: none"> <li>1. Power of attorney by the <i>would be</i> quota holders</li> <li>2. Obtaining notarization and legalization (with Apostille) on powers of attorney</li> <li>3. Drafting the Articles of Association/By-laws</li> <li>4. Obtaining fiscal code number of the quota holders</li> <li>5. Payment of the capital requirement</li> <li>6. Execution of the Deed of Incorporation</li> <li>7. Obtaining individual tax code number of the directors</li> <li>8. Registration of the Deed of Incorporation with the Chamber of Commerce (Register of Enterprises)</li> <li>9. Obtaining VAT number</li> </ol>	<p style="text-align: center;"><b><u>Formation steps:</u></b></p> <ol style="list-style-type: none"> <li>1. Certificate of Good Standing from the <i>would be</i> Parent Company</li> <li>2. Parent Company's Board of directors'/Shareholders' Meeting resolving upon the establishment of the Branch and the appointment of a legal representative</li> <li>3. By-laws of the foreign Parent</li> <li>4. Copy of the passport of the legal representative of the soon-to-be established Branch, and individual tax code</li> <li>5. Power of attorney by the <i>would be</i> Parent Company</li> <li>6. Obtaining notarization and legalization (with Apostille) on powers of attorney</li> <li>7. Sworn translation in Italian of the By-laws of the Parent company</li> <li>8. Execution of the Deed of Formation before an Italian Notary Public. (Italy).</li> <li>9. Execution of the Deed of Incorporation</li> <li>10. Obtaining fiscal code number of the legal representative of the Branch</li> </ol>

	<p>11. Registration of the Deed of Incorporation with the Chamber of Commerce (Register of Enterprises)</p> <p>12. Obtaining VAT number</p>
<p>A LLC/LTD may require formal statutory corporate and accounting books and should file its financial statements every year with the competent authorities. A LLC/LTD should file a corporate tax, VAT returns.</p>	<p>A branch does not need formal statutory corporate books. It requires accounting books and should file the parent's financial statements every year with the competent authorities. A Branch should file a corporate tax and VAT returns.</p>
<p>A LLC/LTD provides for limited liability of the shareholders. In case of one shareholder there would be unlimited liability.</p>	<p>A Branch does not have a corporate shield, therefore, the parent company is unlimited liable for the branch's operations.</p>
<p>There are minimum share capital requirements</p>	<p>No minimum share capital is required</p>
<p>Flexibility in transferring assets or share sale</p>	<p>Lower flexibility in transferring the branch as the transfer of the branch would be considered as a sale of going concern for local purposes.</p>
<p>Strict rules in case of excess losses would require the re-capitalization of the LLC/LTD [thin-capitalization regulations] &amp; be aware of transfer pricing regulations</p>	<p>No specific rules apply in case of equity losses</p>

## Next Step?

**Contact Dahn & Leahy LLP at +978-749-9900.**