**Subsidiaries, branches and tax**

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**Question 1**

There are no taxes imposed on the formation of a subsidiary [1].

**Question 2**

A UK resident subsidiary would pay corporation tax on its worldwide income and gains, whereas a UK branch would be liable to corporation tax only on the items listed in question 3. The charge to UK corporation tax [2] imposed on a non-resident company only applies where the non-resident company is trading in the UK through a permanent establishment. This means that a branch [3] set up for investment purposes only, and not carrying on a trade, is not subject to UK corporation tax, though certain types of income arising in the UK ? notably rent and interest ? may be subject to income tax through withholding [4] (at 20%).

**Question 3**

Assuming that the local branch of a non-resident company is within the UK statutory definition of “permanent establishment” [5] (which is based on the wording of Article 5 of the OECD Model Convention), it will be treated as though it were a distinct and separate entity dealing wholly independently with the non-resident company. It will also be treated as having the equity and loan capital which it would have if it were a distinct entity, which means that the UK thin capitalisation rules [6] will apply to it.

Subject to any treaty provisions to the contrary, the taxable profits of a permanent establishment through which a non-resident company is trading in the UK would comprise:

- trading income arising directly or indirectly through, or from, the permanent establishment;

- income from property and rights used by, or held by or for, the permanent establishment (but not including exempt distributions); and

- capital gains accruing on the disposal of assets situated in the UK and effectively connected with the operations of the permanent establishment.
Question 4

There is no branch profits tax.

[1] Società controllata

[2] Imposta sulle società (p.es. IRES)

[3] Filiale

[4] Ritenuta d’acconto

[5] Stabile organizzazione

[6] La thin capitalization o capitalizzazione sottile consiste nella sottocapitalizzazione di una società rispetto all’attività d’impresa esercitata e nel contestuale finanziamento della stessa con apporto di capitale di credito da parte dei soci qualificati.
COMPREHENSION QUESTIONS

Exercise 1.

The text below contains the answers to four questions (a, b, c, d). Match the questions with the appropriate answers.

a. How would the taxable profits of a local branch be determined in its jurisdiction?

b. What taxes (e.g. capital duty) would be imposed upon the formation of a subsidiary?

c. Are there any other significant taxes or fees that would be incurred by a locally formed subsidiary but not by a branch of a non-resident company?

d. Would such a branch be subject to a branch profits tax (or other tax limited to branches of non-resident companies)?

Exercise 2.

Answer these questions:

i When is UK corporation tax imposed on a branch?

ii When is a branch treated as a distinct and separate entity?

iii When a branch is considered a distinct and separate entity, there are consequences. What are they?

ANSWERS

Exercise 1

Q1/ b;

Q2/ c;

Q3/ a;
Exercise 2

i When the branch carries on a trade

ii When it is a 'permanent establishment'

iii A permanent establishment i.e. a distinct entity is considered to have (1) its own equity and loan capital so (2) it is subject to thin capitalisation rules.