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COMPARISON OF THE TAXATION REGIMES OF PARTNERSHIPS IN EUROPE

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Abstract: *Paper categorises the German taxation regime for partnerships in the European context. In particular, the German option model introduced on 1 January 2022, under which partnerships can choose whether they are taxed like German corporations or - as previously - transparently, is compared with other European taxation methods for partnerships and a detailed comparison is made with France, which also has an option model. The comparison includes both the transparency principle applied to date and a comparison of the opportunities and risks of the option models. In addition, an assessment of the respective company law in Germany and France is made. The comparison focuses on the tax risks, but also on the complexity of both systems and the associated advisory costs, which can have a negative economic impact on the financing of partnerships. To summarise, it can be said that the French option model has slight advantages, as tax law in Germany is significantly more complex and requires more advisory support, and the risk of retroactive taxation can significantly increase the tax burden.*

Keywords: *Options models, Partnerships, Taxes, European comparison, Law*

JEL Classification: H20, H21, H25

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1 Introduction

For many years, German tax law has been characterized by a dual framework that differentiates between the separation principle for corporations and the transparency principle for partnerships. This distinction has been the subject of extensive scholarly analysis, with Jacobs et al. (2015) specifically exploring the tax treatment of individuals and legal entities.

According to the separation principle, a clear distinction is made between a corporation and its shareholders. As a result, a corporation's taxable income is initially taxed separately from its shareholders. Corporate income is taxed at a rate of 15%, plus a 5.5% solidarity surcharge, along with municipal trade tax, which varies by location but is generally around 15%. Additionally, any profit distributions made to shareholders are subject to further taxation upon receipt. Dividends are generally taxed at a flat rate of 25%, plus the solidarity surcharge. However, alternative tax rates may apply under certain conditions. This results in a two-tier taxation system, where profits are taxed both at the corporate and shareholder levels.

A key feature of the separation principle is the recognition of the corporation and its shareholders as distinct taxable entities. This allows for business relationships between the two for tax purposes while prohibiting the offsetting of profits and losses between them. However, corporations can opt to retain earnings, deferring distribution and the corresponding tax liability at the shareholder level. In total, corporate profits are taxed in two stages: at the corporate level, the effective tax burden is approximately 30%, while at the shareholder level, distributed profits are taxed at 25% plus the solidarity surcharge. In cases where the highest personal income tax rate of 45% applies, the effective tax burden on distributed profits can reach about 27% plus the solidarity surcharge. As a result, the total tax burden on corporate earnings can amount to approximately 48%.

In contrast, the transparency principle applies to partnerships. Under this principle, the annual business results and equity of the partnership are directly attributed to the individual partners in a "transparent" manner. With the exception of trade tax, the partners are considered the direct taxpayers, meaning the partnership's taxable income is allocated to the partners and taxed at their individual income tax rates. This taxation process occurs in two stages: first, the partnership's taxable income is determined uniformly, and then each partner's proportional share is assigned. In the second stage, the allocated income is combined with the partner's other income, special expenses, extraordinary burdens, and applicable allowances. Notably, taxation at the partner level occurs regardless of whether profits are actually withdrawn or retained within the partnership.

Furthermore, any special compensation paid by the partnership to a partner—such as for services rendered, loans provided, or assets contributed—is included in the partnership's separately determined results. This remuneration is taxed at the partner's individual tax rate, potentially reaching the highest marginal rate of 45%, regardless of whether the funds are actually received. In summary, partnership income is taxed at a maximum income tax rate of 45%, plus a 5.5% solidarity surcharge, making its effective tax burden comparable to that of corporations. However, if the local trade tax multiplier exceeds 380% (or 400% for the 2020 assessment period), additional trade tax liabilities may arise due to the limited ability to offset trade tax against personal income tax (Jacobs et al., 2015).

Given that this disparity in taxation could put German partnerships at a disadvantage in international tax comparisons due to their legal form, the German legislator introduced a regulation aimed at harmonizing the taxation of different legal forms and facilitating practical implementation for taxpayers and their advisors. This legislative change allows partnerships to forgo the transparency principle and instead opt for taxation under the separation principle. Specifically, the German legislator introduced the option of corporate taxation under Section 1a of the German Corporate Income Tax Act (KStG), enacted through the Corporate Taxation Modernisation Act on March 19, 2021. The implications and effectiveness of this provision are further discussed in the following sections of this paper (Kußmaul & Gottfreund, 2021, p. 161).

In order to ensure neutrality with regard to the legal form, the option of corporate income tax liability according to Section 1a KStG was included in the law. According to this regulation, business partnerships now have the option of applying for corporate income tax treatment. This change in the tax system occurs in the context of a fictitious legal form conversion. In order to assess the actual competitiveness of the German tax system, which has now been extended to include the option model, in comparison to other tax systems at the international level, this article compares the German system with the taxation systems of all other countries in the European Union in a broad overview and, insofar as other countries have an option model, assesses them in detail. The following research question arises in this regard:

- Is Germany the only country in the European Union to offer an option model, and if not, is the German option model a more favourable taxation variant than the other European option models?

- In view of the research question, the author of this paper hypothesises that there must be at least one other option model in the European Union and that Germany does not have a monopoly in the taxation of partnerships. Nevertheless, the German taxation system is considered to be very complicated and unfavourable, so that the author hypothesises that the German method of taxation will be less favourable.

To test the hypothesis, the literature review and theoretical background is presented in Section 2. In Section 3, the individual taxation methods in the European Union are listed. In Section 4, further option models in the European Union are presented, if available, and compared with the German option model in Section 5. Finally, the last Section draws a conclusion and answers the research question mentioned above.

2 Literature Review and Theoretical Background

The European Union currently includes 27 states. The European states remaining alongside Germany each have their own way of taxing the profits of partnerships. These taxation methods will now be examined one by one in alphabetical order. These taxation methods were already listed and compared in detail in the literature. This was done in particular by the analysis of Heuer and Titgemeyer (2006), who already addressed dualistic systems as well as option or mixed models.

This analysis by Titgemeyer and Heuer was verified using other current sources. Particularly worthy of mention in this context are the Corporate Tax Guide published by Ernst & Young, commentaries on the so-called double taxation agreements, which also comment on the national method of taxation, as well as the respective official websites of the tax authorities of the respective

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countries.

Nevertheless, at the time of this analysis, the option model had not yet been included in German law, so that a detailed comparison between the German option model and the European taxation methods was not possible. As a result, no comparison has yet been made between the German option model and the option model of other states in the European Union, which should confirm the added value of this article.

The introduction already described how partnerships in Germany were taxed before the introduction of the option model under the so-called transparency principle. To ensure the neutrality of legal forms, the previously discussed corporate tax option for partnerships under Section 1a of the German Corporate Income Tax Act (KStG) has been incorporated into legislation. This option enables partnerships to elect corporate tax treatment moving forward. The transition to this tax regime is executed through a fictitious transformation of the legal form (Böhmer & Schewe, 2022).

Once a partnership opts for this tax treatment, it is deemed a corporation for tax purposes, while its partners are considered non-personally liable shareholders. However, this classification is purely for income tax purposes and does not alter the partnership's legal status under civil law. By virtue of this fictitious corporate status, the partnership, while maintaining its legal identity, is treated as an independent taxable entity and thus becomes subject to corporate income tax (Kanzler, 2021).

Under German tax law, the relevant reference date for the transition is the end of the financial year preceding the first year in which the option takes effect. If the financial year aligns with the calendar year, the reference date for an initial election in 2022 would be 31 December, 2021. Consequently, the tax regime change and its associated implications for both the electing entity and its partners are directly linked to this specific point in time (Brühl & Weiss, 2021).

If the electing company has either its management or registered office in Germany, it is subject to unlimited corporate income tax liability. This means that regardless of the actual nature of its earnings, all income is classified as commercial income, ensuring that any gains remain fully taxable. Additionally, the opting company is subject to trade tax. Special provisions, such as the offbalance sheet adjustment of income derived from shareholdings in corporations or partnerships, must also be considered. For instance, dividends and capital gains from the sale of investments are now subject to corporate income tax at an effective rate of only 5%. Moreover, the trade tax implications must also be fully considered, as the entire income of the electing partnership is subject to trade tax. In this context, the trade tax loss carry-forward under Section 10a of the German Trade Tax Act (GewStG) presents a significant limitation: any losses carried forward from periods prior to opting for corporate taxation are forfeited. However, for losses incurred by the electing company in the future, maintaining corporate identity is crucial to preserving these losses as long as the case does not involve a legal restructuring. Additionally, the tax exemption outlined in Section 11 (1) Sentence 3 No. 1 GewStG, which allows for an allowance of EUR 24,500, no longer applies once the option is exercised. If the electing entity does not have its management or registered office in Germany but generates domestic income under Section 49 of the German Income Tax Act (EStG), it falls under Germany's limited corporate income tax liability. In the context of limited tax liability, the entity may still earn income from sources beyond trade or business activities (Wacker et al., 2021).

Since participation in an electing entity is tax-equivalent to holding shares in a corporation, the company's profits are no longer directly attributed to the individual partners under the principle of separation (Fuhrmann, 2021). Instead, the income resulting from the corporate relationship qualifies as capital income and is realised through profit distributions. Consequently, these distributions are subject to capital gains tax, which the electing entity is responsible for withholding and remitting on behalf of the shareholders. If the income is held as private assets, the withholding of capital gains tax generally serves as a final tax liability. As a result, any compensation received by a shareholder for services rendered to the company is classified as employment income, effectively placing the shareholder in the position of an employee. When it comes to loans provided by a shareholder to the company—particularly those that were previously part of the shareholder's special business assets—it is clarified that the resulting interest income is considered capital income at the shareholder level. For the company, on the other hand, these interest payments are treated as operating expenses. Another key aspect involves the transfer of assets by the shareholder to the company. Once the corporate taxation option is exercised, any subsequent transfer of assets to third parties is generally classified as rental or lease income, or in some cases, as other types of taxable income. Additionally, the potential establishment of a business split structure must be taken into account (Micker & Pohl, 2024).

3 Tax regimes in the European Union

The following table summarises the different taxation regimes with regard to the taxation of partnerships. This table is based on the work by Heuer and Titgemeyer (2006) and is intended to enable a better categorisation for the purposes of European comparison.

Table 1: Overview of Taxation Regimes with Regard to Taxation of Partnerships

Separation principle	Transparency principle	Mixed model: transparency principle for shareholders with full liability and separation principle for shareholders with limited liability
Belgium	Austria	Czech Republic
Bulgaria	Cyprus	France (inc. Option model to Separation principle)
Croatia	Denmark	Slovakia
Estonia	Finland	
Greece	Ireland	
Hungary	Italy	
Lithuania	Latvia	
Portugal	Luxembourg	
Romania	Malta	
Slovenia	Netherlands	
Spain	Poland	
	Sweden	

Source: own processing.

Table 1 shows that most European countries have opted for either the separation principle or the transparency principle with regard to the taxation of partnerships. Only three countries have mixed models and, like the Federal Republic of Germany, apply both principles to taxation. This includes the following three countries:

<u>Czech Republic</u>

Due to tax law in the Czech Republic, all commercial partnerships, such as general partnerships or limited partnerships, are treated as legal entities under Czech tax law (the same applies, for example, to Czech civil law partnerships) and are therefore generally subject to taxation for legal entities. Nevertheless, the profit shares of natural persons who are partners in the partnerships and have unlimited liability (partners in a general partnership or general partners in a limited partnership) are taxed at the personal tax rate of the respective partners. At the level of the partnership, the tax base is to be reduced accordingly in these cases (Wassermeyer, 1966, DBA Czech Republic, Art. 3, Margin no. 15 et seq).

The corporate income tax rate in the Czech Republic is 19% and, with the exception described above, is applied accordingly to the income of the respective partnership. The worldwide income principle also applies accordingly to partnerships located in the Czech Republic. The withholding tax rate for dividends is generally 15%, but it can be both reduced and increased. This depends on the residency, legal form, and other conditions attached to the respective shareholder (Ernst & Young Global, 2023, p. 455 et seq.).

The Czech taxation regime for partnerships shows some parallels to the German taxation of partnerships. If natural persons with unlimited liability are shareholders in the company, the so-called transparency principle is also applied, so that the profits are taxed at the shareholder level. This is similar to the original method of taxation in Germany. The Czech Republic does not provide for an option that allows such corporate structures to choose between the transparency and separation principles. This can be seen as an advantage of the German method of taxation.

France

According to French civil law, not only corporations but also partnerships are considered legal entities. Nevertheless, in France – as in Germany – partnerships have the option of either having their profits taxed at the level of the partners under the transparency principle, or the company can opt for corporation tax and be treated as a corporation under the separation principle (Wassermeyer, 1966, DBA France, Art. 2, Margin no. 20).

Insofar as the partnerships opt for corporation tax under French law, the amount of the corporation tax burden is therefore of interest. The corporation tax rate in France is 25%, which is also increased by the solidarity surcharge of 3.3% if the corporation tax exceeds EUR 763,000. The solidarity surcharge does not apply to companies that have generated an annual turnover of less than EUR

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7,630,000 and of which at least 75% is owned by individuals and companies that themselves meet this requirement. In addition, there is the possibility of a reduced tax rate of 15% for the first EUR 42,500 of profit, provided that the turnover is less than EUR 10 million and of which at least 75% is owned by individuals and companies that themselves meet these conditions. (Ernst & Young Global, 2023, p. 577) If the corporate income tax option is not exercised, the profits of the partnerships are to be taxed at the personal tax rate of the partners, as described above, which is over 50% at the top tax rate (OECD, 2023, p. 10).

So far, most similarities have emerged in comparison to the German taxation regime for partnerships. In both countries, partnerships have the option to choose between the separation and transparency principle. While the top tax rate in France is significantly higher than in Germany, which is particularly important in the context of the transparency principle, the tax rate for taxation as a legal entity is roughly identical (depending on the size of the company).

<u>Slovakia</u>

Slovakia applies a different concept in this respect. The general partnership is treated as transparent, so that the profits of this form of partnership are taxed at the level of the partners at the personal income tax rate. The same applies to the general partners of a limited partnership, who are fully liable. By contrast, the pro rata profits attributable to the limited partners of a limited partnership (only partially liable) are subject to corporation tax at the level of the corporation in accordance with the separation principle. (Wassermeyer, 1966, DBA Slovakia, Darstellung des slowakischen Steuerrechtes (Overview of Slovak tax law), Margin no. 143).

The corporate income tax rate in Slovakia is generally 21 per cent. However, this may fall to 15 per cent for so-called micro-entities with a taxable income of EUR 49,790 or less. (Ernst & Young Global, 2023, p. 1624) The personal tax rate is progressive and varies between 15%, 19% and 25%. A tax rate of 25% is applied if the taxable income exceeds EUR 38,553.01 (2022). (Slovak Academic Information Agency ["SAIA"], 2022).

<u>Result</u>

In comparison to the German taxation system, it is noticeable that the tax rates in Slovakia are considerably lower, regardless of which taxation principle is applied. The different taxation methods between the transparency and separation principles cannot be freely chosen in Slovakia as they can in Germany, but are necessarily linked to the form of participation in a limited partnership, which, in the author's view, limits entrepreneurial freedom of choice.

If it is now possible to examine the taxation regimes of the three countries mentioned above in more detail, it becomes apparent that the Czech Republic and Slovakia also use mixed models. However, these mixed models cannot be used within the framework of exercising a right of choice. Rather, the position as a shareholder is decisive in this respect.

In the Czech Republic, the separation principle generally applies. However, this does not apply to natural persons with unlimited liability. In this respect, the transparency principle applies without exception.

In Slovakia, on the other hand, the transparency principle is generally applicable for the taxation of partnerships. However, there is also an exception in this respect for limited partnerships, i.e. companies in which some shareholders have only limited liability. This is exactly the opposite of Czech law, where limited partners are subject to the separation principle. Another difference is that this applies regardless of whether the entity is a natural or legal person.

A genuine comparison of these mixed models with the German option model is not possible in this respect, as it is not a matter of choice but rather an obligation depending on the structure of the shareholder position. Only French tax law, like German tax law, offers a genuine choice for partnerships and their partners to help shape their own tax burden. On the one hand, this can lead to greater entrepreneurial freedom in terms of decision-making options, but also to greater liquidity through lower tax expenses.

The following subsections therefore provide a detailed comparison of these two options in terms of both the transparency and separation principles. In this regard, it is particularly worth noting whether these option models are really characterised by entrepreneurial freedom or by further restrictions that increase administrative costs and consulting fees.

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4 Comparison between Germany and France

4.1 French Corporate Law

In the context of French company law, no general definition of a partnership is provided by statute. However, a definition of a community or a company per se can be found in Article 1832 of the French Civil Code. It reads:

A partnership or Company is created by two or several persons who agree by contract to appropriate property or their industry for a common business with a view to sharing the profit, or benefiting from the saving which may result therefrom […]. The Partners bind themselves to contribute to the losses.

This definition can be applied to most forms of partnership. Most partnerships are registered in the Trade and Companies Register (RCS), which can be found at www.infogreffe.com.

French company law is characterised by the fact that there are significantly more legal forms with regard to partnerships. In addition to the usual corporate forms in Germany, such as the civil law partnership (in France: société civile), the general partnership (in France: société en nom collectif) and the limited partnership (in France: société en commandite), various other corporate forms are recognised in France, such as the 'société en participation' and the 'société créée de fait'. In most company structures, the partners have unlimited liability for the company's debts with their private assets. However, in contrast to German partnerships, this does not apply without restriction, but only in proportion to the partner's share of the company's equity. This does not apply, of course, to the limited partners of a limited partnership or to partners whose liability is limited to a certain amount. In this respect, these shareholders are only liable up to the amount of their liable capital contribution. Furthermore, French commercial partnerships under French law must always have a registered office in France (Barnes, 2020, p. 17 et. seq).

In this respect, initial differences to German law can already be seen. In the opinion of the author, the liability of the partners of the partnerships in Germany (and thus also the liability for tax debts) is more pronounced in Germany, since each partner is fully liable for the debts of the partnerships, whereas in France this is (in principle) only the case proportionately according to the respective shareholding. Nevertheless, German law does not appear to be as restrictive and exception-based with regard to the formation of a partnership, since there is no distinction between incorporated and unincorporated companies, or rather, there are generally fewer legal forms and, in addition, there is no requirement for a registered office in Germany per se.

Another major difference, which is, however, basically only of a purely theoretical nature, is that the partnerships in France, which are comparable to the German legal forms, are generally fully legally capable and are therefore treated as independent persons. Only in the case of the above-mentioned other company forms is there talk of non-legally capable companies. Nevertheless, it can be described as a rather technical or terminological difference. Another difference between French and German company law with regard to partnerships is that French law requires by law a voluntary and active, interest-driven and equal cooperation (‘affectio societatis’). Since German law has made a purely objective determination (‘a common purpose must be promoted’), one could see a greater discrepancy here. Nevertheless, ‘affectio societatis’ is also interpreted broadly under French case law, since the requirement of such an independent subjective element is arbitrary. In practical terms, therefore, there is no major difference to German law. A further difference is the consequence for the company if the number of shareholders decreases to one. In this respect, the company would have to be dissolved in Germany, whereas it would continue to exist in France. Depending on the case, this could lead to a lock-up period violation in Germany, while the option model could continue to be applied in France. In addition, there are a few minor deviations in the core elements, which, in the opinion of the author, do not affect the application of the corporate income tax option. In particular, the French requirements for company contributions and the statutory distribution of profits should be mentioned here (Nitschke, 2001, p. 22).

4.2 French Method of Taxing Partnerships

4.2.1 French transparency principle

French law treats the taxation of partnerships in two ways. In this respect, there is a principle and also an optional right to choose. Philippe Derouin in Barnes (2014) commented in particular on the fundamental method of taxation of partnerships in France.

In principle, partnerships in France are treated as 'half-transparent'. This means that the partnerships themselves are not subject to income or corporation tax. Rather, the partners in the partnership must declare and pay tax on their share of the profit or loss in their tax returns. However, this does not mean that partnerships in France do not have to fulfil any formal obligations. Rather, they are required to comply with tax and accounting obligations. Business relationships between the partners of a partnership and the partnership itself are accepted provided that they are conducted at arm's length. In addition, the sale or transfer of the shares in a partnership by the respective partner is considered to be a sale of the shares and a sale of the pro rata assets of the partnership.

The basis for the semi-transparent taxation of partnerships can be found in Article 8 of the 'Code général des impôts' ('CGI'). This article stipulates that, subject to an option to corporate income tax, the partners must in principle tax the profits and losses of the partnership on a pro rata basis. Article 8 lists the types of partnership that fall under this. The most important examples of this are general partnerships and general partners for limited partnerships. Different provisions apply to the limited partners of limited partnerships, i.e. the partners who are only partially liable and not fully liable. These will be explained in more detail below. Partnerships under civil law are also taxed semi-transparently if they do not engage in commercial activities, except for real estate development, and for silent partnerships.

As already mentioned, service relationships between shareholders and the company are generally recognised, provided they comply with the arm's length principle. This concerns the transfer of assets to the company in exchange for shares, the general sale of assets between shareholders and the company, and the provision of services to the company. If the shareholder generates income from this, this is taken into account at the shareholder level in the tax return. The income is not considered to be additional income for the partnership. The expenses incurred are deductible by the partnership. The same applies, of course, when the company provides a service to the shareholder. Accordingly, the income increases by the consideration or the fair market value of the service provided (whichever is higher).

With regard to formal tax obligations, it should be emphasised, in particular, at the level of the partnership, that the company not only has to file a tax return, but is also obliged to file a tax return for each category of partner.

This applies in particular to individuals, legal entities, foreign persons and tax-exempt institutions. At the level of the partner, it is sufficient to submit a single tax return in which the pro rata profits or losses from his/her interest in the partnership and other information, such as the date of entry into the partnership and the amount of the interest, are listed. If a tax audit is pending, it will be carried out at the level of the partnership. Nevertheless, only the partners, and not the manager of the partnership, are entitled to challenge the results of the audit. (Barnes, 2020)

If the partners of the French partnership are resident abroad, they are taxed on their pro rata share of the profits or losses of the French partnership in accordance with the general principles. The same applies to foreign partnerships to which French law applies.(*Taxation of International Partnerships*, 2014, Chapter 8: France)

However, as already described, there are also certain structures of partnerships in France that result in taxation under corporate income tax. This was aptly analysed by Rubechi (2015). For example, partnerships under civil law that carry on a commercial activity are mandatorily subject to corporate income tax. In this respect, property management is not considered a commercial activity per se. Nevertheless, renting out a furnished apartment or commercial property trading is sufficient in this respect. The same also applies to the partners of a partnership with limited liability. In particular, this may be a limited partner in a limited partnership. In this respect, too, the partnership is not considered to be semi-transparent, but rather as an independent tax subject that is subject to corporate income tax. (Rubechi, 2015)

Another special feature that should be emphasised is the fact that there is no trade tax in France. In this respect, the distinction between profit income or (private) surplus income is not significant. Any arrangements as loss vehicles also come to nothing, since if a partner is only liable to a limited extent for the losses of a French partnership, that partner is automatically subject to corporation tax and thus to the separation principle (Hellio & Rädler, 2000, p. 402).

4.2.2 French transparency principle

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If you compare the German and French principles of transparency in detail, it is particularly noticeable that this method of taxation is not per se linked to the legal form of the partnership in France. In Germany, unlike in France, partners in a partnership are not taxed differently based on their liability. However, this has the advantage in France that there should not be any problems regarding restrictions on the offsetting of losses such as those set out in the German EStG.

Furthermore, in France, income is only rarely reclassified if there is a service relationship between the shareholder and the company, which is much less complicated than the German term ‘Sonderbetriebsvermögen’ (special business assets) and, in the author's view, leads to less administrative work. This means that no special balance sheet or special profit and loss statement has to be submitted with the tax return.

The author also emphasises the fact that shareholders can defend themselves directly against the findings of a tax audit, whereas in Germany the company must first file an appeal against the company's tax assessment. In the author's view, shareholders can thus react more directly to the tax consequences relevant to them.

The greater administrative burden on the French side can be seen in particular in the obligation to file tax returns for each shareholder, whereas in Germany only one tax return for the separate and uniform determination has to be submitted.

In conclusion, the French transparency principle appears to the author to be not quite as complex and significantly easier to handle in practice, as it is characterised by fewer exceptions. In particular, the distinction between company and shareholder is clearer, as performance relationships are not reclassified and the shareholder can defend themself directly against the consequences resulting for them from a tax audit.

4.2.3 French transparency principle

As explained in the previous chapter, certain partnerships have the option under French tax law to opt for corporation tax. However, this is subject to certain conditions, which Hellio and Rädler (2000) have analysed in detail.

The basis for the option to pay corporate income tax is Article 206 (3) CGI. This should not be confused with the mandatory application of corporate income tax for commercial civil law partnerships or the limited partners of a limited partnership. Rather, it is an option for qualified partnerships that, if exercised, are not only taxed at the corporate tax rate, but for which all regulations related to corporate tax apply. It is therefore a purely tax-related option that has no corporate consequences.

The option must be exercised within the first three months of the financial year for which the option is requested. Furthermore, the option is irrevocable, so the French partnership should be aware of all the consequences in advance.

With regard to the personal scope of application, the general partnership, limited partnership, but also the civil law partnerships that are not commercially active, fall under the corporate income tax option. Furthermore, other, more specialised corporate forms are also given the option of corporate income tax. In particular, certain joint ventures, professional civil law partnerships, health cooperation groups and outpatient care companies should be mentioned here. However, these special forms will not be discussed in detail in the context of this dissertation (Hellio & Rädler, 2000, p. 401 et. seq).

Kußmaul and Schäfer (2000) have commented in particular on the tax consequences for shareholders and the company and referred to the possible reasons for the option.

In this respect, Article 202ter of the General Tax Code provides a detailed description of the respective consequences. If a partnership generates profit income, the option results in the same tax consequences as the termination of business activity. This means that all of the company's profits that have not yet been taxed must be taxed immediately. This result is subject to immediate taxation in the current financial year. This applies in particular to profits that were previously subject to deferred taxation. In this respect, for example, provisions for which the basis would cease to exist if the option were exercised, as well as short-term (net) capital gains whose taxation has been deferred, should be mentioned. Short-term capital gains and losses include the sale of assets that were purchased or produced within the last two years. All other capital gains and losses are considered long-term capital gains and losses.

If the company has incurred losses, these may generally not be carried forward at the level of the shareholder of the partnership. Nevertheless, short-term capital losses arising from the corporate income tax option are not carried forward, but must be offset immediately against short-term net capital gains. Long-term capital losses must be offset against long-term capital gains of the following ten years. Otherwise, they are offset against the current result at the time of the option.

The disclosure of the profits that have not yet been taxed, i.e. the disclosure of the hidden reserves, can be prevented by exercising the corporate income tax option under the conditions of Art. 202 ter-I (2) CGI, provided that certain conditions are met. The fundamental requirement that no new legal entity may be created is always fulfilled when the corporate income tax option is exercised. The other requirement is that the respective balance sheet items must not be influenced as a result of the option being exercised and that the taxation of the profits, the taxation of which has been deferred so far, or the taxation of the hidden reserves, is generally ensured.

Another special feature concerns the so-called registration taxes. In this respect, qualified contributions in kind, such as the contribution of real estate, rights or business operations, are generally subject to a tax rate of 2.2% at the time the option is exercised ('blocking period'). The triggering of these registration taxes can be avoided by holding the company rights held at the time of the option for at least three years from the time of the option (Kußmaul & Schäfer, 2000, p. 161 et. seq).

In particular, Hellio and Rädler (2000) have commented on the advantages and disadvantages of the corporate income tax option in France. In this respect, advantages exist in particular in the fact that the optionally exercised separation principle can avoid the tax burden at the shareholder level. Especially the personal tax rate in France is very high in international comparison, so that the option can significantly reduce the tax burden. Conversely, however, this means that in the event of a loss, the losses cannot be offset at the shareholder level and therefore cannot be utilised to the maximum extent possible.

Furthermore, if the partnership opts for corporate income tax, a tax group can be implemented with the opting company as the parent company, so that profits and losses can be offset against the subsidiary and profit distributions do not have to be taxed. In addition, the option for corporate income tax enables a more tax-neutral implementation of restructurings such as contributions, demergers and mergers in France.

However, one disadvantage is that the option in France can also lead to the immediate disclosure of hidden reserves if the partnership does not generate any profit income. In this respect, a tax deferral can be requested. In addition, the above-mentioned blocking period must be observed so that, if applicable, registration taxes are to be paid if the shares are subject to the option sold within three years.

Furthermore, there are also disadvantages with regard to ongoing taxation in France. In this respect, the provisions on shareholder debt financing apply, so that interest expenses for such loans may not be deductible if the debt capital exceeds 1.5 times the equity of the company. Furthermore, the opting partnership is not treated as a company in France under the Parent-Subsidiary Directive and the EU Merger Directive of 23 July 1990. In addition, the aforementioned long-term capital gains are not subject to a preferential income tax rate, as is the case with personal income tax, but are subject to current corporate income tax (Hellio & Rädler, 2000).

4.2.4 Comparison of option models

As far as the comparison of the German and French taxation system with regard to opted-for partnerships is concerned, the author of this dissertation emphasises that the transparency principle is applied to partnerships in both countries. Nevertheless, partnerships in both countries can opt for corporation tax, so that the basic system of the taxation regime is the same.

In this sub-chapter, the forms of the French option model are compared with the German one. From the author's point of view, the following similarities can be identified.

Firstly, the corporate tax option does not mean that there are any corporate law consequences in France or Germany. Rather, attention is drawn to the fact that the consequences in both countries arise only at the tax level. However, this applies in full, which means that all effects associated with corporate tax apply to the opting company.

With regard to the purely fiscal effects, it can also be stated that the option for corporate income tax, in particular, was intended by the French and German

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legislators to ensure that the taxation of any hidden reserves is not lost. In Germany, this is resolved by observing the requirements and/or application of the reorganisation tax law. In this respect, the hidden reserves are not disclosed only if the requirements of Section 20 of the German Transformation Tax Law (UmwStG) are met (see Chapter 2.2.3 et seq.). In France, this is ensured by meeting the requirements of Article 202 ter-I (2) of the French General Tax Code (CGI), so that in individual cases it must be carefully examined whether the hidden reserves remain tax-entrenched in the opting partnership. This may be the case in particular if the French company has not generated any profit income. This is also consistent with German law in this respect, since in these cases the hidden reserves must also be disclosed in Germany.

Another similarity is that in both countries the corporate income tax option allows for the creation of a consolidated tax group, and thus for the offsetting of the results of two companies. Nevertheless, in both countries the opting company is not treated as a subsidiary, but exclusively as the parent company of the tax group. Furthermore, the Parent-Subsidiary Directive cannot be applied to the opting partnership in either country.

Nevertheless, in the opinion of the author, there are also some differences in connection with the corporate income tax option. These result in particular from the differences in the generally applicable transparency principle. In this respect, the taxation of short-term and long-term capital gains in France should be mentioned in particular, which can have different effects when exercising the corporate income tax option. This distinction is unknown in German law in this context.

Another difference is that under the German transparency principle, certain service relationships between the shareholder and the company have to be assigned to the so-called special business assets. The option for corporate income tax now has different legal consequences. These effects are completely unknown in the French tax regime, since the service relationships between the shareholder and the company have to be assessed in advance at the shareholder level and not at the company level as special business assets.

In the opinion of the author, the peculiarities of German law are characterised by even more complexity and bureaucracy. In particular, the special business assets can present an obstacle to the option compared to the French regulation, since under German law, in principle, all essential operating assets of the special business assets must be transferred to the company.

The fundamental similarity between the two tax regimes, namely that there is a blocking period with regard to the shares in the opting company, differs in that in the event of a blocking period violation in Germany, all hidden reserves must be disclosed, whereas in France only any registration taxes are incurred. Furthermore, the fact that a re-option is not possible in France, which in Germany would lead to a blocking period violation within the first seven years after exercising the option, means that there is an even greater risk of retroactive taxation and possible liquidity bottlenecks in Germany due to unplanned economic burdens. However, the fact that a re-option is not possible in France limits entrepreneurial freedom to a greater extent than in Germany, in the opinion of the author.

Finally, with regard to the formal application requirements, it should be noted that the application for the option in Germany must be made within one month before the start of the respective financial year, while in France the deadline expires only three months after the start of the respective financial year. In this respect, from the author's point of view, the advantage in France is that you can wait almost the entire first quarter of the financial year to sound out the economic conditions and weigh up whether an option for corporate income tax would be worthwhile in that financial year.

The following Table 2 summarises the key differences between the two option models.

Table 2: Key Differences between France and Germany Option Models

France	Germany
• Special tax treatment of short- and long-term gains and losses	• No such regulation exists.
• No such regulation exists.	• Special tax treatment of special business assets.
• A blocking period can retroactively result in taxation exclusively of registration taxes.	• The blocking period can result in the retroactive taxation of all hidden reserves.
• Return option not possible.	• Return option possible.
• Application within the first three months of the corresponding financial year.	• Application up to one month before the corresponding financial year.

Source: own processing.

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5 Conclusion

In conclusion, the question regarding the choice of location based on tax circumstances is not a trivial one for partnerships between Germany and France. In principle, the top tax rate in France is significantly higher than in Germany, so that the application of the transparency principle in Germany is likely to be more favourable at the top than in France. In the context of ongoing taxation, the option model could therefore offer more advantages in France than in Germany in the author's view, since the effective tax burden could be reduced to a greater extent.

In general, the author considers the taxation regime in France to be complex. However, it is not as complex as the German taxation regime for partnerships, since the risk of retroactive taxation is greater in Germany.

In summary, with regard to the research question and hypothesis, it can be concluded that the option model in France can be regarded as more advantageous, while the choice of the transparency principle in Germany is more favourable for the partners of the partnership due to the lower top tax rate. Compared to the taxation of partnerships in France or the option model in France, hypothesis 4 can be confirmed.

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