Report

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Liselotte Madsen

Taxation of Partnerships - Legal general report for the Nordic Tax Research Council's annual meeting on 22 May 2015 in Aarhus

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1 Introduction and terminology

This report has been written on the basis of a number of Nordic national reports on the subject: *Taxation of partnerships*. The contributions from Denmark, Norway, Sweden, and Iceland have been incorporated in the report to the best of my ability and by relevance.

The term "partnership" is a general term for a number of companies that have a common characteristic - namely that they are not taxable entities, but rather transparent for tax purposes. The company type, partnership, which is not a separate tax subject, can be found in all the Nordic countries. In all the countries, there are partnerships in which all the partners have unlimited liability (*general partnerships*), and partnerships in which there are both limited liable partners and unlimited liable partners (*limited partnerships*). In the Nordic countries, there is a considerable variation in how the word *transparency* is used for the distribution of income and expenditure among the partners, and there are different traditions of whether company law and tax law issues arise out of legal regulation or have to be derived from more general principles and practices. In Iceland, you are free to choose at the time when you establish a partnership, whether the partnership should be transparent or taxed as a taxable entity. This freedom of choice does not take place in the other countries.

In the report, the original language terms for the relevant types of companies are used. These terms are also italicized. On the other hand, I have tried to use uniform expressions for the same actions regardless of the country. For example, the Danish word "udlodning" is used even

though the similar Norwegian word is "utdeling", and so on. In English translation, the word "distribution" is used. I hope that it does not provide any linguistic challenges. The term partnership is used to the extent that it is not found necessary to indicate the national name, and expresses only that it is a transparent business.

First, a short review of the company law rules regarding the establishment of partnerships will be carried out, after which, the tax rules will be reviewed.

2 Company law matters

First, it is relevant to relate to the company law rules applicable to partnerships. A description of this has been deemed important for the understanding of the civil law rules for partnerships, both in relation to the third parties (the creditors) and the inter-relationships among the partners.

The rules in Norway, Sweden, Iceland, and Denmark, respectively, have some significant common features. In all the countries, there are business structures in which all the partners have unlimited liability (general partnerships), just as all the countries have business structures in which only some of the partners have unlimited liability (limited partnerships). In Norway, Sweden, and Iceland, the company law rules regarding the inter-relationships among the partners and the relationship to third parties are regulated by statute. It is different in Denmark, where the rules regulating company law are not laid down by law, but created in practice. In all the countries, regulation to a high degree consists of non-mandatory statutory rules, but in Denmark, however, regulation consists of non-mandatory rules created in practice.

Norway is the country in which company law matters regarding partnerships in general are regulated the most and in most detail, and Norwegian legislation, for example, states that a partnership agreement must be estab-

Liselotte Madsen: Associate Professor, Aarhus University; Email: llm@law.au.dk

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lished¹. There are additional material requirements to the content of the partnership agreement. In addition, there are, for example, statutory rules on the size of limited partners' deposits, because there is a requirement stating that limited partners must make a deposit of at least NOK 20,000.² In the other countries, the rule is that the partners themselves decide on the size of any deposits, and the rules that should apply among the partners.

In the following, the companies in which all the partners have unlimited liability will be reviewed.

2.1 Companies, in which all the partners have unlimited liability

In Denmark, the term *interessentskab* (*general partnership*) is used about a co-operation of at least two partners about the operation of a joint commercial activity. *The general partnership (interessentskab)* is defined by law according to which a partnership is "... a business, where all the partners are personally liable without limitation, jointly and severally for the obligations of the business"³.

In Swedish law, the *handelsbolag* (*general partnership*) is similar to the Danish *interessentskab* in that all the partners are unlimited and jointly and severally liable for the obligations of the business⁴.

In Icelandic law, a partnership in which all the partners have unlimited liability is called a *sameignarfélag* and is also regulated by law.⁵

In Norwegian law, a comparable business structure is called an *ansvarligt selskap* (*general partnership*). In Norwegian company law, an *ansvarligt selskap* is defined as a business in which the partners have an unlimited personal responsibility for the total liabilities of the business either exclusively or partly, and together they account for the total liabilities of the business and act as such towards third parties⁶. A Norwegian *ansvarlig selskap* differs from similar business structures in the other Nordic countries as according to the Norwegian rules, it is possible to share the responsibility between the partners so that there is no joint and several liability for the obligations of the business. The partners can only share the business responsibil-

ity towards the creditors if this is registered in the Register of Business Enterprises (Fortaksregisteret) or is known by the creditors.

2.1.1 Establishment

There are different standards for when a partnership is considered to be established.

In Denmark, there are no formal requirements for the establishment of a partnership. Such a freedom of contract may result in doubt about whether a partnership has been established at all, and challenges can arise in relation to assessing whether an amount that a person has invested in a business, should be regarded as a loan, or whether the amount is invested in the expectation that the person is part of the partnership. Further, it is not a requirement that capital should be invested in a partnership.

Similar issues are not found in Norway, since, as mentioned above, there are legal requirements regarding the establishment of a partnership agreement for both general partnerships (*ansvarligeselskaper*) and limited partnerships (*kommanditselskaper*). Among other things, the partnership agreement should contain information about the partnership's name, name and address of all the partners in the partnership (except sleeping partners), the aim of the partnership, whether the partners are obliged to make cash/non-cash contributions and, if so, the size of the contributions. When establishing a new *ansvarligeselskap* (*general partnership*), there is no requirement regarding investment of capital. If you are running a sole proprietorship and take on a partner, it is considered as a new establishment of a partnership. As a general rule, the sole proprietorship is considered realized by the owner. Taking on a new partner in an already established partnership will not be regarded as realization for the other partners. Input value and invested capital for the share is set to a possible investment in the business.

In Sweden, businesses also have to enter into a partnership agreement in connection with general partnerships (*handelsbolag*), but there are no statutory rules on the content of such a partnership agreement, which may also simply be concluded in writing.

In Iceland, there seems to be no requirements on the conclusion of partnership agreements between the partners either, but this does, of course, not change the fact that it is recommendable to conclude such an agreement.

¹ Cf. the Norwegian company law sections 2–3 and sections 3–1 (selskapsloven §2–3 og 3–1).

² The Norwegian company law sections 3–5 (selskapslovens §3–5)

³ The Danish act on certain commercial undertakings section 2, paragraph 1 (Lovomvisseerhvervsdrivende virksomheder §2, stk. 1.)

⁴ Chapter 2 Section 20 BL (2 kap. 20 §BL (bolagslagen)).

⁵ Lög um sameignarfélög 2007 no. 50 27 March

⁶ Section 1-2, first paragraph b (§1–2 første led bokstav b).

2.1.2 Withdrawal

Denmark, Sweden, and Norway have uniform rules with regard to the partners' ability to withdraw from a partnership without dissolving it. The Norwegian rules are governed by law and conclude that a partner may withdraw from the business with 6 months' notice⁷. In Sweden and Denmark, the rules are not statutory and thus, in these countries, the rule is that partners can only withdraw with the consent of the other partners.

2.1.3 The relationship with third parties

The relationship with third parties primarily concerns the question of to whom the partnership's joint creditors and the partners' separate creditors can direct their claims. This question is not addressed in the same way in all the Nordic countries.

In Sweden, a creditor can direct his claim against the partnership either directly or against any of the partners. The creditor does not have to direct his claim against the partnership before he directs it against a partner in the partnership. A new partner is also liable for former obligations that the partnership has incurred previously, while the general rule is that a partner who withdraws from a *handelsbolag* (general partnership) is not liable for debts incurred after the withdrawal.

In Norway, the rules are different, as here, the partnership's creditors must make their claims against the partnership first. If the partnership does not pay within 14 days after receipt of a request, the creditor may direct his claim against other partners in the partnership. The creditor may also make his claim directly to the partners if it is apparent that the partnership is not able to pay.

In Denmark, there is no company law regulation of partnerships. The question with regard to whom the creditors can direct their claims is thus not regulated by law either, but in theory, it is assumed that the creditor must first direct his claim to the partnership, and if the partnership has not paid the amount within "reasonable time", the creditor may instead make his claim directly against a partner.

If a partner pays some of the partnership's debt to a creditor, the question arises whether the partner can direct a recourse claim against the partnership and/or the other partners.

In Norway and Sweden, the partner can direct his recourse claim against the partnership or against the other partners. In Denmark, a recourse claim can only be directed against the other partners. The practical difference between these two options does not appear to be large.

2.2 Special on limited partnerships

In all four countries, there are different types of partnerships. Above the general partnerships that are characterized by only consisting of partners with unlimited liability are mentioned. Thus, all four countries have also rules involving two types of partners: partners with unlimited liability, and partners with limited liability. In general, it is the same rules that apply to these types of businesses. As mentioned previously, all countries have several types of partnerships. And thus also a business type involving two types of partners: one type of partner with unlimited liability, and a second type of partner who is only liable up to the amount that he has invested. In the following, the special rules applicable to these partnerships will be dealt with.

In Iceland, this business structure is called *samlagsfélag* (limited partnership) and is characterized by the fact that this business structure is only regulated by a few statutory rules and these rules are not written down in a separate act. Both individuals and limited liability companies can be partners in the business.

In Norway, this type of business is called a *kommandittselskap* (limited partnership).⁸ Again, it is a characteristic feature of Norway that also here the business structure in question is relatively well-regulated, which makes it interesting to highlight these rules. Among other things, there are legal requirements stating that the partners must draw up a partnership agreement containing more information than if it was an *ansvarligselskap* (general partnership). The agreement must contain provisions about the partners' liability in connection with the financial obligations of the business and the share capital, as well as how large a part of the capital is tied up.⁹ The agreement must also include provisions about the partners' invested deposits and payment of the share capital.¹⁰

In only one country, namely Norway, it is a legal requirement that a *kommandittselskap* (limited partnership)

⁸ Sections 1–2 first paragraph(e) (Sel. §1–2 første led, bokstav e)

⁹ Cf. Section 3-1 second paragraph of the Partnership Act (sel. §3–1 annet led)

¹⁰ Cf. Section 3–2. (Sel. §3–2)

⁷ Sections 2-32–2-35 of the Partnership Act (Sel. §§2–32 to 2–35.)

must have a certain share capital, where at least 40% is tied-up capital. The tied-up capital must be paid to the partnership not later than 2 years after the partnership has been registered.¹¹ Furthermore, Norway has legal requirements regarding general partners' contributions. This (or these, if there is more than one) must contribute at least 10% of the share capital, own at least 10% of the partnership's net assets at any time and have at least an equal share of the profits and losses. Each limited partner must at least invest NOK 20,000 in a *kommandittelskap* (limited partnership)¹². If the tied-up capital has not been paid within the 2-year limit, the company can be dissolved. If the partnership continues the business even if the *kommandittelskapet* (limited partnership) is dissolved, the rules regarding *ansvarligeselskaper* (general partnerships) apply. This means that the partners have unlimited liability for the obligations of the partnership.

In Sweden, the business structure is called a *kommanditbolag* (limited partnership), and the partners are referred to as *komplementär* (general partners) and *kommanditdelägare* (limited partners), respectively. In such partnerships, the rules for *handelsbolag* (general partnerships) are used in a revised form. The differences can be attributed to the difference in the liability of the two types of partners. In Sweden, the tasks of a *kommanditdeläger* (limited partner) in the partnership are statutory, as this partner has invested capital in the partnership, but is not personally involved in the management of the partnership or in the partnership in general. It is assumed that a *kommanditdeläger* (limited partner) does not have the right to participate in the management unless, otherwise, agreed¹³. Furthermore, a *kommanditdeläger* (limited partner) cannot represent the partnership, like partners in a *handelsbolag* (general partnership) normally can.

In Denmark, the partnership is defined in an act¹⁴. However, there are no rules on the size of a *limited partner's* (kommanditists) deposits or rules on whether a *limited partner* is allowed to participate in the operation of the partnership. There is thus a greater freedom to organize the partnership as requested by the partners than, for example, in Norway. In Denmark, it is not a requirement either that the *general partner* (komplementar) has an owner's share in the *limited partnership*, as can be seen, for example, in Norway, where this is directly statutory.

In Iceland, this type of business is called a *samlagsfélag* (limited partnership), and it has the same characteristics as in the rest of the Nordic countries. There are only a few statutory rules for this type of business and Iceland does not have a specific act on this. A partnership is founded through the preparation of a partnership agreement and the partnership must be registered together with this agreement. In Iceland, there is no requirement for a minimum capital. How large the contribution should be is based on an agreement between the partners.

3 Tax law issues

3.1 Introduction

A common feature of the Nordic countries included in this report is that in all the countries, there are rules that make it possible to establish a business that is not a limited liability company. However, there is a big difference between how the rules regarding taxation of partners in partnerships function in the different countries. In Iceland, certain partnerships have the possibility to choose themselves whether they would like to be considered as being a taxable entity or a transparent partnership. The business must be registered in order to be regarded as being a separate tax subject. The choice is made once and for all and cannot subsequently, be changed. In the following sections, only transparent partnerships will be described.

The general rule is that because partnerships are not separate tax subjects, a decision must be made as to how income and expenses are distributed among the partners.

The fact that a partnership is transparent is not unambiguous. In theory, a distinction is made between whether the partnership is totally transparent or only limited transparent, which are two theoretical extremes. The degree of transparency may, in practice, be somewhere between these two extremes. (Le Gall, 1995; Madsen, 2011).

The term *total transparency* means that the partnership's only task is to determine each partner's share of revenues and expenses, assets and liabilities. Each partner calculates his share of the profit and loss himself and completes his income tax return as if he was the only partner with his proportionate share of the partnership's profits and losses. The partnership as such does not exist for tax purposes.

The term *limited transparency* means that the partnership is considered as an independent unit. It is the partnership that makes the income and bears the costs, just as the partnership owns the assets and the liabilities. The

¹¹ Section 3-1. (Sel §3-1)

¹² Section 3-5. (Sel §3-5)

¹³ Chapter 3 Section 4 BL (3 kap. 4 §BL)

¹⁴ The Danish act on commercial business section 2, paragraph 1 (lovomvisseerhvervsdrivende virksomheder §2, stk. 1)

partnership makes a statement of income and submits a tax return. Only the actual tax obligations are transferred to the partners, who pay tax on behalf of the partnership. As a starting point, the partnership is treated as a limited liability company with the reservation that it is not a separate tax subject. The question of total versus limited transparency is implemented in several countries as a question of gross or net assessment of the partnership.

3.2 Current taxation in the partnership

As mentioned above, it is the starting point in all the countries that partnerships are not separate tax subjects. It is a common feature of all the countries that both individuals and limited liability companies can be partners in partnerships.

3.2.1 Net assessment or gross assessment?

The Swedish, Norwegian, and Icelandic¹⁵ rules have a lot in common as all three countries operate with net assessment of partnerships, whereas Denmark bases its taxation on a gross assessment of the partners. In Sweden, Norway, and Iceland, profit and loss is calculated at company level as if the partnership was a separate tax subject. In Sweden, it is thus described that a *handelsbolag* (general partnership) is a unit where the tax transparency is limited to tax payment (*resultatberäkningsenhet*).

If the partnership sells an asset, the calculation of gains or losses takes place at partnership level in the above three countries. Depreciation also takes place at partnership level with the consequence that the partners cannot individually determine their depreciation of the assets in the partnership. The net income cannot be shared between the partners until the net income is determined at partnership level. In all the countries, the rule is that profit sharing is made according to the partnership agreement concluded between the partners. Where no agreement has been concluded, the calculation will be based on the civil law rules on equal sharing.

In Denmark, the gross assessment principle is applied, resulting in more direct transparency. As a consequence of this, the partners make the decisions that the law allows for. This, for example, applies in connection with the choice regarding depreciations. Here, it is the partners who choose how large depreciations they want to

make. The partners are considered as self-employed persons with an undivided share of the partnership's assets and liabilities.

3.2.2 Taxation of the partners' profits, individuals

In Sweden, Norway, Iceland, and Denmark, partnerships are regarded as transparent, but the four countries handle transparency differently. In Norway, the partners in an *ansvarligsselskap* (general partnership) are taxed according to the net profit share by 27%¹⁶. The profits can be deposited in the partnership or be shared between partners according to choice. When a distribution takes place, the amount is taxed again, so that a distribution that exceeds a specified amount, is taxed further by 27%¹⁷. The marginal tax rate for a person, who participates in a partnership, will be 46.71% in total, which largely corresponds to the tax rate on salary.

In Sweden, a slightly different method is used, as here, the partner will be taxed on the basis of his net share of the partnership's profit regardless of whether the amount is taken out of the partnership or not. Income from a *handelsbolag* (general partnership) is taxed in the income category business activity (*næringsvirksomhed*) with a progressive tax rate between 30 and 57%.

The same seems to apply in Iceland, where the partner will be taxed immediately of the net profits with a tax rate of 37.3 and 46.24%.

In Denmark, it will not make any sense at all to discuss whether part of the profit should stay in the partnership. Here, the share of the profit will be directly included in the partners' income statements. In Denmark, the partners are taxed according to a gross share of each income in the partnership, and have similar deductions of a gross share of each item of expenditure in the partnership. At first, it will provide a marginal tax rate of 56.4%. On the other hand, the partner has the opportunity to use the rules in the Business Tax Act (*virksomhedsskatteloven*) in connection with his share of the profit. In this way, only a provisional tax of 23.5% must be paid (2015) corresponding to what a public limited company pays in tax. After payment of the preliminary tax of 23.5%, the profit can be deposited in an account for accumulated profits. Only when the partner chooses to use the profit, it will be taxed fully, that is, up to a total of 56.4%.

¹⁶ Included in the revenue base *alminneliginntekt*.

¹⁷ The profits are included together with other net income.

¹⁵ Where the partnership chooses to be treated as a transparent unit.

There are different rules in the Nordic countries with regard to whether the result of the partnership is included in a net statement of the partners' total income.

In Denmark and Norway, individual's shares of profits and losses from participation in partnerships will be included in the calculation of the partner's total net income, which may derive from other business activities or earned income, but not from income from passive activities. In Sweden, the rules are different. Here, individual's net shares of profits and losses in a *handelsbolag* (*general partnership*) constitute a separate income category that cannot be deducted from the taxable person's income from other business activities, if any.

3.2.3 Taxation of the partners' profits, legal persons

In Denmark, the share of the profits owned by a limited liability company will be considered as all other income in the company and will be included in the net statement of the company's results. In 2015, profits will be taxed at a rate of 23.5% in the company.

In Sweden, taxation of the partner's result depends on whether the partner is a limited liability company or an individual. For legal professionals, the income category is business (*näringsverksamhet*) as individuals. To legal persons, this is the only income category available. Therefore, the result is included in the calculation of the legal person's total income and is not limited as in the case of individuals as mentioned above.

In Norway, legal persons, who are partners in an *ansvarligselskap* (*general partnership*), will be taxed at a rate of 27% of the profits, corresponding to the taxation of individuals who are partners in an *ansvarligselskap* (*general partnership*). Distribution will, on the other hand, as a general rule, not be subject to taxation as with individuals. On the other hand, the partner must book 3% of the distribution as income¹⁸.

In Iceland, the partner's profit is taxed at a rate of 20%.

3.2.4 Use of losses-individuals or legal persons (limited liability companies)

In general, there are no restrictions in the Nordic countries on the partners' use of the losses in other incomes with re-

gard to losses made in connection with participation in a partnership that only has unlimited liability partners regardless of whether the partner is an individual or a legal person.

Sweden is the only country that does not have this possibility for individuals as both the profit as well as the loss is regarded as a separate income category.

Other rules apply to partnerships that have both fully liable partners and limited liable partners. These rules will be described below in more detail in the section on "limited partnerships".

3.3 Salary from the partnership

The tax consequences for partners, if they, for example, receive salary/labor compensation for a special work effort in the partnership, may be viewed in several ways. The number of ways depends on the degree of transparency in the partnership. In case of total transparency, a salary payment to a partner will be considered as if a partner in the partnership gets a deduction for salary paid to himself as the partner in this situation owns a share of each income and expense, every asset and liability in the partnership. This is not necessarily the case in the countries in which the rules originate from a more limited form of transparency. Here, a salary can be paid even if it means that the partnership in this way will get a loss.

In Norway, transactions between the partnership and the partners are regarded as transactions carried out between separate tax subjects¹⁹. In *selskapsloven* (*the Norwegian companies act*), the Norwegians define the concept labor allowance as an evidence of a compensation that a personal partner is entitled to due to his work effort in the partnership²⁰. Thus, there is a difference between labor allowance and salary. Such a compensation can be deducted in the partnership and will thus, reduce the profit or increase the loss. The payment is not taxed as salary, but as *virksomhetsinntekt* (business income) (27%) and *personinntekt* (personal income) *trygdeavgift* (social security contribution) of 11.4% and *toppskat* (top rate tax) of 9–12% depending on the income. Labor allowance that is not paid will be taxed anyway in the year of accrual.

Similar rules exist in Sweden, where payment of a partner's salary for management of the partnership is deducted before the result is distributed between the partners. In Sweden, the amount is not taxed as salary ei-

¹⁸ Section 2–38, sixth paragraph of the Tax Act (Sktl. § 2–38 sjettedd.)

¹⁹ Section 10–45 of the Tax Act (Sktl. §10–45.)

²⁰ Section 2–26 of the Partnership Act (Sel §2–26.)

ther. On the other hand, the income category business (næringsverksamhet) is subject to tax, which the current profit/loss also is. An individual cannot with tax effect be considered an employee in the *handelsbolag* (general partnership) in which he is a partner.

In Denmark, where the rules are based on total transparency, labor allowance/salary cannot be deducted in the partnership as it would correspond to a situation in which a partner who receives salary would be entitled to a tax deduction for an ideal share of the salary that he receives. In theory, it is assumed that this may be departed from, if the partner's share in the partnership is very small, and the partner is without influence on the decisions made in the partnership, or if the partner, in general, is regarded as an employee.

In Iceland, they have a completely different approach to how salary to a partner is dealt with in terms of tax. Here, salary from a partnership will be qualified as such and will be taxed as earned income, including social contributions, and so on. This is the only country in which it is mandatory that part of the partner's income from the partnership is qualified as salary and is taxed as such.

3.4 Return on capital deposit

In Sweden, the amount paid to the partner as return on investment in the partnership is treated in the same way as labor allowance, see above. Unlike labor allowance, however, the amount will be taxed in the income category capital.

In Iceland, interest payments from the partnership to the partners are taxed as interest at a rate of 20% in the same way as any other interest income to individuals.

In Norway, it is a statutory rule that partners who have made capital investments must be credited for interest of the amount and that this must be deducted from the profit. The interest will be taxable at the time of distribution and not at the time of accrual²¹.

Again, Denmark stands out from the other countries. Return on capital deposit is treated in the same way as labor allowance to a partner. Return on capital deposit is included only as part of profit sharing and will not be considered as an actual interest income for the partner.

3.5 Sale of shares/withdrawal from the partnership

The difference between gross assessment and net assessment becomes clear when you consider what happens if a partner sells his share of the partnership. While in Sweden and Norway, you can "trade" with entities in a way which is similar to the way in which you sell shares, that is, sale of net shares in the partnership, it looks different in Denmark and probably also in Iceland. The starting point in all countries is probably that there is no free transfer of shares in partnerships, where all the partners have unlimited liability as the partners are mutually dependent on each other's good economy. The presentation to the national reports does not include any questions regarding this, however.

In Sweden, a net share in the partnership can be abandoned and thus, a capital gain or a capital loss must be calculated. This is calculated on the basis of a statement of the value of the share as the difference between the compensation and an adjusted acquisition price, that is, a net share. Sale of shares in a *handelsbolag* (general partnership) is included in the income category capital with a proportional tax rate of 30%. For legal persons, gains and losses can be attributed to the income category economic activities.

The same applies in Norway, where also a capital gain is calculated based on a statement of a net profit or loss of the share. Gains will be subject to tax and losses will be tax deductible²². If the partner disposes his share of the business, for example, in an *aktieselskap* (limited company), he is basically exempt from paying tax of gains and cannot deduct tax on losses on realization of shares. When a partner withdraws from the business, the share is regarded as realized by the withdrawing partner, whereas this is not considered to be a realization for the other partners.

In Denmark, the situation is somewhat different. Here, the partner is considered to own an ideal share of each asset and liability. When a partner chooses to withdraw from a partnership, an ideal share of each asset and each liability is thus sold. As the partners individually have laid down, for example, the size of depreciation, a capital gain should be calculated on the basis of this. For the other partners, a partner's withdrawal will also have tax consequences, as they are deemed to have acquired an ideal share of the withdrawing partner's share of the partnership. Thus, in Denmark, it is not possible to sell a net share of the partnership without tax consequences for the re-

²¹ Section 2-25 of the Partnership Act (Sel. 2–25.)

²² Section 10–44 of the Tax Act (Sktl. § 10–44.)

maining partners as in Sweden and Norway. If a withdrawing partner sells his share directly to a new partner who enters the partnership, the situation is different. The withdrawing partner is considered to have sold his share of the partnership's assets and liabilities directly to the joining partner and here, it will only be the income statements of the two persons that are affected by the renunciation and the purchase, respectively, while the other shareholders are not affected by the sale.

The rules in Iceland are more or less similar to the above as the partner is considered to have sold a share of the different types of assets and the associated liabilities. Gains will therefore have to be calculated differently depending on the asset and the applicable depreciation rules for the asset in question.

3.6 Special on limited partnerships

Just like there is a need for a special section on limited partnerships in relation to company law, there will also be special rules under tax law, especially as a consequence of the fact that limited partnerships consist of both partners with unlimited liability, and partners with limited liability. There is, particularly a need for a separate consideration of how the limited partners must behave in case of a deficit on their share of the limited partnership as a result of their limited liability.

As mentioned above, the general rule in Norway outlines that *it is* not a requirement that the partner must invest capital in the partnership when a new *ansvarligsselskap* (*general partnership*) is established. Things are different for limited partnerships as it is a requirement that the partner must invest a certain amount in the partnership. See above for further details on the company law rules. Under tax law, a partner with limited liability, such as, for example, a limited partner, will not be able to deduct losses from the limited partnership from other income, but must carry the deficit forward and use it for later profit or gain in the partnership²³.

In Sweden, income in a *kommanditbolag* (*limited partnership*) is taxed in the same way as income in *handelsbolag* (*general partnership*) as a *general rule*. There are special rules for partners in limited partnerships as a result of their limited liability for the partnership's obligations. If the partnership shows a loss, the partner will only be entitled to a tax deduction for the part of the loss that, together

with previous years' deductions of loss, does not exceed the partner's contributions to the partnership²⁴.

In Denmark, the rules regarding *limited partners'* deduction of loss are covered by a major legal regime. The principal ideas are that the *limited partners* cannot deduct loss that exceeds the amount that the *limited partner* is liable for. This rule is regulated by a tax deduction account. As long as the deduction account is positive, the partner can both deduct losses and depreciations from its participation to the extent that it can be kept within the deposit on the deduction account. If losses and depreciations exceed the contribution, the right to depreciate will first become more limited and next, the access to use the loss will be reduced. Deficits, that have become the subject of the deduction limitation are not lost, but can be carried forward and used in a subsequent income year, where the deduction account may have become positive. Unbound depreciations can just be omitted and be made at a later stage.

Another specific point regarding *limited partnerships* worth mentioning is that in Denmark, it has been discussed in theory, whether it is a requirement that a *general partner* is a co-owner of the limited partnership in order for the limited partnership to have the status of a partnership in a tax law context. A judgment has, however, established that this is not the case.

3.7 National principles for international affairs

When answering the following two questions about national principles for international affairs and foreign companies, which will be taxed as partnerships, the national reports pull in many different directions. As a result, these two points will only describe the various countries' input in outline.

In Norway, the worldwide income principle applies for profit from partnerships²⁵.

If Norway has not entered into a double taxation treaty with the country, or if the agreement is based on the credit principle from Norway's part, the partner can claim credit for the foreign tax paid²⁶. This applies to both the partners' and the partnership's tax. If an agreement based on the

²³ Cf. Section 10-43 of the Tax Act (sktl. §10-43).

²⁴ Cf. Chapter 14 Section 14 in the Income Tax Act (14 kap. 14 §IL).

²⁵ Cf. Section 2-1 ninth paragraph of the Tax Act (sktl. §2-1 niende led) (personal participant) and section 2-2 sixth paragraph of the Tax Act (sktl. §2-2 sjette led) (partner).

²⁶ Cf. Section 16-20 of the Tax Act (sktl. §16-20).

exemption method (*unntaksmetoden*) exists, then Norwegian tax law may not apply. This typically is the case if the partnership has a permanent establishment in another country. Profit in connection with realization of a share in a partnership operating abroad is taxed according to the general rules. Losses are also tax-deductible. If the other state (the source state) regards such a sale of shares as being a sale of an underlying equipment, then double taxation may take place. If Norway has a double taxation treaty with the other state, it will depend on this agreement, whether Norway offers credit for tax paid to the other state. If the double taxation treaty is based on the exemption method (*unntaksmodellen*), then it must be assumed that Norway cannot tax the profit. The global income principle applies in principle also for distribution to a personal partner²⁷. It is a condition for the tax liability in Norway that the partner is liable to pay tax in Norway at the time of distribution. Furthermore, the tax liability only applies for distributions that are related to income that is or has been liable to taxation in Norway.

In Sweden, it is explicitly regulated by law to which extent foreign tax on income earned by tax transparent partnerships can be deducted. The rules imply that foreign income earned by transparent partnerships is regarded as earned by the partner himself. If the partnership has paid foreign tax, then this tax should also be regarded as paid by the partner himself. In this way, settlement of foreign taxes is made possible despite the fact that it can fail in the subject identity, which is normally required, if such an international double taxation, which entitles to settlement, should be established.

In Iceland the rule is that a partnership is considered Icelandic if it is registered in Iceland, or with regard to non-registered partnerships if the majority of the partners are resident in Iceland, and the majority of the commercial activities take place in Iceland. As a consequence of this, a partnership with foreign partners can be considered as domiciled in Iceland. A foreign partner in a partnership will be taxed of all business income earned in Iceland. If the partner is a foreign company, then the participation in the partnership may be considered as a permanent establishment. This depends partly on Icelandic legislation as well as on whether double taxation treaties have been concluded.

3.8 Foreign companies, which are taxed as partnerships

Foreign partnerships, that is, partnerships that are not registered in Sweden, are subject to limited tax liability in Sweden if they constitute a foreign legal person²⁸. The content of the concept is much debated. In order for a foreign partnership to be covered by the concept, the partnership must be able to acquire rights and undertake obligations and be a separate legal entity in relation to courts and administrative authorities. These two conditions are quite simple to assess. There is, however, a second criterion that must be fulfilled according to Swedish tax law before a foreign subject is considered to be a foreign legal person. This criterion is that it should not be possible for a partner to freely dispose of the assets of the business. This would disqualify the business as a foreign legal person. The content of this criterion is not clear. A foreign business, which is not regarded as a foreign legal person, will be ignored completely in connection with Swedish taxation. Consequently, it is the partner's liability to pay tax in the country, which is the decisive factor when establishing whether the partnership's income is taxed in Sweden.

When a business is regarded as a foreign legal person, it will be treated as transparent in Sweden if it is treated as transparent in the home country. Conversely, the partnership will be treated as a separate tax subject in Swedish tax law if this is the case in the foreign state in which the partnership is domiciled. The idea is that the business should be treated symmetrically in the foreign state and in Sweden.

In Denmark, the tax law qualification of a foreign business takes place according to internal Danish tax law. Here, emphasis is on personal liability for at least one of the partners, the goals of the business, and moreover, the criteria, which are developed in practice. The foreign qualification is not decisive for the Danish qualification. The fact that foreign partnerships are qualified according to internal Danish tax law will have a decisive importance when it has to be determined whether any double taxation relief should be made, and whether tax of the profit can be withheld. Thus, it follows from practice that the Danish qualification in interaction with the provisions in the double taxation treaties will have a decisive impact on the answers to these questions. In cases where a foreign separate tax subject is qualified as a partnership according to Danish law, the Danish qualification of the benefits flowing from the foreign business is decisive for a double

²⁷ Cf. Section 10–42 of the Tax Act (sktl. §10–42).

²⁸ Cf. Chapter 6 section 8 in the Income Tax Act (6. kap. 8 IL).

taxation relief. It follows from the transparency principle that according to Danish law, participation in a partnership provides access to claim depreciation on the partnership's assets. As a result of this, partnerships have been used for tax planning. Danish law comprises rules that are established in order to counteract that a taxpayer can use a different qualification of a business in two states to obtain tax advantages. The provisions are based on a principle that establishes that the Danish qualification of a tax subject equals the qualification the tax subject has in the other state. One of the rules thus, means that a partnership that is full or limited tax liable in Denmark and consolidated with a legal person in a foreign state will be reclassified into a transparent entity when the partnership in the other state is considered to be transparent. It is a condition that the Danish partnership is controlled by the foreign partnership. Another provision regulates the reverse situation. In other words, a Danish transparent entity is reclassified as a separate tax subject. The purpose of the provisions is to prevent exploitation of a different qualification of the business in the two states.

In Norway, foreign partners in Norwegian partnerships are normally liable to pay tax on current profit²⁹. If the partnership is considered to have a permanent establishment in Norway, the partner will also have a permanent establishment in Norway. A distribution will be taxable in Norway if the partner is liable to pay tax in Norway at the time of distribution. The tax liability only applies to distributions related to income that is or has been liable to taxation in Norway.

4 Conclusion

This report has been prepared on the basis of national reports from Iceland, Norway, Sweden, and Denmark. In the report, it has been established that even though all the countries concerned have rules regarding transparent businesses, these rules are indeed very different.

It is also clear that there are different traditions regarding the degree to which the legal status for partnerships with regard to tax law as well as company law is regulated either directly in law or inferred of general principles and practices. It is clear to me that Norway has gone further in their regulation within a large number of areas than any of the other countries, and Denmark is located on the other

end of the scale where almost nothing is particularly regulated by law. Whether you are an advocate of one principle or the other probably depends on whether you are a believer in the greatest freedom of contract possible, or whether you prefer that the rules are clear, as they are, when they are included in an act. In Denmark, there are fewer partnerships than limited liability companies. One of the traditional explanations for this is that limited liability companies are well regulated by law, while partnerships as a rule are not regulated much by law. Whether this would be different, if we "adopted" the Norwegian rules, is not a question for me to answer.

There are also clear differences in how the so-called transparency principle has been implemented in the individual countries. Here, the extremities are on the one hand Sweden and Norway, where Norway has made the greatest effort to limit transparency. In Norway, transactions between the partnership and the partners are regarded as transactions carried out between separate tax subjects. On the other hand, regulation in Denmark is based on total transparency, where each partner owns an ideal share of each asset and liability and has an ideal share of all income and expenses in the partnership, and the partner's labor allowance will be considered as being part of the distribution of profit and not as an expense that must be deducted from the partnership before distribution is made to the partner.

All in all, it is very interesting to see how the Nordic countries have developed different rules for regulation of partnerships, all of which are based on the existence of transparent businesses, where the partners are taxed directly on the income of the business.

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²⁹ Cf. Section 10-41 of the Tax Act, cf. section 2-3 first paragraph (b) of the Tax Act (jf. sktl. 10-41, jf. sktl. §2-3. første led, bokstav b).