THE EUROPEAN ECONOMIC INTEREST GROUPING

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On 25th July 1985 the Council of the European Communities created a new entity to assist effective cross-frontier cooperation and play a modest role in securing a "harmonious development of economic activities and a continuous and balanced expansion throughout the Community". (Council Regulation (EEC) No.2137/85). The principal purpose of this article is to give an overview as to how this entity, the European Economic Interest Grouping ("the Grouping"), is taxed in the United Kingdom. In future issues of the Review we hope to analyse the benefits and pitfalls of using a Grouping. We would particularly welcome any comments or reports on practical applications.

Background

Before dealing with the detailed tax provisions it may be helpful to give a brief outline of the Grouping's main characteristics. The primary source of legislation is the Council Regulation itself ("the Regulation"). The European Economic Interest Grouping Regulations 1989 (SI 1989 No.638) ("the 1989 Regulations") deal with the registration of Groupings in the United Kingdom.

(a) Legal Personality

Under the Regulation a Grouping is deemed to "have the capacity, in its own name, to have rights and obligations of all kinds, to make contracts or accomplish other legal acts, and to sue and be sued" (Article 1 paragraph 2). The individual Member States are given the discretion to determine whether Groupings registered at their registries have legal personality. The 1989 Regulations provide that a Grouping registered in Great Britain shall be a body corporate (Article 3).

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(b) Formation

Parties intending to form a Grouping must enter into a contract setting out the Grouping's name, official address, objects, registration details and duration (except where this is indefinite) (Article 5). The Grouping must then be registered in the state in which it has its official address; this will be either where the Grouping has its central administration or where one of the members has its central administration or, in the case of a natural person, his principal activity, provided that the Grouping carries on an activity there (Article 12). Article 7 requires the contract of formation to be filed at the appropriate registry. Any amendments to the contract, including any change in the composition of the Grouping, must also be filed at the registry together with details of any setting up or closing of an establishment by the Grouping, appointments of managers, winding up or proposal to transfer the official address.

The detailed rules governing the registration of Groupings in UK are set out in the 1989 Regulations. The fee for registration is the same as the registration fee for a company (The European Economic Interest Grouping (Fees) Regulations 1989 (SI 1989 No. 950)).

(c) Purpose

Article 3 of the Regulation provides that the purpose of a Grouping is "to facilitate or develop the economic activities of its members" and that its activities should be related to the economic activities of its members but must not be "more than ancillary to those activities". In a Press Release dated 19th April 1990 the Inland Revenue gave processing, packing, marketing or research as examples of purposes for which a Grouping could be formed. The Regulation is, however, more specific about what a Grouping should not do; in particular, its purpose should not be to make profits for itself. Furthermore, a Grouping may not:

(a) exercise directly or indirectly a power of management or supervision, either of the activities of its members or of another undertaking, in particular in the fields of personnel, finance and investment;

(b) hold shares in its members;

(c) employ more than 500 people;

(d) be used to make loans to, or transfers of properties to, directors in certain circumstances where restricted conditions apply;

(e) be a member of another Grouping.

(d) Membership

The members of a Grouping must be either companies or firms which have been formed in accordance with the laws of a Member State or natural persons who carry on any industrial, commercial, craft or agricultural activity or who provide professional or other services in the Community. Each Grouping must comprise at least either two companies or firms which have their central administrations in different Member States, or two natural persons who carry on their principal activities in different Member States, or a mixture of both (Article 4). Therefore, it must be a truly international entity.

(e) Management

Article 19 provides that a Grouping shall be managed by one or more natural persons appointed in the formation contract or by decision of the members. A Member State may provide that legal persons may be managers on condition that they designate one or more natural persons to represent them. This power has been adopted in respect of Groupings registered in the UK by Article 5(1) of the 1989 Regulations. A manager so appointed would be responsible both for the administration of the Grouping and in dealing with third parties. Indeed, Article 20 stipulates that it is only the managers who may represent a Grouping in respect of dealings with third parties.

(f) Profits and Losses

For fiscal purposes the Grouping is transparent. Under Article 21 the profits arising from a Grouping's activities are deemed to be the profits of the members and are apportioned among them in the proportions laid down in the formation contract or, in the absence of such provision, in equal shares. Similarly, to the extent that the Grouping's expenditure exceeds its income, the members must contribute to the payment of the amount in accordance with the contract or, if the contract does not stipulate, in equal shares.

Taxation

This brings us to the question of how those profits and/or losses are treated for the purposes of UK taxation. Article 40 of the Regulation deals with taxation as follows:

> "The profits and losses resulting from the activities of a Grouping shall be taxable only in the hands of its members."

In other words, the tax treatment of the Grouping should reflect its fiscal transparency. The detailed provisions are left to the individual Member State; the Recital to the Regulation says:

> "Whereas this Regulation provides that profits or losses resulting from the activities of a Grouping shall be taxable only in the hands of its members; whereas it is understood that otherwise national tax laws apply, particularly as regards the apportionment of profits, tax procedures and any obligations imposed by national tax law."

The United Kingdom introduced legislation governing the taxation of Groupings in the Finance Act 1990 (s.69 and Sch 11). This Schedule inserted s.510A into the Income and Corporation Taxes Act 1988 (ICTA 1988) and ss.12A and 98B into the Taxes Management Act 1970 (TMA 1970). In addition, some small changes to other administrative provisions were introduced.

Income Tax

Section 510A applies to any Grouping formed in pursuance of the Regulation, whether registered in Great Britain or elsewhere (s.510A(1)). In outline, it provides that a non-trading Grouping is to be regarded as acting as the agent of its members and that where any trade or profession is carried on by a Grouping it shall be regarded as carried on in partnership by the members. These aspects are considered in more detail below.

(a) Non-Trading Groupings

Where a Grouping does not carry on a trade or profession, s.510A(2) provides

> "For the purposes of charging tax in respect of income and gains a Grouping shall be regarded as acting as the agent of its members."

For these purposes, the activities of the Grouping are to be regarded as those of its members acting jointly and each member is to be regarded as having a share of Grouping's property, rights and liabilities (s.510A(3)(a)). The member's share is to be determined in accordance with the contract of formation, or if no such provision is made, by reference to the member's share of the profits to which he is entitled under the contract and, if this is not covered by the contract, the members shall be regarded as having equal shares.

As the Grouping is treated as the member's agent, a United Kingdom resident member of a Grouping will be subject to the normal provisions governing whether he is taxable on his share of any income arising or whether he is entitled to a deduction for his share of expenditure. This latter point was confirmed by the Inland Revenue Press Release of 19th April 1990 which stated that "the availability of relief for contributions by a member to the EEIG's running expenses and of capital allowances for contributions towards capital expenditure, will be determined under the normal rules". In particular, in order to be able to deduct his share of the Grouping's expenditure the member will need to show that the payment is made wholly and exclusively for the purposes of his trade.

As s.510A(3) treats each member as having a share in the Grouping's assets the member may be able to claim capital allowances on his share of any qualifying expenditure.

(b) Groupings which Carry on a Trade or Profession

Where the Grouping carries on a trade or profession it is treated as a partnership of the members for the purposes of charging tax in respect of income and gains (s.510A(6)). However, the provisions in ICTA 1988 which require tax to be assessed in the name of the partnership (ss.111 and 114(4)) are disapplied so that each member is separately charged to tax on his share (s.510A(7)). The amount on which the members are chargeable to income tax in respect of such trade or profession is computed jointly. It should be noted that where a United Kingdom resident is a member of a Grouping which is situated outside the United Kingdom and which carries on a trade or business abroad, he will be chargeable to income tax under Case V of Sch D on profits earned by the grouping if he takes no part in earning those profits (see *Colquhoun v Brooks* (1889) LR 14 App Cas 493). Losses arising from such a trade would therefore only be available for offset against other Case V income.

Capital Gains Tax

For capital gains tax purposes a member is regarded as acquiring or disposing of a share of the assets of the Grouping whenever the Grouping makes an acquisition or disposal of assets (s.510A(3)(b)). The same treatment would apply on the occasion of a member becoming or ceasing to be a member of a Grouping or whenever there is a change in his share in the Grouping. It is understood that the Inland Revenue have confirmed that they will apply paragraph 4 of their Statement of Practice D12 where the members are treated as being in partnership, so that no immediate gain or loss will arise where there is a change in the property sharing ratios (unless a payment is made or the asset has been revalued in the accounts) (See European Economic Interest Groupings: Finance Act 1990 [1990] BTR page 335.)

Other Matters

Three further points arise from the Inland Revenue's Press Release of 19th April 1990:

(i) Although a Grouping is fiscally transparent in respect of charging tax on income and gains, this treatment would not apply to provisions relating to other matters such as deduction of tax. Accordingly, as it is treated as a company for UK tax purposes a Grouping would be required to deduct and account for tax in the circumstances prescribed by ICTA 1988 ss.349, 350 and the normal PAYE rules would apply.

(ii) Where a Grouping pays interest or makes other annual payments, the appropriate share of the payments will be treated as a charge on income of the member in computing the member's own liability to income tax and corporation tax.

(iii) Where relief for the payments depends on tax having been deducted, the tax will be treated as having been deducted by the members. Similarly, where payments are received by a Grouping under deduction of tax the members will be treated as bearing the tax suffered by the deduction.

VAT

No specific legislation has been introduced in the United Kingdom to cover the VAT treatment of a Grouping. It would appear, however, that no member could be regarded as a Grouping's holding company within the meaning of s.736 of the Companies Act 1985. Accordingly, a Grouping would not be eligible to be treated as a member of a VAT group (s.29(3) Value Added Tax Act 1983).

Administration

An Inspector may issue a notice requiring a return of specified information, accounts and statements from a Grouping for the purposes of making assessments to income tax, corporation tax and capital gains tax (s.12A(2) TMA 1970). If the Grouping is registered or has an establishment in Great Britain or Northern Ireland the notice may be given to the Grouping itself (s.12A(3)). For other Groupings the notice may be given to any member who is resident in the United Kingdom or, if all the members are non-resident, to any member; separate notices may be given to such of the members as the Inspector thinks fit (s.12A(4)). In Statement of

Practice 4/91 the Inland Revenue confirmed that the information which will be called for from a Grouping will be limited to information for the purpose of assessing members to income tax, corporation and capital gains tax in respect of the Grouping. The Inland Revenue will apply the general principles on the issue of returns set out in SP4/91 to the Grouping. A Grouping which produces accounts would normally be required to provide these with the return, irrespective of whether it was carrying on a trade.

The information, accounts and statements required may vary in different periods depending on the type of Grouping and the different types of income and gains (s.12A(6)(7)). Where a notice to make a return is served on a Grouping everything required to be done shall be done by the Grouping acting through its manager or any of its managers. Where none of the managers is an individual, the Grouping shall act through any individual designated as the representative (s.12A(8)).

A return must include a declaration by the Grouping or member making the return to the effect that the return is to the best of the maker's knowledge correct and complete (s.12A(5)).

Penalties

Where a Grouping or a member fails to comply with a notice under s.12A a penalty not exceeding £300 (and £60 per day for continued failure) may be imposed under s.98B(2) TMA 1970. No penalty shall be imposed after the failure has been remedied; if it is proved that there was no income or chargeable gain to be included in the return, the maximum penalty is £100 (s.98B(4)). Where a Grouping or member fraudulently or negligently delivers an incorrect return, accounts or statement, or makes an incorrect declaration, a penalty not exceeding £3,000 per member may be imposed (s.98B(5)).

Two further amendments are made to the existing legislation. Under s.36(4) TMA 1970 the 20 year time limit for fraudulent or negligent conduct applies to each member of the Grouping. Finally, s.40(4) TMA 1970 applies the time limit for assessment on personal representatives to each member of the Grouping.