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## **ARE S.C.I ENTITIES CONSIDERED AS OPAQUE OR TRANSPARENT BY HMRC ?**

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*The Finance Act 2008 having received the Royal Assent on 21 July 2008 and now in force brings some clarification to the tax treatment of sociétés civiles immobilières (SCI) incorporated in France by non-residents to purchase and hold secondary homes.*

*Although the French Taxation Administration has no difficulty with the concept that SCI entities are transparent for tax purposes, or at least 'translucent', HMRC continues to consider them as opaque.*

Until the late 1990's, HMRC often accepted the *de facto* transparency for tax purposes of an SCI. The Members of an SCI being taxed in France were able to claim the benefit of the 'Convention between the United Kingdom of Great Britain and Northern Ireland and France for the avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income' of 22<sup>nd</sup> May 1968 and the 'Double Taxation Relief (Estate Duty) France (Order) 1963' (SI 1963 No 1319) applicable to inheritance taxes.

The application of these Treaties permitted double taxation on members of an SCI to be avoided (1)

Although the Treaty of 22 May 1968 did not directly mention SCI entities, the 1963 Anglo French Treaty of 1963 covering inheritance tax made an express reference thereto in Article IV para g: " an interest in a partnership, which term includes ..... and a *société civile* under French law, shall be deemed to be situated at the place where the business is principally carrying on; and in the case of a *société civile immobilière*, this shall be where the land developed in accordance with the objects of the *société* is located". Thus for IHT purposes, SCI's are assimilated to 'partnerships' which, in English law, are treated as transparent.

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(1) A new Anglo-French Double Tax Treaty was signed on 19<sup>th</sup> June 2008 covering taxes on income and capital gains between the United Kingdom and France to replace the 1968 Treaty which will remain in force until the new Treaty is ratified.

An English partnership is not itself directly taxed on its profits, but each partner is liable to income tax on his proportionate share in partnership profits.

HMRC now considers that SCI entities are opaque, not transparent, for tax purposes.

### **I - SCI ENTITIES ARE OPAQUE**

From 2000 onwards, case law in England addressed the issue on whether companies were opaque or transparent.

The decisions in *Memec Plc v Inland Revenue Commissioners* (1998) STC 754 and *Joseph Carter & Sons Ltd v Baird and Wear Ironmongers Ltd* (1999) STC 120 led to a change of position by HMRC which proceeded to re-classify various foreign legal entities, and more particularly SCI's as opaque.

It is necessary to explain here the terms 'transparent', 'translucent' and 'opaque'. In French tax law, a company is transparent when for tax purposes one looks through it to its members and tax is levied on and paid by the members. Only condominium civil companies which exist to give entitlement/rights of use to a specific lot in a condominium development are truly always transparent (Art 1655 ter CGI).

Translucent entities are those which although having their own separate legal personality and whose profits are computed at company level, in fact their members are personally liable to pay tax, calculated for each member on the basis of his own allowances and tax rates: thus an individual who is an SCI member will have his share of profits made liable to income tax but a member who is liable to corporation tax will be taxed at the appropriate corporation tax rates. The SCI is a good example of this.

Opaque companies are separate legal entities which are subject to corporation tax on their profits. When such a company distributes its profits after tax, the distribution is taxed again in the hands of the beneficiaries either by income tax for individuals or corporation tax for opaque entities, usually in the form of dividends. Examples are SA, SAS and SARL French companies.

These principles, particularly complicated where translucent entities are concerned, have no direct equivalents in English tax law which knows only transparent and opaque entities.

Tax Bulletin 39 published in February 1999 contained a list of six criteria that HMRC considered as significant in determining the opaque or transparent nature of a company :

1. Does the foreign entity have a legal personality separate from that of its members ?
2. Does the entity have a capital consisting of shares or comparable interests ?
3. Does the entity carry on a business, trade or other independently or jointly with its members ?
4. Are the members of the entity entitled to their share of the profits or is the decision to distribute profits subject to the prior decision of the members ?
5. Who is liable for the debts of the entity ? The entity itself or its members ?
6. Do the assets owned by the entity belong to it or to its members ?

On the basis of these criteria, HMRC unilaterally took the position that for English tax law purposes, a French SCI is opaque.

It is interesting to note that Tax Bulletin No 50 issued in February 2001 classified a French *société en nom collectif* (SNC) as transparent, which perhaps goes some way to explaining the

recent phenomenon adopted by some practitioners to use SNC entities to purchase secondary homes in France.

Tax Bulletin No 83 published in 2006, replaced Bulletins Nos 39 & 50, contained a classification of French companies into those that were considered as opaque and those considered as transparent:

**OPAQUE**

Société civile immobilière (SCI)  
Société civile agricole  
SARL & SAS  
Groupement Foncier Agricole (GFA)  
Groupement d'Intérêt Economique (GIE)

**TRANSPARENT**

Société en nom collectif (SNC)  
Société en commandite simple (SCS)  
Société en participation

The position of HMRC is clear - a French SCI is an opaque entity. As a consequence thereof, HMRC reserve the right to tax members on the benefits in kind that they receive, on capital gains realised and also with Corporation tax

**II THE CONSEQUENCES OF OPACITY**

In accordance with articles 145 and 146 of ICTA 1988, company directors have long since been liable in England to income tax on benefits in kind that they are deemed to receive by reason of their occupation or use of corporate assets (living accommodation charge -- chapter 5 Income Tax Earnings and Pensions Act 2003)

A House of Lords ruling in R v. Allen (2001) UKHL 45 widened the concept of benefit in kind and a further ruling in Secretary of State for Trade and Industry v. Deverell (2001) Ch 240 extended the definition of shadow directors.

These rulings tended to support the position taken by HMRC in respect of SCI and lead practitioners to use SCI's with circumspection.

There was a real risk that British members of an SCI could be taxed in England with income tax based on a deemed income on the basis of benefits in kind received through using and enjoying corporate assets.

However in Budget Note 50 (BN 50) published on 21 March 2007 prior to the Budget of that year, the Government undertook to introduce into the Finance Act 2008 provisions that would exempt individual persons, who had purchased or who would in the future purchase secondary homes abroad through a company, from being assessed for benefits in kind arising from their personal use of corporate assets.

It was also announced that these provisions would be retrospective and would be subject to the following conditions :

- 1 the company in question must be controlled by individual persons and not by other companies;
- 2 the business of the company must be restricted to the holding of the real property assets and its private use by its members;
- 3 the property must be the only or substantially the only asset of the company;
- 4 the acquisition or holding of a property must not be directly or indirectly financed by a

connected company or one in the same group.

Article 45 of the Finance Act 2008, which has been in force since 21st July 2008, duly amended the provisions of the Income Tax Earnings and Pensions Act 2003 (ITEPA) and clarified the issue by introducing new articles 100 A and 100 B, the effect of which are:

1. Subject to various conditions (see above), HMRC accepts in principle that a French law SCI would fall within the definition of the new exemption from benefit in kind taxation that would otherwise fall on its members;
2. A tax on benefits in kind can nonetheless still be applied if, for example, the SCI falls within any of the following five criteria :-
  - It owns other assets which are not destined for the personal use of its members;
  - it carries on, in addition to holding the property, a commercial or other business;
  - it acquired the property from another company within the same group at an understated consideration;
  - it borrowed funds from a connected company (unless such borrowing was made on normal commercial terms) or authorised expenditure on the property by diverting funds from another connected company;
  - it uses fraudulent means or indulges in tax evasion.

One can therefore conclude that the acquisition of a secondary home in France by an SCI by individual persons for the purpose of managing their investment and family interests and/or for the purposes of legitimate estate planning, without any express intention of tax avoidance would fall within the aforesaid exemption from benefit in kind taxation, by application of the said Article 45.

There remain differences between the English and French tax authorities concerning the tax treatment of SCI entities. The exemption outlined above applicable to Great Britain to remove the risk of assessment applies only to SCI members who have complied with certain conditions. We therefore advise caution in giving advice to English clients or those resident for tax purposes in the United Kingdom who wish to incorporate an SCI and draw their attention specifically to the potential risks to which they will be still exposed for tax purposes (benefits in kind and capital gains) in the United Kingdom. The stated position of HMRC (opacity) cannot be ignored even though no English Court (to our knowledge) has yet given a ruling on the exemption from benefit in kind taxation.

Furthermore, the English members of an SCI will still have difficulties in English tax terms given that the position of HMRC pursuant to *Memec* remains unchanged -- that is to say that an SCI is considered for tax purposes as opaque. As a consequence of this, when the SCI sells its French property, notwithstanding the French capital gains tax payable in France by its members personally, HMRC could seek to tax the distribution of 'profits' by applying UK corporation tax thereto.

Corporation tax in England is a different tax from French capital gains tax payable in France and consequently the members of the SCI would not obtain any credit for tax paid in France as against the English liability as the same is not covered by the Anglo-French Double Tax Treaty of 22nd May 1968. There is therefore a risk of a double taxation.

Finally, the French law 'translucent' concept is peculiar to it and is difficult to assimilate it elsewhere. In addition, the French Administration seems to wish to apply this concept internationally but is not yet prepared to do so internally, as it continues to misread the consequences. The consequence in international relations, is that the position is still not as clear as it ought to be.