SCIS, "SHADOW DIRECTORS" AND BENEFITS IN KIND

Peter Harris[1]

The ownership of residential property in France through *Sociétés Civiles* by residents and non-residents alike is currently going through significant changes.

Change in the Legislation

In France, to the delight of certain wealthy Frenchmen, *Sociétés Civiles* (SCs) established prior to 1st July 1978 were sometimes able to escape registration, and to rely on their contractual nature for their existence.

This meant that the identity of *associés* could be hidden from the public view, as there were no *statuts* filed at the Registre de Commerce et des Sociétés (RCS): the only method of ascertaining the identity of *associés*.

In effect, a change in the law in 1978 required that an SC constituted after the date of coming into force be registered to provide notice to third parties of its existence, and, more importantly of the rights and obligations of its *associés*, and of the requirements imposed on third parties suing the *associés* and the SC.

The situation became so heteroclite that the money-laundering legislation of 15th May 2001 required all SCs, including the older ones to identify themselves by registering with the competent RCS of their *siège social*. The deadline is 1st November 2002. Unless they comply, a recalcitrant SC will be effectively dissolved, with significant fiscal effects. In addition, after 1st November 2002, any attempt to sell immovable assets will meet with significant problems on attempts to

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[1] Peter Harris, Barrister, 3 Temple Gardens, Temple, London EC4Y 9AU.
Tel:(020) 7353; Fax:: (020) 7583 2044, e-mail pharris@taxcounsel.co.uk

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register the sale.

The French solution to this is that the *gérant* (manager) of the SC would undertake the registration. However, given the change from the comparatively liberal, if not lax, régime which certain older SCs have enjoyed, it would be prudent to take the opportunity to approve registration by a decision of *associés* and at the same time make any appropriate changes to the *statuts* to bring them into line with the new legislation and practice. In other words, advice is needed in a short time delay.

Whilst this affects both French and foreign owned SCIs alike, the effects certainly on the older SCIs may well be felt by residents in the United Kingdom.

The SCI and the Inland Revenue

The current debate on whether a French *Société Civile Immobilière* (SCI) is the most appropriate estate planning route for those British residents who wish to own a house in France, and leave shares in it by will outside the forced heirship rules has been given a further twist by the Inland Revenue who are seeking to extend the United Kingdom benefits in kind rules under as ss.145 and 146 ICTA to tax *associés* of an SCI on a deemed benefit in kind. This might be understandable in cases such as *R v Allen* STC 2001 1537, involving United Kingdom real estate, and offshore limited companies, established in anglo-saxon jurisdictions such as Gibraltar. However, the specific civil law aspects of the ownership of French property may require the interposition of an SCI under certain circumstances for purely civil reasons.

British land and the specific wording of the Anglo-French Income Tax Treaty, in the author's opinion do not permit the Inland Revenue to challenge SCIs on this basis.

That the ownership of French land in this manner, a traditional French estate planning technique, should be considered to give rise to a form of benefit in kind under a British income tax régime does not constitute anything resembling a correct application of private international law. There is no primary tax avoidance incentive in such a structure.

There is a fundamental difference between the French concept of a *société*, and the somewhat more restricted English notion of a company.

The French distinguish *sociétés civiles*, or *sociétés de personnes*, which are generally speaking transparent, from Commercial Companies, which have limited

liability, and which are arguably not.

French *Sociétés Civiles Immobilières* (SCI) do not have a particular statutory legal system, in the same manner as trading companies governed by the Commercial Code: they are subject to the ordinary civil companies' *régime* set out in general terms in the Civil Code.

Under the Civil Code, the definition of a civil company is a catch all solution. When a company is not governed by any specific codification, commercial, insurance or other, it is by definition civil:

"All companies for which the law does not provide another character due to their form, nature or purpose are civil [non-trading] companies" Art.1845 al.2 of the Civil Code.

Original text: Ont le caractère de société civile toutes les sociétés auxquelles la loi n'attribue pas un autre caractère à raison de leur forme, de leur nature ou de leur objet.

In other words, the Commercial and the Insurance Code are the only French Codes which enable a company to have limited liability. Limited liability in France is in its principle limited to persons having the status and capacity of traders trading personally or through commercial trading companies alone, in certain of which a limitation of liability is established by shares. These are known as *sociétés de capitaux* or *commerciales* . Only *sociétés de capitaux* are opaque under French law, as only these have any form of limitation of liability. *Sociétés de capitaux* are constituted with *actions*, the closest to a share. *Sociétés de personnes* including *sociétés civiles* are not. There is no French equivalent of a company limited by guarantee. It is possible to have a commercial company which has unlimited liability, called a *société en nom collectif,* but these have to be instituted under a specific form, and are usually avoided, unless the fiscal transparency associated with the joint and several unlimited liability is required by the traders concerned.

The SNC is considered transparent by the Inland Revenue. Neither the SNC nor the SCI can issue shares which are transferable on any register, the rights of each *associé* are set down in the Statutes, and the *parts*, the same word is used, can only be transferred by modification of the *statuts* either by a notarial or private deed. This legally renders the members' rights legally identical, saving the question of the manner in which the liability is unlimited.

The Court of Appeal decision in *Dreyfus* is discussed in greater detail below.

What is curious is that the Inland Revenue are prepared to accord treatment equivalent to that of a partnership to a *Société en nom collectif*, but not to an SCI, probably due to the fact that under article 1857 of the Civil Code an *associé* of an SCI can only be called to pay a share of an SCI's liabilities by a creditor, having merely a right of compensation from his co-*associés*.

However, it is clear that in both cases, the *associés'* liability is not limited to his share of the capital contributed, but remains technically unlimited. The author, a mere linguist, has been educated in the belief that mathematically infinity cannot be divided with a view to reducing it to a finite amount. The liability of a member of an SCI remains therefore unlimited, although he may share this burden of Atlas with someone else.

The fundamental issue is whether a *Société de personnes*, and in particular an SCI has sufficient similarity with a company for the purposes of ICTA 1988, and in particular, s.832. The author would indicate the following areas where the comparison could lead to a query whether a *Société de personnes* has any comparable aspects to English definitions of company existence at all:

1. Articles of association: any *Société de personnes* has by-laws, which include certain matters, but not all of those are addressed in the Companies Acts, it may be taken that this contractual aspect of corporate existence might in principle be satisfied in most cases.

2. Corporate or legal personality: here it is unlikely that a *société de personnes* has corporate or legal personality in the English sense of the term. A *Société de personnes* exists once the agreement between the *associés* is complete, and it takes its legal identity on registration. However, the notion of *intuiti personae* with which the *société* is imbued, renders the notion of corporate existence incomparable with its English equivalent. It should be noted that the Inland Revenue has in the past considered Liechtenstein entities which require registration in Liechtenstein to acquire validity as trusts, not as companies.

3. Directors: a *Société de personnes* does not have directors in the English sense of the term, as the French notion of *intuiti personae* is incompatible with this function, as the Directors manage the day to day affairs of the Company, almost to the exclusion of shareholders. This is not the case in a *Société de personnes*, where the concept of a *gérant*, or a manager, is optional, and has no legal affinity with the function of a director.

4. Share capital: here the distinction between a share and a *part* is sufficient to close the debate. A *part* gives rise to unlimited liability, as discussed below, may not be reduced to a negotiable certificate (as the *associés'* agreement is with specific persons, and agreement is required before any change in fellow partners may be made, saving with heirs under certain circumstances).

The Distinction Between A *Société De Personnes*, and A *Société De Capitaux*

The *Société civile* is a *Société de personnes*, and by definition not a *société de capitaux*.

The French notion of *intuiti personae* is the key to understanding the distinction, which is fundamental. The agreement which constitutes the *Société de personnes* involves so much personal involvement that any attempt to assimilate an *associé* to an English shareholder in a company limited by shares or by guarantee is doomed to failure.

The legal principle underlying the tax treatment of a *Société de personnes* is that the *associés* are themselves liable to taxation on the profits of the entity irrespective of whether they are paid out to them or not. This is the consequence of the tax régime known as *translucidité*. It is not an issue independent of the Code Civil, as it reflects the legal position of the *associés* under the Code Civil. A general principle of French tax law is that the tax treatment of a structure follows the legal principles unless there is an express provision to the contrary.

The limitation of liability allowed to companies such as *Sociétés Anonyme* does not apply to *Sociétés civiles*, who would otherwise lose their civil status and suffer criminal sanctions. The only hybrid *Société* enjoying a degree of limited liability is the *Société à responsabilité limitée* or Sarl, which is generically a mix of a *Société de personnes* and a commercial company, but which may be established for commercial reasons by traders. Again, a Sarl like other *sociétés civiles* has no board of directors, but a manager known as a *gérant*. The status and capacity of a director under French law is laid down in the Commercial Code, not in the Civil Code. The difference is between a *Société commerciale*, which is legally reserved to *commerçants* or traders and whose liability is limited by shares *actions*, and a *Société civile* which only involves members having a common civil object. It is entirely possible and proper for a member of an SCI to have a participation in the life of the Civil Company and its assets and its liabilities totally out of proportion to any contribution.

The tax treatment accorded to the Sarl is as hybrid as the entity itself. Generally it is subject to Corporation tax unless it is either an *EURL* or a family company, in which case it may opt for income tax treatment, with its *associés* being liable directly for income tax, and incidentally for their own social security contributions.

The tax treatment given to an SNC at the present time is also important. Although these are commercial companies by nature, the fact that there is no limitation of liability means that they are in principle *translucide*, in other words transparent, unless they opt for Corporation tax treatment.

MEMBERS' LIABILITY:

Under Article 1832 of the French Civil Code:

> "The [civil] company is created by at least two persons, who agree by contract to allocate assets or industry to a common venture with the intention of sharing the profit or the benefit of the saving which may result. It may be constituted by the act of a sole person in certain cases defined by law.
>
> The members undertake to contribute to deficits."

Original text: La société est instituée par deux ou plusieurs personnes qui conviennent par un contrat d'affecter à une entreprise commune des biens ou leur industrie en vue de partager le bénéfice ou de profiter de l'économie qui pourra en résulter.
Elle peut être instituée, dans les cas prévus par la loi, par l'acte de volonté d'une seule personne.
Les associés s'engagent à contribuer aux pertes.

Moreover, Art.1857 al.1 of the Civil Code provides that:

> "With regard to a third party, members have an unlimited liability in proportion to their participation, at the date when the debts have to be paid or at the date of any default in payment."

Original text: A l'égard des tiers, les associés répondent indéfiniment des dettes sociales à proportion de leur part dans le capital social à la date de l'exigibilité ou au jour de la cessation des paiements.

Note that the agreement may still be a company without registration, a simple contract suffices. The civil company as established after 1978 only achieves its legal identity on registration, but nonetheless remains a civil company as between its *associés* prior to registration.

TRANSPARENCY, TRANSLUCIDITY OR THE LACK OF OPAQUENESS

The French Civil Code (Art.1832 and Art.1857) provides that members have a several liability in proportion to their participation. It is very important to note that this several liability implies that there is no opaqueness within the SCIs' legal structure. The members are responsible directly for the entity's debts, in the proportions agreed between them, and therefore from this viewpoint, it is as if there was no company at all, merely a contractual agreement as to the proportion in which the liabilities of the company fall. It is perfectly in order for the proportions to be different from any contributions made to the company's assets by the *associés*.

It is therefore clear that the *Société civile* as such has no real equivalent in the English system. It has no directors, normally functions without employees, has no limitation of liability, cannot in principle trade, with the slight exception of furnished lettings of its assets. Its primary object in most acquisitions is not to trade, but to hold property in a manner enabling interests in land to be created over and above the relatively narrow property rights over land set down in the Civil Code.

It is therefore best analysed in the conveyancing sense, and from that viewpoint alone, within the wider context of the questions of *copropriété* and *lots* which are also frequently employed in the division of property.

The notion of company and of contract under French law is far wider than under English principles, as it may serve to similar effect as a trust over land. Let us remember that the French Civil Code contains no concept of equitable interests in the same manner as in England, and indeed the French Government refused to sign the Hague Convention on Trusts without a reservation that it would not apply to French land. It has since refrained from ratifying this Convention.

The French tax administration, who have statutory means of taxing individuals who occupy houses owned by French and foreign limited companies are unable to do this in the case of a civil company such as an SCI. Those of us used to filling out the ubiquitous *imprimés n° 2746* for the 3% annual tax on real property holding companies will be aware of the consequences of a tick or its absence in the relevant box III 1, on page 2.

The arguments addressed in this article fall into two categories:

1. Whether an interest in an SCI can be considered to constitute an interest which may be lawfully treated as giving rise to income under ss.145 and 146 ICTA, assisted by a wrongful interpretation of qualified by s.168; and

2. if so, whether the amount of the income can actually be valued under s.837 TA 88, and taxed under ss.145 and 146.

The issue of whether an SCI can actually be considered a company at all, under the English taxing definition is addressed, through passing references when the issues involved are evoked.

1. Can an interest in an SCI be lawfully treated as giving rise to a taxable emolument under ss.145 and 146?

The problem arises in the definition of a company under English law. For the purposes of what may be loosely described as the benefits in kind legislation (sections 145 and 146 ICTA), it has been said, in the author's opinion incorrectly, that it includes any body of persons having legal personality.

Under s.831 ICTA 1988

"body of persons" means any body politic, corporate or collegiate, and any company, fraternity, fellowship and society of persons whether corporate or not corporate;

"company" means, subject to subsection (2) below, any body corporate or unincorporated association but does not include a partnership, a local authority or a local authority association;

The term "society of persons" is a literal translation of the term *société de personnes*.

An SCI has precisely that meaning, irrespective of whether it is a purely transparent structure designed to allocate apartments by designated shares in an SCI owning a building: *transparence fiscale*; a more opaque variety which is bedecked in a French form of fiscal transparency, described as *translucidité*, which serves to tax its *associés* as individuals, on a tax base established at the SCI level, to that of an opaque SCI, or other forms of limited company, which may opt for fiscal *translucidité*.

The definition itself allows for a body of persons to be corporate or not corporate.

Why should the term 'society of persons' be included in such a definition section if it did not have a legal meaning? The question remains: is such a society a body corporate or not, and if it is whether it is not a partnership. The second question must be replied to in the negative, it is not a body corporate which can be assimilated to a Company in the British sense of the term.

The principle on which a *société de personnes or société civile* of any description is founded, is dualist. In other words, it is both institutional and contractual. The contractual aspect involves the notion of *intuiti personae*, in other words the members are directly involved in the entity. This is the reason why a *société de personnes* is just that, a society of persons, each person who is an *associé* remains part of the company's identity, and when such a *société* is sued, each individual *associé* is directly involved in the suit, although his unlimited responsibility for the *sociétés* debts is shared between himself and the other *associés* in the proportion laid down in the *contrat de société*, and the claimant has to seek redress in these proportions against each individual *associé*. The affairs of a *société de personnes* are never directed by a director. Its manager or *gérant* behaves more like a managing partner of a partnership, and has a far closer day to day relationship with the *associés*. Certain of these points were not presented to the Commissioners in *Dreyfus* who therefore made a finding of fact which could not be set aside by Rowlatt J. or by the Court of Appeal who nonetheless circumvented the question.

It is therefore clear that, before the Inland Revenue can extend ss.145, 146 and 168(8) ICTA to a foreign body such as a *société de personnes* including an SCI, it might wish to make itself more aware of the exact nature of the entity closer to a partnership than a company partnership with which it is in fact dealing. It does not have a legal personality distinct from that of its members in the English sense of the term. It is therefore not a company, and therefore cannot be dragged with its *associés qua* directors within the scope of ss.145, 146 or 168(8) ICTA. An *associé* by definition cannot be in a position of subordination to himself.

Again, it is no accident that the French language version of an OECD report 'The Application of the OECD Model Convention to Partnerships: Issues in International taxation n°6', published 16th August 1999, refers to *sociétés de personnes* as partnerships as distinct from companies. In other words, a *société de personnes* is the closest equivalent to the anglo-saxon term 'partnership'. A partnership is not a company, in the British sense, and a *société de personnes* cannot appoint a Director or a Shadow Director, which are both concepts of British law and practice.

The Anglo-French Double Tax Treaty

In effect, the French consider companies owning French soil and buildings as land, and inevitably tax such creatures, generically termed as *sociétés à prépondérance immobilière*, as such.

This explains the specific wording of Article 5(2)(b) of the Anglo-French Income Tax Treaty, which would otherwise appear entirely bizarre:

Article 5: Income from immovable property

5(1) Income derived by a resident of a Contracting State from immovable property (including income from agriculture and forestry) situated in the other Contracting State, including income derived from rights attached to such property, may be taxed in that other State.

5(2)(a) The term "immovable property" shall, subject to the provisions of sub-paragraphs (b), (c) and (d) below, have the meaning which it has under the law of the Contracting State in which the property in question is situated.

5(2)(b) Shares or rights in a company *or legal person,* the assets of which consist mainly of immovable property situated in one of the Contracting States, shall be treated as immovable property situated in that State. For the purposes of this provision, immovable property pertaining to the industrial, commercial or agricultural operation of such a company or legal person or the performance of independent professional activities shall not be taken into account.

Here it is clear and constant practice, at least in France, that the definition of immovable property in Article 5(2)(b) is of overall application throughout the Treaty. It is also clear that immovable property includes companies and other legal entities owning immovable property, and includes not just companies in the English sense of the term, but also other legal persons, including SCIs and Scots Limited partnerships.

Let us address the conceptual position first.

There is little doubt that the term immovable property has the French meaning, as both the property and the SCI are situated in France, and certainly cannot bear any English technical meaning.

If the alleged taxable income is not income derived from land under article 5 (1) and (2)(a) and (b), then what is it? It can only be income derived from land, under the Treaty definition.

The basis of the income tax charge under ss.168, 145 and 146 is that the taxpayer is considered to be in a form of employment or deemed employment. Is it correct to say that land can employ people other than in a figurative sense? The answer is no.

Is it therefore possible that the Inland Revenue can drive a coach and horses through Article 5(2)(b) by refusing to accept that an SCI is what the article dictates it to be (the term "shall" is used), that is, land, and attempt to ascribe British employment or deemed employment provisions, drawn up for a limited and therefore commercial trading situation, into a purely French civil context?

Let us again remember that even the French who have an extraordinarily punitive benefit in kind legislation of their own do not tax *associés* of an SCI on a perceived benefit in kind.

This is one explanation of why most land holding structures involving SCIs owning property in France of a certain value let the property on a civil unfurnished lease to a commercial company which then furnishes it and lets it on short term commercial leases to third parties, leaving the *associé* to take the choice between a period of free occupation, reserved within the terms of the civil lease, or paying a rent for the time which he occupies it.

The definition clauses in each version of the Treaty are significantly different when brought alongside Article 5(2).

English version:

2(1) In this Convention:

...

(f) the term "person" comprises an individual, a company and any other body of persons;

(g) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes;

5(2)(a) The term "immovable property" shall, subject to the provisions of sub-paragraphs (b), (c) and (d) below, have the meaning which it has under the law of the Contracting State in which the property in question is situated.

5(2)(b) Shares or rights in a company or legal person, the assets of which consist mainly of immovable property situated in one of the Contracting States, shall be treated as immovable property situated in that State. For the purposes of this provision, immovable property pertaining to the industrial, commercial or agricultural operation of such a company or legal person or the performance of independent professional activities shall not be taken into account.

This is consistent with the French approach of Shares being Shares in Companies having commercial form, as distinct from rights in other legal persons such as *associations* or *sociétés civiles*.

French version

Art. 2. 1. *Dans la présente convention:*
...

f. *Le terme « personne » comprend les personnes physiques, les sociétés et tous autres groupements de personnes*

g. *Le terme « sociétés » désigne toute personne morale ou toute entité qui est considérée comme une prsonne morale aux fins d'imposition ;*

Art. 5. 2.

a. *Sous réserve des dispositions des alinéas (b), (c) et (d) ci-dessous, l'expression « biens immobiliers » a le sens que lui attribue le droit de l'État contractant où les biens considérés sont situés.*

b. *Les parts ou actions et les droits dans une société ou une personne morale dont les actifs sont principalement constitués par des biens immobiliers situés dans un des États contractants sont considérés comme des biens immobiliers situés dans cet État. Pour l'application de cette disposition, ne sont pas pris en considération les biens immobiliers affectés par cette société ou cette personne morale à sa propre exploitation industrielle, commerciale ou agricole ou à l'exercice d'une profession indépendante.*

The first point is that an SCI is not treated as a body corporate for tax purposes.

Whilst the *associés* tax liability is calculated at the level of the SCI, his liability corresponds to his legal responsibility in relation to the SCI and his fellow associates. He is liable for no more and no less than his own taxation divided as a proportionate share at the SCI level.

Here the distinction is sufficiently important for the French to have added terms to distinguish *sociétés de personnes (parts)* from *sociétés de capitaux (actions)* and other *personnes morales (droits)*, and to introduce the French distinction between *sociétés de personnes* and *sociétés de capitaux* at Article 2.1. f. and g.

The Treaty clearly states that an interest in a real property holding company is an interest in land, not in a company. It also clearly states that income derived from such an entity is rental income. Have the Inland Revenue considered how the term "derived" and the phrase "he is treated as receiving emoluments for" may be treated as conceptually or substantially different? Under their proposal,an *associé* having a right to occupy, as of right under the statutes of the SCI, in other words by contract between himself and the other *associés* of the SCI, not by contract between the SCI and himself, is treated as receiving an emolument under an anti-avoidance provision. With a *reductio ad absurdam*, should he not also be paying tax as a member of the SCI on the deemed rental received by the SCI for his occupation, and a further tax on the distribution and be therefore taxed twice in the United Kingdom, and not at all in France? The point of the Treaty is to eliminate double taxation, not to foster it!

In the author's view, the terms of the Treaty require sections 168, 145 and 146 to be interpreted consistently with Article 5 (1) and (2), and not inconsistently with it. The word "derived" employed in Article 5 (1) is sufficiently broad to encompass the domestic taxing provisions concerned, and to render them incapable of enforcement contrary to the Treaty terms.

The fact that an SCI is also a company under French civil law is of no relevance, as subparagraph (b) provides an express exception to (2)(a).

For the sake of comparison and clear thinking, what is the French régime? Here the Inland Revenue have apparently missed the fundamental difference in French law between a civil company and a commercial company. If they choose to argue that they are basing their attack on French law, then let it be so, and let them take the consequences.

It is a fundamental principle of French law that the Tax Code and the Civil Code are both of equal legal weight. It is impossible to distinguish the two in the manner in which the Inland Revenue have attempted to do, and argue solely on the basis of the

Civil Code. Incidentally, the Civil Code deals with certain aspects of corporate existence, in addition to that applicable to Civil Companies, but the actual company law, as understood in the United Kingdom is contained in the Commercial Code.

French Civil Companies

The French have a tax notion of "transparence fiscale" in precisely this area, limited to *société civiles immobilières*, which may also be extended to commercial companies by virtue of the Tax Code.

In the rental tax area, specifically *revenus fonciers*, even where the SCI, the civil company, owning a residential property has no *transparence fiscale*, and attributes it to an *associé*, there is no taxable benefit in kind, and the company has no liability to account for any tax on the deemed benefit accorded.

Even where a Company is deemed to have retained the property for its own use, under Article 15-II of the CGI, it cannot deduct any of the running expenses from any tax, but there is no taxable *avantage en nature* arising to the member. Prior to 1976, the position was the contrary, it was considered a benefit in kind, and the company had to account for income tax, not corporation tax on the deemed rental.

An SCI is by form and, normally, by object a civil company, and can only be subject to French Corporation taxation if it opts for it and effectively engages in what is fiscally considered commercial trading. This is the exception and not the rule, as its objects are by definition civil and not commercial.

The point is that a civil company is allowed to trade as a *commerçant*. One of its uses is to transform immovable into movable property for civil, not trading, purposes. The point is to enable the property to pass by a foreign will without falling foul of forced heirship rules.

The French Civil Code does not recognise trusts, and the SCI also fulfils a function in estate planning that would be otherwise partly fulfilled by such structures. There is therefore no income avoidance issue, as there would be in the case of a trading company which, as an incident to its trading activity allows employees or directors living accommodation in property owned by the company.

The reader is directed to the recent OECD report on Partnerships, and will note that the term *société de personnes*, which includes *Sociétés Civiles* is used as the equivalent of a partnership. Indeed, the Scots Limited partnership, which has legal personality, is treated as a partnership and not as a company in the United Kingdom.

It is clear that the notion of legal personality frequently advanced by the Inland Revenue as a justification for applying ss. 145 and 146 is open to criticism.

The Inland Revenue's contradictory treatment of an SNC and an SCI arises from a highly partial recognition of the concept of *translucidité*, which involves the manner in which tax is calculated and charged on an *associé*, to one the SNC, and a refusal to recognise it to another, the SCI.

The income or corporation tax liability of the *associé* is calculated as a share of the mass arising in the accounts of the *société de personnes*, or, in the case of an SNC or *Groupement d'Intérêt Economique*. This principle is applied to all forms of *société de personnes*. The Inland Revenue are prepared to grant transparency status to SNCs and to GIEs, but, inconsistently, are not prepared to grant it to other forms of *société de personnes*.

French Commercial Companies

The situation is entirely different for Companies which are subject to French corporation tax. However, even here, the legislation makes a distinction between Commercial Companies in general and those having commercial form, but which have civil objects: Article 239 octies specifically lays down that where a limited company subject to corporation tax has as its object the free attribution of residential property to its members, the benefit in kind is not treated as taxable, and is effectively ignored.

Where there is no such object, then the French Corporation tax system will treat the benefit in kind as income in the hands of the recipient, and as a non-deductible distribution in the hands of the company.

The Inland Revenue's position could be interpreted as implying that their French colleagues are being lax, a contradiction in terms.

The present taxing provision dealing with the treatment of civil companies and hybrid commercial companies in France is Article 8 CGI.

The exception, considered fiscally transparent by the Inland Revenue, is the SNC, which is organised in a similar way to a *société civile*, but is only open to traders. It has unlimited joint and several liability. Another form of mixed company called the *société en commandite simple* allows the *commandités* or general partners income tax treatment unless an option has been made for French corporation tax.

It would be curious if the next so-called anti-avoidance trend was to constitute SNCs for Englishmen wishing to organise their estates in France, simply to avoid ss.168(8) and 145 and 146.

Dreyfus v Commissioners of Inland Revenue TC Vol XIV 560

Certain difficulties in analysing *sociétés de personnes* arise from the decision of the Court of Appeal in the joint cases *of Dreyfus v Commissioners of Inland Revenue* TC Vol XIV 560. The case concerned a *Société en Nom Collectif* which is a hybrid commercial trading company currently open to *associés* who are *commerçants*, but which has certain characteristics of a *société de personnes*, notably unlimited liability, and was seen as having certain characteristics in common with a partnership. The Inland Revenue were arguing that the individual *associés* were liable to Super Tax on their shares of the trading profits of the entity, despite the fact that they had no connection with the United Kingdom other than that the SNC traded in London and paid income tax there.

The position taken both by Rowlatt J. and the Court of Appeal was that the entity was not a partnership, and that the *associés* could not therefore be liable to Super Tax, which could only be assessed on individuals.

Attempts have been made to distinguish this decision without confining it to its facts and what was at stake. The result is that the Inland Revenue continue to treat SNCs as partnerships, despite a clear decision to the contrary, but do not recognise the fundamental reason in private international law why such entities can rely on a degree of fiscal transparency. The reason is perhaps that at the time partnership profits were determined under English law in the same manner as those of an SNC, i.e. after the partnership shares are determined. However the decision was taken on the application of Income Tax Act 1918 s.20 proviso ii. Rowlatt J. held that there had been a finding of fact by the Commissioners that an SNC only owed its existence not to the combination of the two appellants, but to a written document deposited and published. This may certainly be the case with an SNC, which has such fundamentally dangerous unlimited liability in the trading sense, but it is certainly not the case with an SCI. With respect to the Commissioners, this finding of foreign law, therefore necessarily of fact, is certainly incorrect in relation to an SC, as such a company created prior to 1st November 1978 and at least until November of this year, exists validly without such registration and publishing. Indeed, under the present legislation, the registration of the SC is not required for the SC to be a valid civil company as between its *associés*. Rowlatt J. may have been correct in finding that the SNC was not a partnership, but his finding that it is a legal person distinct from its individuals of which it is composed is incorrect,

or only correct in part, on the basis " that the legal formality of registration is distinguishable from the consensus of the parties which led to and is evidenced by the document". Under French law, a valid civil company is constituted on the signature of the *statuts* by the *associés*, subsequent registration reinforces the protection of the *associés* in relation to third parties but does not affect the validity of the company as between *associés*, and persons with the French equivalent of notice of the content of the *statuts*.

Lord Hanworth MR on appeal stated with admirable clarity that "Super Tax is not paid by companies...." Unfortunately the facts found that the *société* owed its existence not to the combination of the parties at all but to a written document and it is there and only there that you will find what is the nature of the embodiment of these persons. I read on "When these formalities have been complied with the *société* becomes a legal person as from the date of the deed, distinct from the individuals of which it is composed." Whilst this may be the case with a *société en nom collectif*, which entails swinging unlimited responsibility for trading debts, this is clearly not the case with an SC under Article 1832 Code Civil coupled with the catch all definition of Article 1845 al 2, which works to exclude a *société en nom collectif* from the definition of a civil company by its nature and purpose. An SNC is restricted to registered traders.

Findings of fact on foreign law can lead to decisions that lack comity and consistency. The present Inland Revenue position according transparent status to SNCs and not to SCs is the entirely illogical and incoherent result.

There are several types of *société civil immobilière*.

There are those which are absolutely transparent, and merely serve to allocate apartments by way of parts in a building owned by the SCI.

There are those which own buildings and which have the same object, but have not proceeded to such an allocation by way of a decision of *associés*, and others which have a more general investment holding object. Whilst the latter comes the closest to the English understanding of a company, its form and manner of administration is far removed from the type of structure attacked in *R v Allen*. It may be necessary that a set of more carefully worded questions and answers to questions of French law be obtained by persons subjected to attack under ss. 145 and 146 ICTA on the sole basis that they have purchased their French chalet or second home through an SCI.

Let us now analyse the Inland Revenue's treatment of French *sociétés*.
(Source Tolleys Tax Link)

Groupement d'intérêt Economique	Transparent	
Société en Nom Collectif	Transparent	
Société Civile Immobilière	Opaque	*Wrong*
Société Civile Agricole	Opaque	*Wrong*
Société Anonyme	Opaque	
Société en Commandite Simple	Transparent	
Société en Participation	Transparent	
Société à Responsabilité Limitée	Opaque	
Fonds Commun de Placement à Risque	Transparent	

Now let us analyse this list the French way, according to French principles of company law and Article 8 of the Code Général des Impôts:

Commercial	**Article**	
Groupement d'intérêt Economique	Transparent*	Unlimited Liability
Société en Nom Collectif 8	Transparent*	Unlimited Liability
Société Anonyme	Opaque	Limited Liability
Société en Commandite Simple 8	Transparent*	Unlimited Liability
Société en Participation 8.2	Transparent*	Unlimited Liability
Société à Responsabilité Limitée 8.3	Opaque or Transparent*	Limited Liability
Fonds Commune de Placement à Risque	Transparent	Investment Fund
Société d'attribution Immobilière 1655	Transparent	Can have Limited Liability

Civil

Société Civile d'attribution Immobilière	1655	Transparent	Unlimited Liability
Société Civile Immobilière	8 1	Transparent*	Unlimited Liability
Société Civile Agricole	8 1	Transparent*	Unlimited Liability
Sociétés Civiles Professionnelles	8 ter	Transparent*	Unlimited Liability

(* translates Translucide)

The incoherence of the Inland Revenue's position and interpretation at once becomes clear. The two civil companies in which the *associés* have unlimited liability are treated as opaque, whilst the Commercial Companies with unlimited liability are not. In addition, the Inland Revenue's list is wrong in law and in fact on at least two counts.

It is curious how each individual tax administration in the world has the utopian tendency to consider that its own legal and anti-avoidance principles are of global application, whilst forgetting that these principles only obtain real substance within the framework of its purely domestic legislation.

Despite this clear and entirely rational French treatment of the situation, let us remain English about this, and argue each individual step of the way, with the same reasoning as the Inland Revenue, which has even suggested that it is applying the French civil law, doubtless as a shield under Article 5(2)(a), before checking whether it has actually applied the remainder of the relevant treaty provision correctly.

The relevant sections of the domestic United Kingdom Tax legislation cited by the Inland Revenue are ss.145, 146, 154, 167 and 168 , and a further set of principles on the purely British notion of shadow directors ending in the case *R v Allen* STC [2001] 1537.

The notion of a "shadow director", which has been introduced by the back door into ss.145 and 146 ICTA, is one of purely British conception, and has arisen because of a distinction between the legal concept of a director, and the increasing influence of persons who are not over corporate decisions. It can therefore only be applied to British companies, and, even if it may be extended to foreign legal creatures, only with the greatest of care to foreign limited companies of a similar legal architecture and construction. An SCI has no counterpart in the British legal system, as it is not

a limited company, whether by shares, guarantee or otherwise, but is, if one is to trust the OECD, the equivalent of a civil partnership. It is of purely civil law conception and breeding. An SCI has only *associés*, each with unlimited several liability in proportion to their participation, which under the OECD treatment of partnerships have been equated to partners, not shareholders. The entity is managed, if at all, by a *gérant*, a manager, who in no circumstances can be considered a director. There is no board, no notion of collective management. Were the Inland Revenue to be dealing with the hybrid, between an SCI and a *société anonyme*, known as an Sarl, then the Revenue might be able to suggest that the notion of directorship were comparable without attracting too much ridicule, as the Sarl has a form of limited liability. However, even an Sarl does not have directors in the British sense of the term.

To be blunt, a shareholder or member of an English company must have a share. An *associé* of a *société civile* does not have a share, in the English sense of the term, but a *part*, which is not the same concept, and certainly cannot be transferred without an alteration of the contract forming the *société*, whether this be in the form of a notarised or private deed. It cannot be reduced to a certificate as it is not a share or *action* in a *société de capital*, but a *part* in a *société de personnes*. The only relevant method of assimilating an English company to a French company is through comparing the comparable, not the fundamentally distinct.

However, let us continue to be thorough, as s.168 (8) ICTA 1988 does include the following wording:

s.168(8) Subject to subsection (9) below, "director" means–

(a) *in relation to a company whose affairs are managed by a board of directors or similar body, a member of that board or similar body;*

(b) *in relation to a company whose affairs are managed by a single director or similar person, that director or person; and*

(c) *in relation to a company whose affairs are managed by the members themselves, a member of the company,*

and includes any person in accordance with whose directions or instructions the directors of the company (as defined above) are accustomed to act.

The affairs of an SCI may be managed by a manager, a *Gérant*, it might therefore be sufficient for a *Gérant non associé*, in other words a manager who is not a member to be appointed to manage the affairs of the so-called company.

Bearing in mind the point made at the beginning of this article, s.831 states that:

"body of persons" means any body politic, corporate or collegiate, and any company, fraternity, fellowship and society of persons whether corporate or not corporate;

"company" means, subject to subsection (2) below, any body corporate or unincorporated association but does not include a partnership, a local authority or a local authority association;

Under a literal reading of s.168 (8) the term company does not include a body of persons, nor for that matter a society of persons. Under any form of statutory interpretation, the word "company" is used separately in relation to ".... fraternity, fellowship and society of persons". Section 168 cannot therefore apply to a society of persons, as it is not a "company, whose affairs are managed by the members themselves".

It is clear that a society of persons is treated differently from a company under the definition of a body or persons. By definition, therefore the Inland Revenue have to show that the distinction between a society of persons and a company in that definition does not follow through to the definition of a Company on which s. 168 (8) relies.

The *société de personnes* is elsewhere treated as a form of partnership, notably in the OECD discussions on the treatment of partnerships, and the fact that a *société en nom collectif*, which is a form of commercial company open to traders and not a civil one is allowed transparent treatment by the Inland Revenue on the sole basis that each *associé* has unlimited joint and several liability for the Company's debts. The issue is also that the SNC under French principles is considered *transparent* and *translucide*, and also a person capable of residence in France. The fact that the SNC is notwithstanding considered transparent is conveniently forgotten.

Firstly, a society of persons may well be 'a body of persons' under s.831. However, more has to be adduced to enable the Inland Revenue to qualify the society as a company under s. 168 (8). The reader is directed to the argument expanded above.

Under this definition, which avoids using the term "shadow director", it is superficially open to argument that an SCI's *associés* may be assimilated to 'members', and where the members manage the affairs of the company themselves, that they be considered Directors of the Company, under sub paragraph (c) and therefore subject to income tax on the deemed benefit.

However, the notion of member under English law is totally different from the term *associé* under French law, and given the fact that we are dealing with a benefit in kind situation, it is rather the Inland Revenue which should be put to proof that the term 'member' is the same as an *associé*. Let us bear in mind that a *société de personnes* has rightly or wrongly been assimilated to a partnership in most OECD documentation, and that the term 'member' could be restricted to members of stock companies, or companies which are limited or unlimited.

The rights to occupy property arising to an *associé* of an SCI arises as of right from the statutes, not from his function or deemed terms of employment with a company. How can this be then turned into a benefit in kind, when it is what would be qualified even under British interpretation as a shareholder's right and not that of an employee?

Here, we are not dealing with an English company, but with an entity which is categorically defined as land, under the relevant Treaty. If I am not mistaken, this definition is binding. What is more, it is specific to the Franco-British Treaty at the French behest, in order to ensure the correct treatment of disposals of *parts* in French *sociétés civiles immobilières*. Were the Inland Revenue ignorant of what their Minister was signing? It is here that their logic escapes me, and I suspect that this is where the incoherence of their position becomes manifest.

The position is clear, a French SCI whether totally transparent, or having only 50% of its assets in French immovable property is defined as being land; both for rental and for capital gains purposes under the Treaty, and a specific provision had to be inserted to ensure this.

The word 'shall' does not allow for interpretation or degradation by interpretation, and it certainly does not allow the Inland Revenue to requalify the rights of *associés* into benefits in kind or rights taxable under s.145 ICTA 1988 et seq.

The next question is what happens when the SCI's *parts* are sold by the individual who capitalised it to acquire the residence, which he has been deemed to occupy as an employee, rather than as an owner, and which the Treaty considers land. The Inland Revenue's literal exploitation of the Treaty would enable them to consider the *associé* as firstly an employee and secondly the owner of the land, the combination of which would only enter a French tax inspector's mind after a significant abusive absorption of claret.

The issue of the remuneration in France of such a *gérant associé* may be usefully compared.

In general where an *associé* is also a *gérant*, his remuneration is not taxed as a salary, as it is not deductible, and in effect, is already taxed in his hands. It is only where the *gérant* is not an *associé* that his remuneration is taxed and treated as a salary or emolument.

The final point is that the effect of ss. 145 and 146 as qualified by ss.168 is to tax side effects of employment which are not directly linked to the Company's commercial objects. This is hardly the case of an SCI whose object is precisely to attribute the ownership of land to its *associés*.

2. Section 837 and the Annual Value of Land

s. 837 "Annual value" of land

(1) For the purposes of, and subject to, the provisions of the Tax Acts which apply this section, the annual value of land shall be taken to be the rent which might reasonably be expected to be obtained on a letting from year to year if the tenant undertook to pay all usual tenant's rates and taxes, and if the landlord undertook to bear the costs of the repairs and insurance, and the other expenses, if any, necessary for maintaining the subject of the valuation in a state to command that rent.

(2) Section 23 of the General Rate Act 1967 (adjustment of gross value by reference to provision of or payment for services etc.) shall apply for the purpose of subsection (1) above, and in relation to land in Scotland or Northern Ireland shall apply as if it extended to the whole of the United Kingdom.

(3) Where any question arises as to the annual value of land it shall be determined by the General Commissioners and those Commissioners shall hear and determine the question in like manner as an appeal.

It has been said that this section could only apply to the valuation of English and Welsh soil, given the reference to section 23 of the General Rate Act 1967, and the need to apply the provisions of that Act to Scotland and Northern Ireland. The Inland Revenue are not competent to value foreign land under English principles.

The Inland Revenue have notwithstanding issued SE 11441 which effectively advises Inspectors to extend their application of the section to foreign residences, implying that the reference to s.837 in s.145(2) permits this.

Living accommodation: meaning of annual value for properties outside the United Kingdom

For living accommodation situated outside the United Kingdom the annual value is broadly the amount the property could be let for on the open market.

The annual value of property as determined for any rates or taxes in countries outside the United Kingdom is not for that reason on its own an acceptable measure for United Kingdom tax purposes. The annual value of living accommodation outside the United Kingdom should therefore be determined in accordance with the definition in section 837.

...

For living accommodation situated outside the United Kingdom the annual value is determined under section 837 as the annual rent at which it could be let for a year unfurnished on the assumption that

- The tenant met all the customary tenant's burdens, and
- The landlord met the cost of repairs insurance and other landlord's expenses.

Where the section 145 charge is based on the open market rental of the property then Extra Statutory Concession A91(b) prevents there being any further charge under section 146.

The question of the period living accommodation has been provided for is often an issue for properties outside the United Kingdom. If the charge is for a period of less than a year apportion the annual rent on a time basis.

The onus is on the employer to come up with an estimate of the market rental of the property. He will normally be able to obtain an estimate from a local estate agent in the country concerned.

If you wanted to check the estimated market rental figure was reasonable get a full description of the accommodation and locality (accompanied, where appropriate, by photographs). Where an acceptable figure cannot be negotiated, make a full report to Personal Tax Division, Solihull before any appeal is set down for hearing.

The application of this to foreign property in the case of an SCI is equivalent to attempting to evaluate the sale of a kilogram of asparagus at the sterling equivalent

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The application of this to foreign property in the case of an SCI is equivalent to attempting to evaluate the sale of a kilogram of asparagus at the sterling equivalent

for potatoes weighed in pounds and ounces. The point of introducing s.23 of the General Rate Act 1967 into s.837 was to introduce certainty, not to allow the Inland Revenue to evaluate broadly. In addition, do ss.837 and 145 and 146 allow an extension which in the author's opinion, is unwarranted and outside the intention of Parliament to include persons who were not in the mind of Parliament when passing the ICTA. An *associé* is and cannot be an employee in the sense described above, as requiring accommodation during his employment abroad. He cannot be assimilated to one as he cannot be considered to be employing himself under the French legislation governing the entity concerned with a specific express contractual provision.

The question immediately arises, who is the employer? The SCI cannot be deemed to be an employer in this case, where there are no express contractual relationships of subordination involved, let alone French social security payments, and the object of the SCI is to allow its members to occupy the premises owned by the SCI rent free.

The SCI cannot employ anyone without specific written contractual engagement, and it is unlikely that any provision would be made for the *associés* to be able to employ anyone in the statutes, save in naming a *gérant* and giving him the authority to do so.

It is curious that the Inland Revenue are alleging that the 'member' can be taxed on an *ultra vires* basis. Are they alleging that an *associé* can employ himself, without a formal contract?

There is no doubt that an Estate Agent could be found to provide a professional estimate of rental on an arm's length basis, but this would not be ascertainable under English principles, as it would be unlikely that the provisions of an English tenancy agreement could be brought to bear on French land.

In addition, although it may be possible to evaluate a French rental under French terms between the SCI and a third party, it would be viewed as a futile initiative in France, as the *associé* would have contributed the capital for the acquisition of the property. Why should he pay a second time for the same right?

The only manner in which this issue can be resolved is by fighting any attempt by the Inland Revenue to tax an *associé* on this basis, and to require a Court decision as to whether such cases as *R v Allen* are capable of such extension beyond their *ratio decidendi*, in particular where there is no reason to suggest that there is any avoidance of the payment of United Kingdom tax, as there was in that case. Sections 145 and 146 were designed to ensure that the owners of English companies

did not escape taxation on benefits in kind derived from English property.

The Conclusion

As usual, the advice is that any person interested in an SCI owning French situs property may be well advised to give his interest an overhaul, particularly where it was formed prior to 1978.

It is essential to have this done on both sides of the Channel by competent lawyers in each jurisdiction, and not rely on the advice of persons holding themselves out to have knowledge, such as French estate agents or *marchands de biens*.