

European Economic Interest Grouping: transfer pricing rules (3/42/18)

Multinational enterprise groups engaged in frequent cross-border transactions seek to optimise the provision of services and to cut their costs, for example, by entering into a **cost contribution arrangement** or by setting up a separate legal entity to provide shared services. In this article, from a Latvian transfer pricing (TP) perspective we explore the European Economic Interest Grouping (EEIG), a type of legal entity that mainly aims to minimise the financial and legal burden by providing support to its business partners.

The legal framework

The EEIG is a type of EU legal entity introduced by **Council Regulation (EEC) No. 2137/85 of 25 July 1985** to reduce the legal and fiscal difficulties facing individuals, entities and other arrangements.

As you may know, EU regulations are pieces of legislation issued by EU bodies that impose obligations in general and are directly applicable in all member states, including Latvia. In line with the Regulation, Latvia has adopted the EEIG Act, but its purpose is to lay down registration rules and explain how the Regulation should be applied, rather than explaining the EEIG concept and operations.

The main goals and other aspects

The Regulation describes the concept and operational goals of the EEIG. The main purpose of setting up an EEIG is to facilitate or expand the business of its members by pooling resources, activities or skills to achieve better results than what the members could achieve by working separately. The EEIG basically operates to provide an ancillary or auxiliary function linked to its members' business.

Unlike a standard commercial entity, the EEIG does not aim to make a profit (Article 3(1) of the Regulation). Any profit the EEIG might make will be considered its members' profit and split between them in accordance with the EEIG memorandum of association, or if there is no provision for this, in equal shares.

Under the Regulation, any profit from the EEIG's activities is not taxed until its members have gained it. In other words, although the EEIG is responsible for paying VAT and employee social insurance contributions, the EEIG's profits are exempt from corporate income tax (CIT) on payment to its members.

Hiving off support functions is a good option for many multinational enterprise groups seeking to minimise their cost and tax burden, but in practice EEIGs are used quite rarely. There are a number of reasons why an EEIG is not set up more frequently, for example, to provide shared intragroup support services:

- Only relatively small groups are eligible, i.e. an EEIG is restricted to 20 members and 500 employees;
- An EEIG is not permitted to attract investments publicly;
- The EEIG's operations should be linked to its members' business but cannot replace it, for example, the EEIG cannot undertake any professional activities with respect to third parties;
- Related parties should meet TP principles, meaning that an arm's length markup may have to be added to the cost of intragroup services;

- When profits are distributed, the members are liable to pay CIT under the national legislation of their member states, which may even increase the tax burden on the multinational group.

Applying TP rules to EEIG related-party transactions

As stated above, the main purpose of an EEIG is to facilitate the business of its members by providing them with shared support services. Many groups might find such a legal arrangement attractive since the Regulation provides that the EEIG does not aim to make a profit. When providing services, the EEIG is not required to add a markup to its service costs, which means an extra saving for its members. However, this matter should be evaluated in the light of local as well as international legislation.

The Regulation has remained practically unchanged since 1985 and may give the impression that it fails to reflect the latest trends stemming from, say, the OECD's BEPS reports and current TP practices.

If the EEIG is a tax resident of Latvia, the Latvian CIT Act should be consulted to find out whether the EEIG's related-party transactions are covered by TP requirements. Entities subject to Latvian CIT should meet Latvian TP requirements and adjust their CIT return if the price (value) of their controlled transactions is not arm's length.

Under the CIT Act, commercial entities operating as partnerships (including EEIGs) are liable to pay CIT on profit distributions, and the EEIG is therefore subject to Latvian CIT. The CIT Act also provides that partnerships are covered by an obligation to make CIT adjustments if their transactions are not arm's length. Although the Regulation provides that CIT is charged on profits in the hands of an EEIG member, the Regulation does not restrict the application of the CIT Act with respect to TP requirements.

Article 40 of the Regulation provides that making a profit is not the EEIG's main goal, but Latvian legislation treats the EEIG as subject TP adjustments, meaning that the EEIG should meet Latvian TP requirements and evaluate the need to apply an arm's length margin on services it provides to related parties.