TAX NEWS REVIEW

This review of tax news focuses on the main case law decisions of recent months

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I. Research tax credit: eligibility, calculation and reimbursement

TA Cergy-Pontoise, March 13, 2023, No. 19141374, *SAS Extia*; CAA Lyon, September 21, 2023 No. 21LY03203; TA Montpellier, July 3, 2023, No. 2103911

Regarding the Research tax credit, only the company that incurs research expenditures is entitled to the tax credit, regardless of whether it carries out the research on its own behalf or on behalf of a third party (French Tax Code, art. 244 quater B). By way of exception, if an approved external organization is entrusted by a company with research operations, the expenses incurred for these operations are included, within certain limits, in the research tax credit base of the main company and are deducted from the base of its own research tax credit (French Tax Code, art. 244 quater B, II, d ter).

Thus, an unapproved company cannot be refused the benefit of the research tax credit on the grounds that it would not be exposed to any risk and that it would be merely providing staff, when it is clear from contracts and invoices that the company had provided subcontracting services for projects for which it has assumed the risk, and that cannot be treated as simply providing staff (**TA Cergy-Pontoise, March 13, 2023, No. 19141374, *SAS Extia***).

In addition, it has been ruled that a public subsidy related to an operation qualifying for the research tax credit must be fully deducted from the calculation basis of the research tax credit, even if not all the expenses related with the operation are eligible for the tax credit **(CAA Lyon, September 21, 2023, No. 21LY03203)**. These public subsidies must therefore be fully deducted from the calculating basis of the tax credit for the year during which they were granted.

Lastly, it is important to note that SMEs are entitled to an immediate refund of the research tax credit (French Tax Code, art. 199 ter B, II). This request for immediate reimbursement operates as a claim within the meaning of Article 190 of the French Tax Procedures Book (LPF), which provides a three-year claim period starting from the emergence of the right to immediate reimbursement of the portion of the research tax credit. In this case, an SME had not applied for immediate reimbursement and had applied for a refund at the end of the standard three-year period, in the absence of a deduction from corporation tax for the year and the three subsequent years. The court **(TA Montpellier, July 3, 2023, No. 2103911)** ruled that the sole end of the three-year period could not constitute an event giving the company a new period offering a claim, and that it could not seek full repayment of its tax credit by relying on the ordinary deadline settled in Article 199 ter B of the French Tax Code.

The research tax credit deserves full attention, in terms of its scope, its calculation and its implementation.

II. About the deductibility of indirect remuneration paid to company directors

CE October 4, 2023, 9th et 10th combined chambers, No. 466887, *Collectivision company*

As a reminder, an expenditure is only deductible in the ordinary course of business operations; otherwise, such a transaction may be qualified as an "abnormal act of management".

In this case, the Collectivision company had deducted in 2013 fees paid to the Sonely company in respect of management services provided by a joint manager, being specified that this manager was the managing director of Collectivision and co-managing director of Sonely. Collectivision was subsequently reassessed for corporation tax in respect of this deduction, on the grounds that these payments revealed an "abnormal management".

The Marseille Administrative Court of Appeal upheld the reassessment, observing that the services provided by Sonely were not related to technical functions but to the inherent functions of a limited liability company director. Consequently, according to the Court, Sonely had not provided any services that were distinct from the activities that the manager was required to perform as manager of Collectivision.

The French Supreme Court quashed this decision, ruling that the conclusion by company A of an agreement with another company B for the performance, by the director of company A, of the management functions incumbent upon him, did not necessarily constitute an abnormal act of management.

According to the French Supreme Court, the company had validly established that its competent corporate bodies intended to remunerate the manager indirectly with paying the fees corresponding to these services; therefore, this payment was not without consideration for the company, as the choice of a method of indirect remuneration does not in itself characterize an impoverishment for purposes unrelated to its interests.

The decision also states that the lack of remuneration of a company's director during a financial year does not constitute a management decision preventing the same director from being remunerated, by decision of the competent corporate bodies, during a subsequent financial year, retroactively if necessary, or during the same financial year, through another company.

This decision contradicts previous case laws from Administrative Courts of Appeal, according to which management fees paid by a subsidiary company to its parent company for management services provided by a common manager could not be considered as part of normal management, since these services cannot be separated from the responsibilities of the person concerned as manager of the subsidiary. It should be noted that the Court of Nancy had rejected the argument stating that the director did not received any income from the subsidiary, since this circumstance was part of a management decision that was enforceable against the company (CAA Nancy, October 9, 2003, 98NC02182, *Gamlor*; along the same lines: CAA Paris, October 10, 2018, No. 17PA02373, *Sté Fideclic*; CAA Paris, November 6, 2019, 18PA02628, *Sté Self Media*, CAA Paris, March 22, 2023, No. 21A04911, *Sté Media 6*).

However, as the public rapporteur pointed out in her conclusions, doubts remain, for example about the consequences that could be drawn in terms of social security contributions.

III. About deductibility of penalties: the double penalty

CE, 3rd, 8th, 9th, and 10th combined chambers, December 8, 2023, No. 458968, *Alder Paris Holdings Ltd*

As a reminder, according to Article 39-2 of the French Tax Code, pecuniary sanctions and penalties of any kind handed down against violators of legal obligations are not deductible. This provision applies to both penal and administrative sanctions pronounced by an independent administrative authority.

According to the French administrative doctrine, these provisions should in principle also apply to sanctions imposed by a foreign court for activities carried out in France (BOI-BIC-CHG-60-20-20).

The general context of this case should be understood regarding the rules of civil liability in the United States, which provide for the possibility of paying punitive damages to the victim when the wrongdoer has committed an inexcusable or a particularly serious fault, such as deliberately causing harm to the victim for malicious purposes or to gain profit.

The Ratier-Figeac company deducted an expense of 3.7 million euros and a provision of 3.4 million euros corresponding to punitive damages it had been ordered to pay by a Kansas court to an American company in a dispute against it.

Following a tax audit, the French tax administration questioned the deduction of these expenses and provisions. However, the Administrative Court of Montreuil subsequently granted the company a full tax relief. Upon appeal against this judgment, the Administrative Court of Appeal of Versailles then stated that punitive damages should be considered not as pecuniary sanctions but as an additional compensation awarded to the victim for the satisfaction of private interests, exceeding the amount of the suffered damage (CAA Versailles, October 5, 2021, No. 20VE00034). The repair of this particular damage could not, according to the Court, be assimilated to a pecuniary sanction or penalty within the meaning of Article 39-2.

According to the conclusions of the public rapporteur, the Administrative Court of Appeal made a legal error by relying on the quality of the punitive damages' beneficiary and on the pursuit of the beneficiary's private interests to exclude those punitive damages from the scope of Article 39-2. Indeed, in the public rapporteur's view, the fact that punitive damages are paid to the victim does not exclude their qualification as pecuniary sanctions inflicted to violators of legal obligations. The public rapporteur's analysis even indicates that unlike compensatory damages, punitive damages do not aim to compensate a damage and are intended to punish the guilty party and discourage the repetition of the fault.

To begin, the French Supreme Court states as a general assessment that a pecuniary sanction imposed by a foreign authority due to a violation of a foreign legal obligation is not deductible unless this sanction is contrary to the French conception of international public order. In other words, the judge examines whether the foreign decision is in line with the French vision of fairness and justice and whether it is consistent with the general configuration of the French legal system – in this perspective, a foreign sanction considered as excessive would fall outside the scope of non-deductibility.

To settle the case, the French Supreme Court takes into account the nature of the sums involved: these punitive damages were aimed to discourage the repetition of similar acts by the violator and were added to compensatory damages paid in order to repair the damage caused, giving them the quality of a pecuniary sanction within the meaning of Article 39-2 of the French Tax Code.

Nevertheless, the French Supreme Court does not overturn the discharge pronounced by the Administrative Court of Appeal and sends the parties back to the same court.

The French Supreme Court confirms a very broad approach on sanctions for the application of article 39-2 of the French Tax Code, but its decision shows that a precise legal analysis of the sanction's motivation is required when it is imposed by a foreign authority.