TAX NEWS REVIEW

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

JULY 2024

I. Non-deduction of definitive losses of a permanent establishment

Supreme Court, April 26th, 2024, n°466062, *SPIE Batignolles*, written account from Romain Victor

In corporate tax matters, the principle of territoriality set in the first paragraph of Article 209 of the French Tax Code ("FTC") subjects to tax only the profits made by companies operating in France and those whose taxation is attributed to France by a tax treaty. In addition, the Court of Justice of the European Union ("CJEU") has ruled that the freedom of establishment guaranteed by Article 49 of the TFEU requires that a company be able to deduct from its taxable income the definitive losses incurred by its branch in another Member State (CJEU, *Mark & Spencer*, December 13th, 2005, aff. C-2446/03).

In this case, the tax authorities rejected the French company's request to deduct the loss carried forward resulting from the definitive losses of its permanent establishment in Luxembourg to the taxable income of the tax consolidated group. The Montreuil Administrative Court censured the tax authorities by approving this set-off on the basis of freedom of establishment, a position confirmed by the Paris Administrative Court of Appeal ("CAA").

After reminding the CJEU that it considers that a difference in treatment does not constitute an obstacle to freedom of establishment if it relates to situations which are not objectively comparable or if it is justified by an imperative requirement in the public interest and proportionate to that objective (CJEU, *A/S Bevola and Jens W. Trock ApS v Skatteministeriet*, June 12th, 2018, aff. C-650/16), the Supreme Court ruled against the court's decision.

Resolving the case on its substance, the Supreme Court noted that it resulted from the stipulations of Article 4 of the tax treaty of April 1st, 1958, between France and Luxembourg that losses incurred by the Luxembourg permanent establishment of a French company were attributable only to Luxembourg.

The Supreme Court decided that these stipulations and the provisions of domestic law constitute a difference in treatment, without constituting an infringement of the freedom of establishment, since the French branch of a French company and the Luxembourg branch of the same company are not in an objectively comparable situation with regard to the loss allocation rules in a tax consolidated group.

Although the case law of the CJEU was described by the public rapporteur as *"meandering and casuistic*", the Supreme Court refused to refer a question to the CJEU for a preliminary ruling.

It should be noted that this decision was based on the old Franco-Luxembourg tax treaty, which has since been replaced by the new tax treaty of March 20th, 2018, which abandoned the exemption method in favour of the tax credit method, thus breaking down the treaty barrier of the territoriality of losses. We will therefore have to wait for the Supreme Court to rule on a similar situation under this new treaty.

It should also be noted that in two decisions dated December 15th, 2023 (nos. 21PA03001 and 21PA01850), the Paris CAA ruled that the losses of a Belgian subsidiary and a Latvian subsidiary could be deducted in France provided that they were definitive in the State in which they were established. Conversely, the Paris CAA (May 22nd, 2024, no. 22PA02964) ruled that the losses of a Slovakian company could not be used in France. We await with interest the decision of the Supreme Court in these three cases: if the high court were to validate the new decisions of 2023 of the CAA of Paris, we would then have a distortion of treatment between a foreign branch and a foreign subsidiary.

II. Recapitalization of a subsidiary before a merger: deductibility of the capital losses

Supreme Court, June 11th, 2024, n°470721, *Société Agapes*, written account from Céline Guibé

Pursuant to Article 39 quaterdecies 2bis of the French Tax Code ("FTC"), the tax authorities challenged the deduction from the taxable income declared by the Flunch company for the 2015 financial year of the short-term capital losses recognized on the merger of a first subsidiary and the dissolution of another subsidiary in September 2015, which it had recapitalized in December 2013.

As a reminder, the purpose of this Article is to treat the capital loss arising from a recapitalization less than two years before the sale in the same way as a non-deductible financial subsidy.

The case was referred to the Supreme Court, which began by confirming that the cancellation of shares held by a company following a restructuring operation resulting in the transfer to it of all the assets and liabilities of the company whose shares are cancelled must be regarded as a disposal within the meaning of Article 39 quaterdecies 2bis of FTC.

The Supreme Court goes on to state that securities subscribed by a parent company as part of the recapitalization of its subsidiary followed, in the short term, by the dissolution of the subsidiary with the transfer of all of its assets and liabilities to its parent company are equity securities, provided that this transaction results in the company holding the securities exercising direct control over the assets and liabilities of the company whose securities have been cancelled.

Lastly, the Supreme Court noted that when the Flunch company subscribed for the shares issued in December 2013 by its subsidiaries in return for capital increases, it intended to retain control of these two companies, even if this meant dissolving them and transferring the assets and liabilities to itself. From this perspective, the shares were indeed equity securities.

The Supreme Court therefore dismissed the applicant's appeal.

However, the Supreme Court did not rule on the transfer of shares to a third party, in which the transferor losses control over the assets of the transferred company. As a reminder, in a decision regarding a company in the banking sector, the Supreme Court (November 8th, 2019, no. 422377) allowed the deduction of such a capital loss on the grounds that the accounting rules for credit institutions authorizes the classification of equity interests in the same company in different accounts (equity interests / investment securities). We will have to wait and see whether such reasoning can be accepted for other companies governed by the general chart of accounts; in this respect, a position from the French Accounting standards Authority would be welcome.

III. Qualification of a full transfer of assets for VAT purposes

Douai Administrative Court of Appeal, May 22nd, 2024, no. 23DA00846
Toulouse Administrative Court of Appeal, June 6th, 2024, no. 22TL20979

As a reminder, under the terms of Article 256 of the French Tax Code ("FTC"), any supply of goods or services for consideration by a taxable person acting as such is subject to VAT; furthermore, Article 257 bis of the FTC states that: "*In the event of the transfer for consideration, free of charge or in the form of a contribution to a company of a full or partial transfer of assets between VAT payers, no supply of goods or services is deemed to have taken place* ".

The notion of transfer of a full or partial of assets is understood as the transfer of a business or an autonomous part of a business, comprising tangible and, where applicable, intangible elements, which together constitute a company or part of a company capable of pursuing an autonomous economic activity on a lasting basis.

In these two cases, the tax judge refused to allow the taxpayers to benefit from Article 257 bis of the FTC when they sold assets.

In the first case, on the same day, the taxpayer terminated the leases on a property it held under finance leases, exercised the option to purchase the property, and then sold the property to a commercial company to set up its car trading activity.

The Douai Administrative Court of Appeal ruled that in the absence of a transfer of the leases and the pursuit of the leasing activity, the taxpayer was unable to affect the transfer of a full of assets, thereby excluding the operation from the exemption provided from Article 257 bis of the FTC.

In the second case, a farmer sold machinery to an agricultural driver in his employ. The driver produced a certificate to prove that he had taken over the customers of the transferring company, and that the transferring company had ceased operations a few months after the transfer of the equipment.

However, the Toulouse Administrative Court of Appeal ruled that the applicant had failed to establish (i) that the transfer was part of a business takeover, and (ii) that the transferee generated a significant proportion of its sales from work carried out with the transferred machines. The sale of the agricultural equipment could therefore not be considered as part of a full transfer of assets and liabilities, thereby excluding the operation from the exemption provided for in Article 257 bis of FTC.

Although the first decision is not controversial, the position taken in the second case appears more severe.

This question of the transfer of a full or partial of assets is very important, as the terms of Article 257 bis of the FTC are applicable and, symmetrically, if the tax authorities consider that a business capital or an autonomous part of a company has been transferred, and if the two parties have made the transaction subject to VAT, the transferee company's right to deduct VAT will be challenged, as the operation is deemed not to have occurred.