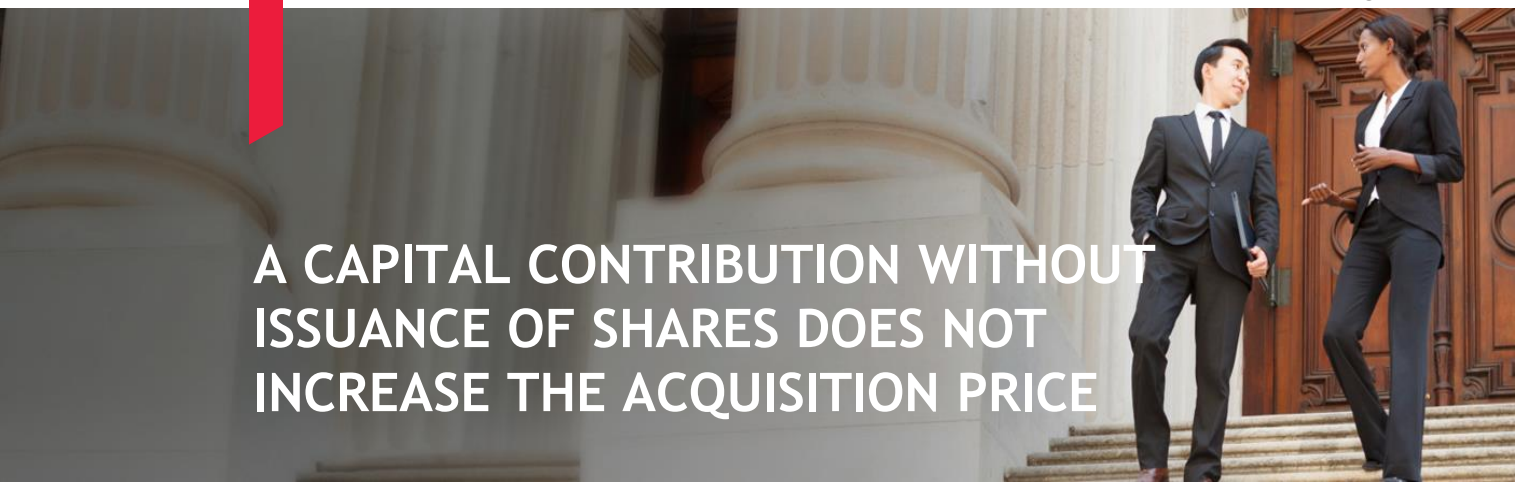


A CAPITAL CONTRIBUTION WITHOUT ISSUANCE OF SHARES DOES NOT INCREASE THE ACQUISITION PRICE

On 31 March 2022, the Luxembourg Higher Administrative Court confirmed the judgement of the Luxembourg Lower Administrative Court dated 11 May 2021, which ruled that capital contributions made into a Luxembourg company without issuance of shares (also known as "115 account contributions") are not part of the acquisition price to be considered for application of the parent subsidiary withholding tax exemption.

Background

In January 2016, a Luxembourg resident company ("AB") received a dividend from another Luxembourg resident company ("FE"). A 15% withholding tax was levied by FE and paid to the Luxembourg tax administration because the 12-month holding period was not met and no commitment was taken by AB to keep its shareholding in FE for a period of at least 12 months.

On 9 October 2017, AB claimed a refund of the withholding tax paid by FE as it considered that the conditions to benefit from the parent-subsidiary exemption were met.

On 5 January 2018, the tax office rejected the refund request based on the fact that AB did not meet all the conditions of the Luxembourg participation exemption regime in order to receive the dividend from FE free from withholding tax.

With respect to the conditions of the Luxembourg participation exemption regime, it is recalled that the shareholding that qualifies for the above exemption is either a participation of at least 10% or alternatively an acquisition price of at least € 1,2 million. In the case at hand, AB held a participation of 4,5% in FE, but considered that the acquisition price of its shareholding exceeded € 1,2 million.

In order to determine said acquisition price, AB took into consideration the purchase price paid and the 115 account contributions made into the equity of FE in the course of 2014.

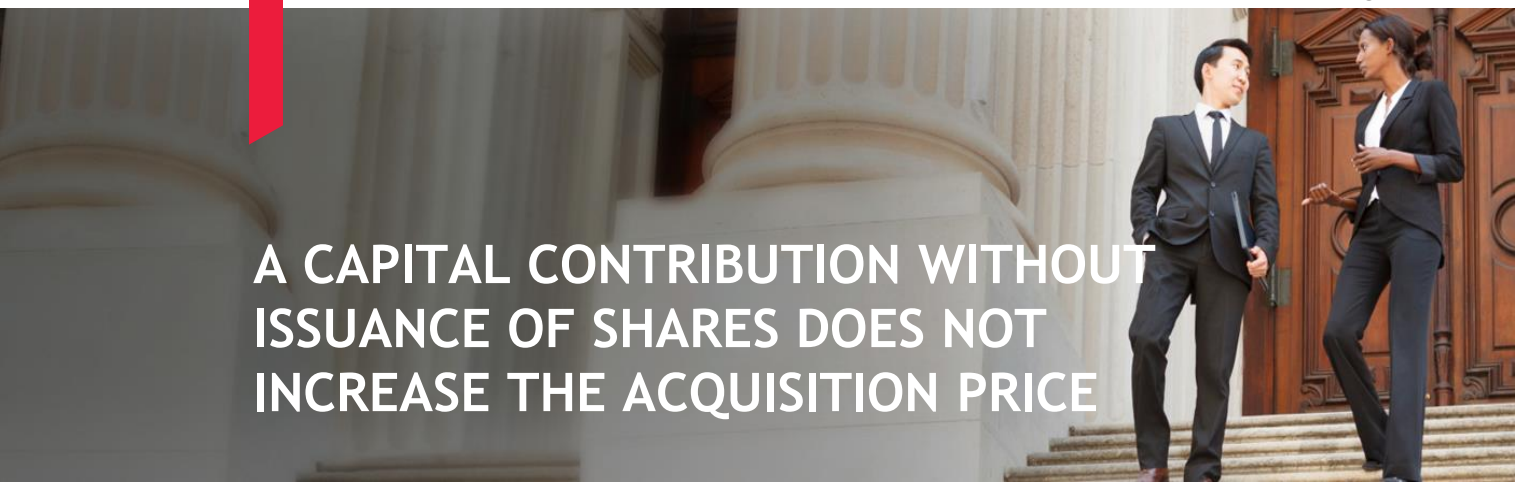
The Luxembourg tax authorities, followed by the Luxembourg Lower Administrative Court, considered however that the contributions to the account 115 of FE did not constitute a participation in the capital of the latter and, accordingly, ruled that the conditions of article 147 of the Luxembourg Income Tax Law ("LITL") were not met.

Decision of the Luxembourg Higher Administrative Court

In a nutshell, the Higher Court confirmed the decision taken by the Lower Court on 11 May 2022.

The taxpayer developed several points to argue that the 115 account contributions should be a component of the purchase price of a shareholding, including the following:

- as hidden capital contributions have been consistently treated as equity for Luxembourg tax purposes, any actual – but informal – contributions (i.e. not hidden) should follow the same tax treatment;
- in order to determine the acquisition price of its shareholding, AB should follow the principles set by article 25 LITL and take into account all costs and expenses incurred in order to acquire such shareholding. In this respect, the contributions made into the account 115 of FE should be added in order to determine the "*effective acquisition price*";



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- from an accounting perspective, contributions to account 115 would be recorded by the parent company as being part of the acquisition price of the shareholding. As article 40 LITL establishes the principle of linking the tax balance sheet to the commercial balance sheet and since, for tax purposes, a participation must be valued at its acquisition price in accordance with article 23 LITL, it would therefore be contrary to article 40 LITL not to consider the 115 account contributions within the application of article 147 LITL.

The Higher Court dismissed the appeal made by the taxpayer, mainly based on the following facts:

- the increase of capital of a public limited company is ruled by the amended law of 10 August 1915 on commercial companies. Such law does not provide for a capital increase through informal contributions such as contributions to account 115 recorded by AB;
- the Court assessed that the acquisition price paid by AB in order to acquire its 4,5% participation in FE and the subsequent contributions made by AB into the account 115 of FE were not linked (even if both transactions occurred on the same day) and, consequently, the contributions made to the account 115 should not be part of the acquisition price of the shareholding held in FE by AB.
- as a matter of principle, the Court mentioned the fact that a contribution to account 115 is included in the equity of a target company, but remains foreign to its share capital and does not confer to the shareholder any right to a direct consideration (e.g. shares in the share capital or an increase of the nominal value of shares held) means that such 115 account contribution does not present a link sufficient to be part of the acquisition price of a participation.

Before its conclusion, it is nonetheless interesting to note that the Court added that, even if AB had made its contributions into the account 115 of FE with the intent to increase the value of its participation, the articles of FE did not provide that said contributions should be exclusively allocated to AB, particularly in case of a reimbursement of those contributions, so that the proportion in which AB's contributions into the account 115 of FE would have increased the value of its participation in FE cannot be determined.

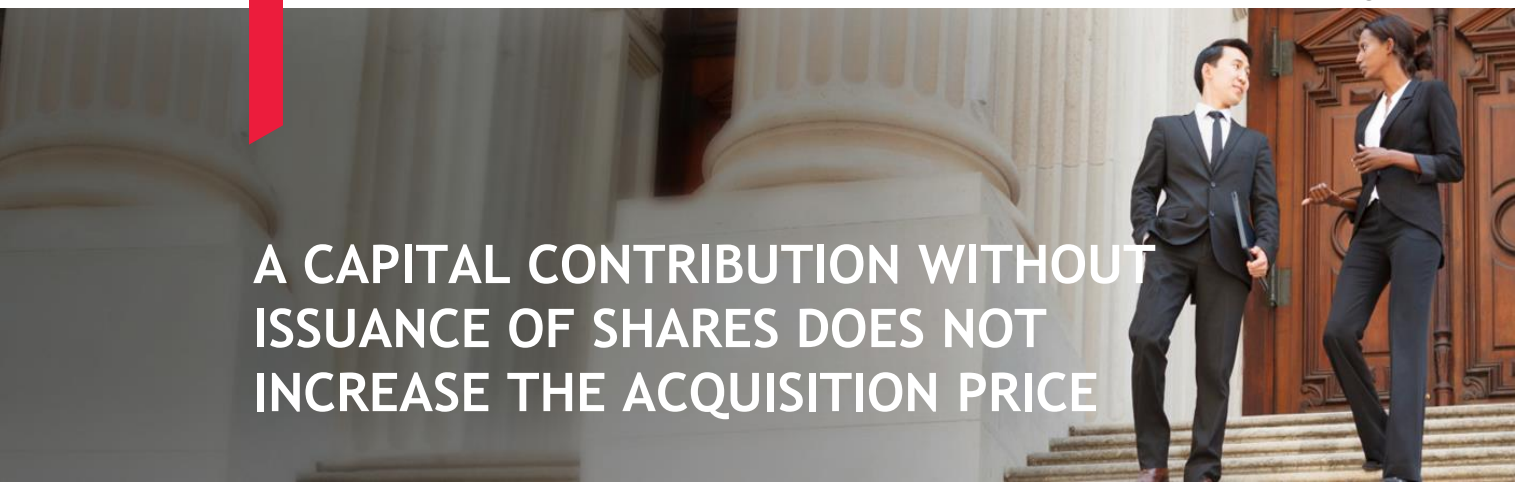
Takeaway

Luxembourg companies holding a participation in another Luxembourg company of less than 10% and that rely on the alternative condition of the acquisition cost of their participation in order to benefit from the parent subsidiary exemption (both for the withholding tax exemption and the exemption of dividend and capital gains) should carefully review their structure if the acquisition cost includes contributions made to account 115.

In addition, it would be interesting to know how the tax authorities would treat those 115 account contributions for net wealth tax purposes.

We would strongly recommend the Luxembourg taxpayers being in one of the above situations to liaise with their tax advisor in order to review their financing structure and take appropriate action where necessary.

One possible quick fix to avoid the risks triggered by the decision of the Higher Court would be to modify the articles of a target company so that the 115 account contributions are converted into share capital and share premium. However, this solution would likely decrease the benefit of using account 115 since the latter normally requests very little corporate paperwork (and in any case no notary deed).



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INTERESTED?

Get in touch with:

Paul Leyder
Partner
+352 45 123 734
paul.leyder@bdo.lu

Gerdy Roose
Partner
+352 45 123 371
gerdy.roose@bdo.lu

Astrid Barnsteiner
Director
+352 45 123 575
astrid.barnsteiner@bdo.lu

Bertrand Droulez
Director
+352 45 123 591
bertrand.droulez@bdo.lu

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