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Recent decision of the Administrative Court in relation to the 115 Account: What is at stake?

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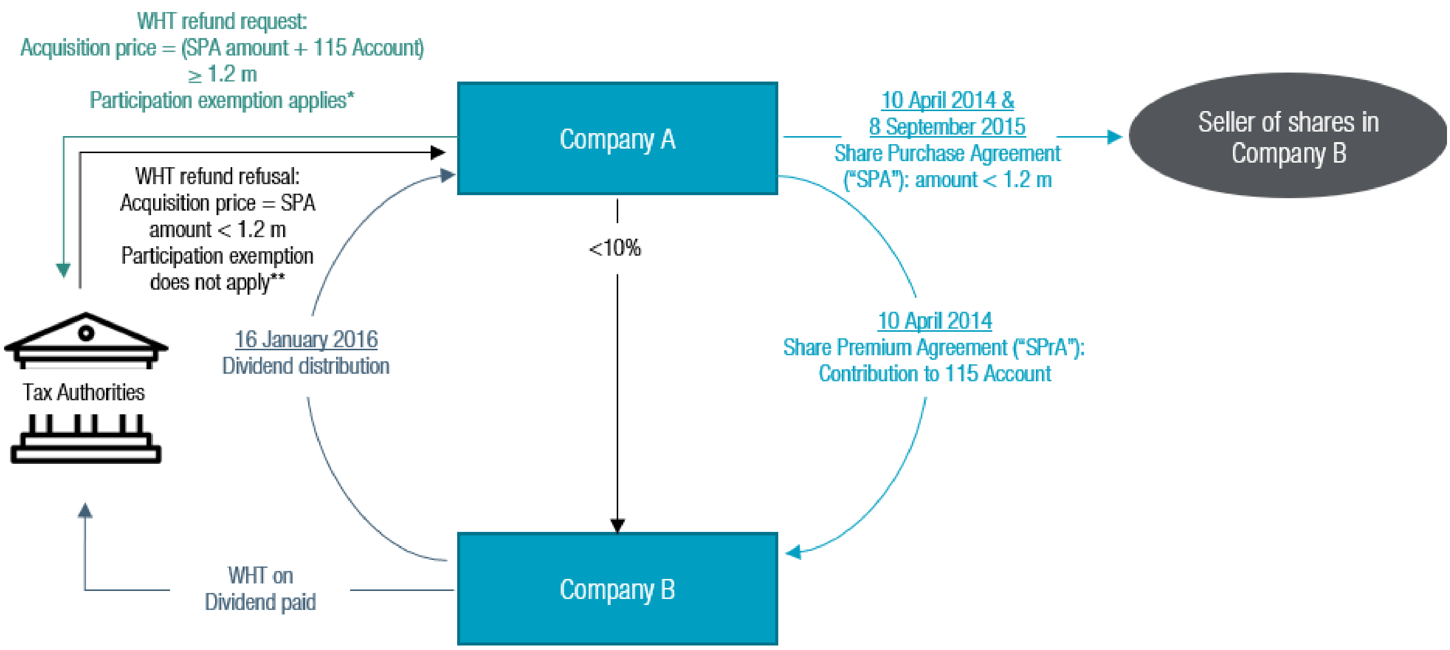
In a recent decision of 31 March 2022, the Luxembourg Administrative Court (the “Court”) ruled on whether contributions to the “115 Account” (capital contribution without issuance of shares) have to be taken into account when computing the acquisition price of a shareholding for the application of the Luxembourg participation exemption regime. The 115 Account is a subcategory of the equity account “share premiums and similar premiums” in the financial statements of Luxembourg companies.

Following a debate between the taxpayer and the tax authorities on whether or not the 115 Account qualified as share capital and had to be taken into account for the computation of the acquisition price of the shares, in relation to which the benefit of the participation exemption was requested, the Luxembourg Administrative Tribunal decided, in a decision of 11 May 2021, that the contributions to the 115 Account, as performed in the case at hand, could not be taken into account in order to compute the minimum acquisition price of EUR 1.2 million under the Luxembourg participation exemption regime. In its decision, the Court confirmed the first-instance decision.

The facts of the case were very specific – the 115 Account contribution was disconnected from the share acquisition. Nonetheless, from now on, the surprising and questionable conclusion of the Court should be kept in mind when the 115 Account is used.

Facts and position of the parties



Position of Company A: various arguments amongst which:	*****Position of the tax authorities:***
• The contribution to the 115 Account should be considered as a direct participation in the share capital. • The law does not require that the 1.2m threshold should be reached by contributions to the company's share capital in the strict sense. • The acquisition price would therefore need to be assessed in relation to the acquisition value of the shareholding on the assets side of the parent company's balance sheet and not the value of the subsidiary's share capital. • In the absence of explicit provisions providing the contrary, the 115 Account should thus also be considered as an element of capital for tax purposes, including in the context of the participation exemption.	• Provision of funds through the 115 Account cannot be considered as a direct participation in the share capital of the company. • From an accounting point of view, reserves, retained earnings and share premiums are not part of the share capital itself. • Informal contributions to Company B in which Company A already held a participation, without receiving securities representing the capital or a remuneration in return are not part of the acquisition price of said participation. • SPA and SPrA do not make any link between the acquisition of the shares in Company B and the contribution to the 115 Account of Company B.

Decision of the Court

By reference to the case law of the Court of Justice of the European Union "*Les Vergers du Vieux Tauves*", the Court restated the fact that the concept of a 'holding in the capital' within the meaning of the participation exemption refers to the legal relationship between the parent company and the subsidiary.

On this basis, the Court concluded that in the specific context of the participation exemption, the concept of "shareholding in the share capital" within the meaning of Articles 147 and 149 of the Luxembourg Income Tax Law ("LITL") refers to the holding of shares or interest in the share capital of the distributing company within the meaning of the law of 10 August 1915, since only the holding of these securities places its holder in a direct legal relationship with the subsidiary company which confers the rights inherent to the status of shareholder or member of this company. This point (i.e. the meaning of "shareholding") was nevertheless undisputed.

In relation to the way the acquisition price of this shareholding should be computed, the Court decided that:

- In assessing the requirement of a purchase price of at least EUR 1.2 million under Articles 147(2) and 149(4a) LITL, the term "purchase price" must be interpreted in accordance with Article 25(1) LITL according to which the purchase price of an asset corresponds to the total expenses incurred, with the result that costs incidental to the acquisition of the holding form also part of the purchase price.
- However, an expenditure may only be considered as part of the acquisition price of the holding in the share capital of the subsidiary company if it results in an increase in the number or nominal value of the shares held, or is a direct accessory to such an increase.
- Since a contribution to the 115 Account remains outside the share capital of the Company and does not entitle the shareholders to any direct consideration consisting of either the granting of new shares or units in the share capital or an increase in the nominal value of the shares, such a contribution does not have a "sufficient link with the participation in the share capital of the company to enable it to form part of the purchase price of the participation in the share capital".
- It follows that a contribution to the 115 Account cannot be taken into account for the purpose of determining the acquisition price of a participation in the share capital of a resident capital company in order to assess the threshold of EUR 1.2 million for that acquisition price.
- Even if the taxpayer had made such "contribution" with the intention of increasing the value of its shareholding, the articles of association of the company did not provide that the amount paid by the taxpayer in the form of a "contribution to 115 Account " would be allocated exclusively to the taxpayer, in particular in the event of repayment of the said "contribution", so that the proportion in which this "contribution" would have increased the value of the shareholding held by the taxpayer could not be determined.

The conclusion of the Court was particularly brief and did not address various arguments raised by the taxpayer.

Analysis and implications

The conclusion of the Court is surprising and highly debatable on various points. Here is a brief description of some of them.

The interpretation of the notion of "acquisition price" in the context of the participation exemption by the Court, which would be limited to the amount formally paid to receive shares, seems contrary to the aim of the law and the intention of the Luxembourg lawmaker, as expressed in the parliamentary works, on many aspects. For instance, the comments made in relations to Article 25 LITL which defines the acquisition price for the purpose of the Luxembourg income tax law mentions clearly that *"the purchase price of a participation also includes the incidental costs of acquisition. In the following, the initial acquisition price may be increased or decreased. An increase e.g. when the partner in that capacity grants a bonus (a cash payment or other benefit) to the company in order to contribute to the coverage of an expense or operating loss of the company or (...)"*. Such bonus payments (named « bonification » in French) are in this case not made "for the acquisition of the shares" and have no impact on the numbers of shares held or their nominal values. On the contrary, the purpose of equity contributions made to the 115 Account by shareholders can precisely be "the coverage of an expense or operating loss of the company".

The decision is also disputable to the extent it establishes a necessary link between the acquisition price of shares in a company and the sole share capital of that company (i.e., the effective acquisition of shares or new shares) with the consequence that the acquisition price is reduced to contributions to the "share capital" *stricto sensus* and to the amounts paid at the time of the acquisition of the shares for the sole purpose of such acquisition. Neither the legal provisions on the participation exemption, nor the parliamentary works requires such a tight link. The acquisition price refers only to the "participation" which is in turn defined in relation to the share capital. Article 166 LITL is clear in this respect: the reference to the share capital is used to define what is a qualifying participation and not to outline and restrict the 1.2m acquisition price threshold.

In addition, the approach of the Court seems to be in contradiction with the substance over form approach followed by the Tribunal and the Court in the recent past to qualify some financial instruments (like IFL or PPL) as additional participation into the share capital for purpose of the participation exemption regime.

However, even if the position of the tax authorities, now strengthened by the decision of the Court, can still be challenged on reasonable grounds, here are the key takeaways when relying on contributions to the 115 Account to calculate the acquisition price of a shareholding, based on this case law.

	Mentioned in the share purchase agreement as a part of the acquisition price	Not mentioned in the share purchase agreement and paid on the same day as the acquisition of the shares	Not mentioned in the share purchase agreement and paid after the acquisition of the shares
Contribution to account 115	✓	✗	✗

In this respect, the facts and the legal documentation supporting the acquisition of the shares is decisive and this link must be systematic to protect eligibility for the participation exemption regime.

This decision of the Court could impact the application of the participation exemption regime but also the application of other provisions of the Luxembourg tax law (article 97 LITL, §60 StAnpG, etc.) and could question the substance over form approach, which is very sensitive in tax law today. Consequently, Luxembourg structures using the 115 Account should be assessed in case-by-case analysis based on the lessons of this case law. Potentially, some actions may need to be taken to mitigate the pros and the cons of using the 115 Account to fund a Luxembourg company.

It remains now to be seen how this case law will be followed by taxpayers and what will be its practical application by the tax authorities. However, in this respect, we have no doubt that this case law is the not the final chapter of the 115 Account saga. To paraphrase W. Churchill, with this decision of the Court: "Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning".

Do you have further questions?

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