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CONTRIBUTION AT A REDUCED VALUE: A TAXABLE GIFT FOR THE BENEFICIARY COMPANY

Private Clients Tax Law Private Equity | 22/05/18 | Xavier Rohmer Clara Ferrari

The Council of State, in a decision handed down in plenary session (Council of State, May 9, 2018, no. 387071, *Cérès* case), ruled that, in reality, the contribution of shares to a company at a reduced value dissimulated a gift that was taxable for the company receiving the contribution in an amount of the difference between the value at which the shares received were booked in assets and their actual value.

In this case, a taxpayer had given to his son some shares in company X, which he managed.The son had immediately contributed these shares, at the same unitary value, to company C, formed with his brothers and sisters.Subsequently, this taxpayer had also contributed the bare ownership of some shares to company C.

The tax authorities considered that the value at which company X's shares were booked in assets had been reduced, and they notified company C of an adjustment of its taxable profits corresponding to the difference between the contribution value and the actual value of the contributed shares.

Firstly, the Council of State pointed out that Article 38.2 of the French Tax Code provided that the net profit is based on the difference between the value of net assets at the closure and beginning of a fiscal year less the additional contributions made by the shareholders.

Hence, as a principle, the additional contributions made by shareholders are not taken into account in determining a company's net profits for a fiscal year.

However, the Council of State also refers to Article 38 *quinquies* of Annex III to the French Tax Code, which provides that fixed assets acquired for free are booked in the balance sheet at their market value.Yet, according to the Council of State, the contribution of an asset at a reduced price takes place in part for free; the company receiving the contribution, therefore, must book the market value of the contributed asset in its assets.

Through a combined reading of Articles 38.2 and 38 *quinquies* of Annex III to the French Tax Code, the Council of State concluded that:"*when the contribution value of the fixed assets, accounted for by the company receiving the contribution, has been voluntarily reduced by the parties to dissimulate a gift made by the contributor to the beneficiary company* […] *the tax authorities are substantiated in correcting the original value of the fixed assets contributed to the company in order to substitute their market value for the original value, thereby increasing the company's net assets in the amount of the contribution made for free.*"

Secondly, the Council of State ruled on the existence of a gift and found that, when a company receives a contribution at a deliberately reduced value, and this does not include any financial consideration for the undervaluation, the benefit granted must be seen as a gift given to the company receiving the contribution.

In this respect, the Council of State points out that, "*the burden of proof of such a gift must be seen as having been met by the tax authorities when the existence has been established, firstly, of a significant discrepancy between the agreed price and the market value of the contributed asset and, secondly, of an intent, for the contributor to make and for the beneficiary company to receive, a gift due to the conditions of the contribution.There is a presumption of this intent when the parties have a relationship based on 'interests'.*"

In this case, the burden of proof of such a gift was considered to have been meet due to a significant discrepancy (nearly 50%) between the shares' contribution value and their market value and given the presumption of an intent to make a gift (a court-made rule) when the parties have a relationship based on "interests" (the relevant companies' shareholders are in the same family).

Based on the principles stated above, the Council of State transposed the case law laid down for sales of fixed assets at a reduced price (Council of State, Jan. 5, 2005, no 254556, *Minister vs. Société Raffypack*) to contributions to companies.

We will need to make sure that the tax authorities, in exchange for this adjustment, will allow the company receiving the contribution to book the asset in its balance sheet assets at its market value to avoid penalizing it subsequently at the time of allowances for amortization, provisions or the subsequent sale of the given asset.Indeed, if there is no corresponding correction in the balance sheet of the company receiving the contribution, this would result in a double taxation (firstly, as a gift and, secondly, by calculating the amortization, provisions or capital gains on a sale based on the reduced contribution value).