

Non-binding translation

Administrative Court of Versailles 8 October 2002 n° 96-3131 and 97-1755, 5th Chamber; Silicon Graphics

As regards domestic law:

Whereas the terms of Article 212 of the French Tax Code state that “The interest pertaining to sums which the shareholders leave or put at the disposal of the company shall be allowed as deductible expenses under the conditions set down in Article 39, 1-3°. However : 1° The deduction shall only be allowed, as regards shareholders or partners who, in law or in fact, are responsible for the management of the company or who hold more than 50 % of the financial or voting rights attached to the shares issued by the company, if this sum does not exceed, for all such partners or shareholders, one and a half times the amount of the share capital. This limit shall not apply:b. to interest on loans granted by one company to another where the first stands, vis-à-vis the second, as its parent company in the meaning of Article 145”; whereas under the terms Article 145 of the same Code : “The tax regime for parent companies as defined under Articles 146 and 216 shall apply to companies and other bodies subject to corporate income tax at the standard rate...”;

Whereas Silicon Graphics, whose registered office is located at Jouy-en-Josas and whose share capital is held as to 99.5 % by the US corporation Silicon Graphics World Trade Corporation, deducted from its taxable income for years 1991 and 1992, all interest paid to its parent company as remuneration for the loans accorded to it by the latter during the same years; whereas the French Revenue added back to the results of the claimant the fraction of the interest deemed excessive and subjected this sum to withholding tax by virtue of the combined provisions of Articles 109, 1, 110 and 119 bis, 2 of the French Tax Code;

Whereas Silicon Graphics World Trade Corporation is not liable for corporate income tax at the standard rate; whereas it cannot therefore be regarded as having the capacity of a parent company vis-à-vis the claimant in the meaning of the aforementioned provisions of Article 145 of the French Tax Code;

Whereas Silicon Graphics cannot usefully rely on the Administrative Documentation 5 B-622, which does not bear any relation to the tax rules applied;

Whereas the French Revenue was therefore justified, in view of the provisions of the French Tax Code, in adding back to the taxable income of Silicon Graphics the fraction of the interest which the latter paid to its parent company Silicon Graphics World Corporation, for the portion exceeding one and half times its share capital, by virtue of the aforementioned provisions of Article 212, 1° of the General Tax Code;

As regards the France-USA tax treaty:

Whereas under the terms of paragraph 3 of Article 24 of the tax treaty applicable at that time to income and wealth tax, signed between France and the United States of America on 28 July 1967, which supersedes the Convention of Establishment signed on 25 November 1959: “A company from one contracting State, whose capital is held, either directly or indirectly, in whole or in part, by one or more residents of the other contracting State, shall, in the first contracting State, be subject to no taxation or obligation relevant thereto, which is other or greater than that to which a company of the first contracting State, with the same activities

and whose capital belongs entirely to one or several residents of this first contracting State, shall or might be subject”;

Whereas Silicon Graphics argues that the terms of paragraph 3 of Article 24 of the tax treaty prohibit the application made to the company of Article 145 of the French Tax Code;

Whereas Article 145 of the French Tax Code relies, for application of the tax rules to parent companies, on whether or not corporate tax is applied to a company at the standard rate; whereas it has constantly been upheld that unless it has a permanent establishment in France, a foreign corporation will not be taxed in France at the standard rate of corporate income tax; whereas, therefore, the criterion used by this rule to define its scope of application relies on the status of resident of the company holding the shares of the French company; whereas as a result, Silicon Graphics, subsidiary of a US corporation which cannot be taxed at the standard rate of corporate income tax, unlike a French corporation performing the same activities, has been subjected to a tax treatment which differs from that applied to a French company, subsidiary of a French parent company, which would be taxed at the standard rate of corporate tax;

Whereas, according to the above, Silicon Graphics is justified in relying on the aforementioned terms of the France-US tax treaty in order to contest the application made in its respect of French domestic law; whereas this company is therefore entitled to claim the deduction as expenses of all interest paid, during the period in question, to Silicon Graphics World Trade Corporation, in remuneration for the loans granted to it by the latter; whereas it should thus be relieved from the withholding tax to which it has been subjected in respect of 1991 and 1992 following the adding back to its income of the portion of the interest deemed excessive, together with the minimum contribution applied in this connection for the same year.

Decision: Discharge.

Non-binding translation

Administrative Court of Toulouse, 28 January 2003, n° 98-655, 1st Chamber, SARL Aerovac Systèmes France

Whereas the French limited liability company (SARL) Aerovac Systèmes France, an enterprise specialising in the manufacture and sale of composites, was subject, in 1996, to a tax audit, which for matters of corporate income tax covered the financial years closed in 1993, 1994 and 1995, following which the French Revenue notified the company of a number of reassessments in accordance with the contradictory procedure; whereas the claim referred to the court is concerned only with the reassessment resulting from the limitation of the deductibility of interest paid to the UK company Aerovac System (Keighley) Ltd, of which it is a 76 % subsidiary and which is also its main supplier, in remuneration for the loans and facilities granted by the latter;

Whereas according to the terms of section I of Article 39 of the French Tax Code: "Income shall be determined after deduction of all expenses, including ...notably...: 3. Interest paid to shareholders in respect of sums which the latter leave or make available to the company, in addition to their share in the legal capital, whatever the form of the company, within the limit of the interest calculated at a rate equal to the average annual gross yield on issues of bonds by private companies..."; whereas the terms of Article 212 of the same Code states: "Interest on sums left or made available to the company by its shareholders shall be admitted as deductible expenses subject to the conditions set down under 3° of section I of Article 39. However: 1° Deduction shall only be allowed, as regards partners or shareholders who in law or in fact have responsibility for the management of the enterprise or who hold more than 50 % of the financial or voting rights attached to the shares issued by the company, provided that these sums do not exceed, for the full number of partners or shareholders, one and a half times the amount of the share capital. This limit shall not apply...: b. to interest on loans granted by a company to another company when the former has the capacity of parent company of the latter, in the meaning of Articles 145..."; whereas under the terms of said article: "The tax rules for parent companies, as defined under Articles 146 and 216, shall apply to companies and other bodies subject to corporate income tax at the standard rate..."; whereas finally, Article 25-4 of the amended treaty between France and the United Kingdom signed on 22 May 1968 states with regard to income tax that: "Companies of one contracting State whose capital is, in whole or part, directly or indirectly, held or controlled by one or more residents of the other contracting State, shall not be subject in the first State to any taxation or obligation relating thereto which is different to or greater than that to which other companies of the same kind from the first State are or might be subject";

Whereas the French Revenue, basing its arguments on Aerovac Systems Keighley's inability to rely on the parent-subsidiary rules, since it is not a corporate taxpayer in France, only allowed the deduction of interest paid to the latter by the claimant as remuneration for the loans granted to same within the limit of one and a half times its share capital and added back the excess to the taxable results for the financial years in question; whereas the claimant argues, more particularly, in support of the aforementioned conclusions that the position adopted by the French Revenue, reserving the exception to the limitation on the deduction of interest paid to majority shareholders or those who in law or in fact take responsibility for the management of the company, to the subsidiaries of parent companies which pay corporate income tax, is incompatible with the non-discrimination clause contained in the amended treaty of 22 May 1968 between France and the United Kingdom; whereas it is clear from the terms of the aforementioned Article 25-4 that this exception should benefit, under the same conditions, the subsidiaries of a UK parent company; consequently, and with no need to go into the others means of defence, the demand of Aerovac Systèmes France should be satisfied and, consequently, the taxable income for each of the financial years under review should be reduced, subject,

nonetheless, to the offsetting to which the French Revenue rightly draws attention in its conclusions between the tax allowance resulting from the above and the sum of 7,272 F corresponding to the excess remuneration for the loan of 1,990,000 F granted by its parent company for a period of five years at a rate of 8.5 %, whereas the annual average gross yield on bond issues by private companies was 8 % in 1995.

Decision: Reduction