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**CONSEIL D'ETAT**

Ruling in contentious proceedings

Based on the report of the 8th sub-section of the litigation department

Mr. Berezyiat  
*Rapporteur*

Mr. Bachelier  
*Commissaire du gouvernement*

Hearing of 12 December 2003  
Reading of 30 December 2003

Having regard to the motion registered on 18 May 2001 with the registry of the litigation department of the Conseil d'Etat, lodged on behalf of SA ANDRITZ, whose registered office is located at 12, avenue Claude-Guillermin in Orléans (45071 Cedex 2), represented by its Chairman in office and representing the rights of Andritz Sprout Bauer, SA ANDRITZ requests that the Conseil d'Etat:

1. set aside the decision of 13 March 2001 whereby the Nantes administrative court of appeal, acceding to the grounds of appeal of the Ministry of Finance, set aside the judgment of 6 May 1997 of the Orléans administrative court releasing Andritz Sprout Bauer from payment of the corporate income tax and corresponding penalties charged to it in respect of financial years ended from 1991 to 1993, and confirmed the contested taxation;
2. grant a stay of execution of the contested decision;
3. ruling on the merits of the case, release the company from the taxation in question.

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Having regard to the other exhibits;

Having regard to the France-Austria Convention of 8 October 1959 with respect to taxes on income and fortune and succession duties, amended by the Protocol of 30 December 1970, the laws numbered 61-714 and 71-1039 of 7 July 1961 and 24 December 1971 authorising the ratification thereof as well as the decrees numbered 61-1109 and 72-572 of 4 October 1961 and 30 June 1972 ensuring the publication thereof;

Having regard to the French tax code and the French tax procedures manual;

Having regard to the French code of administrative justice;

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Having heard during the public hearing:

- the report of Mr. Bereyziat, *Rapporteur*,
- the comments of SCP Lesourd, the lawyers of SA ANDRITZ,
- the findings of Mr. Bachelier, *Commissaire du gouvernement*;

The exhibits submitted to the courts below reveal that Andritz Sprout Bauer:

- was subject to a corporate income tax audit covering financial years ended in 1991 and 1992 and an audit based on its tax records for financial year 1993;
- that additional corporate income tax assessments and late payment interest were charged to the company in respect of each financial year covered by the audit, due to the add-back to its taxable profits, in application of article 212-1° of the French tax code, of a portion of the interest it paid to the Austrian company Maschinen Fabrik Andritz AG, by which it was held at 99 %, on the current account advances granted to it by the latter;
- when its claim against the additional assessments was rejected, Andritz Sprout Bauer referred the case to the Orléans administrative court, requesting it to order release from payment of the additional tax assessed, which was granted by a judgment of 6 May 1997 on the grounds that § 3 of article 26 of the France-Austria Convention of 8 October 1959, amended by the Protocol of 30 October 1970, precluded the application of said French tax law;
- SA ANDRITZ, representing the rights of Andritz Sprout Bauer, is appealing against the decision of 13 March 2001 delivered by the Nantes administrative court of appeal which, further to an appeal by the Finance Ministry, set aside the judgment of the Orléans administrative court of appeal and confirmed the contested additional assessments.

Without having to consider the other ground of the motion:

Whereas:

- According to article 212-1° of the French tax code, the interest relating to amounts left or put at the disposal of a company by its shareholders, who constitute the legal or de facto managers of said company or hold over 50% of the financial rights or voting rights attached to the shares issued by said company, only constitutes a deductible charge if said amounts do not exceed, for all the shareholders, one and a half times the share capital of the borrowing company.
- However, by virtue of article 212-1° b), the former interest relating to loans granted by a company to a third company of which it constitutes the parent company, within the meaning of article 145 of said code, constitutes a deductible charge without any limitation to the amount.
- By virtue of the same article participation exemption rules apply, under certain conditions, to all companies and organisations subject to corporate income tax at the standard rate. On this ground, which is not contested, the court decided that the tax authorities were entitled, under French law, to add back to the taxable profits of Andritz Sprout Bauer the interest paid

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by the latter to the Austrian company Maschinen Fabrik Andritz AG relating to the portion of current account advances granted by said Austrian company that exceeded one and a half times the share capital of Andritz Sprout Bauer, on the grounds that the beneficiary of the interest did not constitute the parent company of the taxpayer, within the meaning of Article 145 of the French tax code, in that it was not subject to corporate income tax at the normal rate in France, and therefore did not qualify for the preferential tax rules provided by article 212-1° b) of said code

- However, according to article 26 § 3 of the France-Austria Convention of 8 October 1959, amended by the Protocol of 30 October 1970 which was in force at the time:

*“Enterprises of one of the two States, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more persons domiciled in the other State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of that first-mentioned State are or may be subjected.”*

and according to article 6 § 5 of said Convention:

*“Where an enterprise established in one of the two States, by virtue of its participation in the management or capital of an enterprise established in the other State, grants to or imposes upon the latter, in their commercial or financial relations, conditions differing from those which it would make with a third enterprise, all profits which would normally have appeared in the balance-sheet of one of the enterprises but which have in this manner been transferred to the other enterprise may, without prejudice to the legal remedies available and to the mutual agreement procedure laid down in article 25, be added to the taxable profits of the first enterprise.”*

Finally article 17-A-IV of the Convention provides that:

*“Where, owing to a special relationship between the payer and the recipient or between both of them and some other person, the amount of the interest paid, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the recipient in the absence of such relationship, the provisions of this article [providing for the taxation of interest paid in the State of residence of the creditor] shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each State, due regard being had to the other provisions of this Convention.”*

First, contrary to the arguments of the Ministry of Finance, there are no grounds for referring to the commentary of the OECD tax committee on article 9 § 1 of the model convention drafted by said organisation in order to interpret the provisions of the aforementioned articles 6 § 5 and 17-A-IV, due to the fact that said commentary was published after the adoption of the provisions in question.

These provisions, which only refer to commercial or financial “conditions” granted to or imposed upon one company by another and imply the necessity of comparing the transactions entered into between companies of the same group and those which would be made with a third party, whilst they can notably be interpreted as authorising the States party to the France-Austria Convention to assess whether the interest on a loan granted by a first

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company, residing in one of these States and belonging to a group of companies, to a second company of the same group established in the other State is arm's length, by comparing said interest to that which would have been agreed upon by two independent companies, shall neither by their purpose nor effect allow said States to assess the normality of a decision by a company to finance the activity of another company which it holds or controls by way of a loan rather than a contribution from capital and to draw any tax consequences therefrom.

Therefore, the Ministry of Finance cannot validly argue, given the circumstances, that these provisions preclude the application of article 26 § 3 of said Convention.

Second, according to article 26 § 3 of the France-Austria Convention, for the application of article 212-1° and with reference to article 145 of the French tax code, the French subsidiary of an Austrian parent company must be considered as "similar", within the meaning of this provision, to the French subsidiary of a French parent company, not only in the case where the Austrian parent company has a permanent establishment in France which holds or controls all or a portion of the capital of the subsidiary and is liable for corporate income tax in France at the standard rate, but even in the absence of such permanent establishment, in the case where said parent company would have itself been liable to said tax in France at the standard rate, had it performed its business on the French territory.

Therefore, by deciding that SA ANDRITZ did not constitute a "similar enterprise", within the meaning of article 26 § 3 of the France-Austria Convention of 8 October 1959 as amended, to the French subsidiary of a company constituting a parent company within the meaning of article 145 of the French tax code, on the sole grounds that the plaintiff was held by an Austrian company which, in the absence of a permanent establishment in France, was not subject to corporate income tax in said State at the standard rate and without verifying whether the latter would have fulfilled the conditions laid down in the aforementioned article 145, had it performed its activity in France, the court incorrectly interpreted this provision and based its decision on a mistake of law.

In light of the above, SA ANDRITZ is well-founded in requesting that the contested decision be set aside.

Given the circumstances of the case in question, the Conseil d'Etat has good grounds for applying the provisions of article L. 821-2 of the code of administrative justice and settling the case on its merits.

First, the investigation reveals, and it is not contested, that had it performed its activity in France, given its legal form and the nature of said activity, Maschinen Fabrik Andritz AG would have been subject to corporate income tax at the standard rate in respect of each of the financial years covered by the audit.

Therefore, in application of article 145 of the French tax code, it would have constituted a parent company with regard to its French subsidiary Andritz Sprout Bauer, whose capital it held at 99%. Consequently, said subsidiary should be considered, in respect of each financial year in question, as being similar, within the meaning of the aforementioned article 26 § 3 of the France-Austria Convention of 8 October 1959 as amended, to the French subsidiary of a company constituting a parent company within the meaning of article 145 of the French tax code.

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As a result, the provisions of the Convention preclude Andritz Sprout Bauer from being subject to taxation on the interest it paid to Maschinen Fabrik Andritz AG on the current account advances that is other or more burdensome than that provided for in article 212 b) of the French tax code, for cases in which a French company pays interest to its parent company on amounts left or put at its disposal by the latter.

Second, the most recent documents issued by the Ministry of Finance maintain that the disputed taxation may be legally based on the provisions of the first paragraph of article 57 of the French tax code, which provides that: *“to calculate the corporate income tax due by companies that are subordinate to or control companies located outside France, the profits indirectly transferred to the latter, either by increasing or reducing purchase or sales prices or by any other means, are added back to the results recorded in their accounts. The same conditions apply to companies that are subordinate to a company or group which also controls companies located outside France”*.

Based on this provision, the Ministry of Finance insists that the purpose of the advances granted by the Austrian parent company to its French subsidiary was to make up for the under-funding by said parent in the capital of its subsidiary and to allow the latter to deduct from its taxable results the interest on the additional funds thus put at its disposal in the form of advances, in preference to non-deductible dividends remunerating the shareholders' contributions. The Ministry of Finance claims that this constitutes a transfer of profits to the parent company within the meaning of article 57 of the French tax code.

However, the purpose or effect of the provisions of article 57 of the French tax code cited above, like those of article 6 § 5 of the France-Austria Convention, is not to authorise the tax authorities to assess the normality of the choice made by a foreign company to finance the activity of a French company that it holds or controls by means of a loan rather than a contribution from capital and to draw any tax consequences from said situation.

As a result, the grounds for appeal put forward by the Ministry of Finance for the substitution of a new legal tax base for the tax base initially taken into account by the tax authorities, may not under any circumstances be allowed.

In consequence whereof, the appeal of the Ministry of Finance against the judgment of the Orléans administrative court of 6 May 1997, granting that SA ANDRITZ, representing the rights of Andritz Sprout Bauer, be released from the additional corporate income tax and late payment interest charged to the latter due to the add-back to its taxable profits of the interest relating to the portion of current account advances granted to it by Maschinen Fabrik Andritz A.G. exceeding one and a half times its share capital, is not well-founded.

### Application of the provisions of article L. 761-1 of the French code of administrative justice

Given the circumstances of the case, there is reason to apply said provisions and sentence the State to pay SA ANDRITZ an amount of 4 500 Euros to cover the expenses incurred by the latter both before the Nantes administrative court of appeal and the Conseil d'Etat and not included in the legal costs.

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**THE COURT DECIDES THAT:**

Article 1: the decision of the Nantes administrative court of appeal of 13 March 2001 is set aside.

Article 2: The appeal lodged by the Ministry of Finance before the Nantes administrative court of appeal is rejected.

Article 3: The State shall pay SA ANDRITZ an amount of 4 500 Euros in application of article L. 761-1 of the French code of administrative justice.

Article 4: This decision shall be served to SA ANDRITZ and the Ministry of Finance.