EUROJURIS
INTERNATIONAL BUSINESS GROUP

BUDAPEST Meeting
17-18 April 2015

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Our topic for today's meeting:

Did you know that, in France, a loan granted by a foreign bank to the foreign holding and its French subsidiary cannot be approved by the latter if it exceeds its financial capacity, this being considered as an irregular management act?

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- A Hungarian holding company takes out a €50 million bank loan in the whole group's name and asks its French subsidiaries to act as co-borrowers.

- The French subsidiary has to commit under the repayment guarantee provided for in the loan contract, from which it will indirectly and partly benefit.

- But the subsidiary has a €1 million share capital, a €3 million equity and a €10 million turnover.

- Therefore, a full repayment guarantee commitment under the loan would exceed the subsidiary's financial capacities and, as such, would be considered an irregular management act.

- A solution would be for the subsidiary to limit its commitment to its actual repayment capacities.

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- To be valid, the decision to grant a guarantee commitment must meet a number of conditions, namely:

  1. be made by the French subsidiary's Board of Directors
  (art. L.225-35 of the French Commerce Code) in the SA;

  2. be signed by a duly authorized delegatee (the validity of the delegation of authority and signature by an authorized delegator needs checking);

  3. the subsidiary's corporate officer cannot attend the Board meeting when the decision is taken.

- The following cases cannot be considered irregular management acts:

1. any overdraft on current account which does not result in an unreasonable commitment for the subsidiary based on the latter's planned development

2. for a mother company to fulfill guarantee commitments taken by one of its subsidiaries in place of the subsidiary's shareholders, insofar as:

a) such guarantee is requested by the bank

b) the mother company has agreed to provide a guarantee for the guarantor

c) the loan is in the interest of the mother company since it is to support its subsidiary's normal operation;

3. for a mother company to receive no interest on the overdraft granted to its subsidiary if, in the latter's country, granting such overdrafts does not necessarily give rise to payment of any interest.

CASE LAW

(*Conseil d'Etat*,* 3rd. and 8th. subsection, 11 June 2014, Nr 363168; company: FRALSEN HOLDING)

- From 1997 to 2000, FRALSEN HOLDING granted FF6.5M to its subsidiary TIMEX FRANCE, which later on was unable to reimburse the overdraft in full.

- FRALSEN HOLDING recognized a FF3.5M loss and deducted it from its taxable result – which Corporate Tax authorities considered was irregular.

* French Supreme administrative court

- The Tax Litigation Judge rendered a decision in favor of the holding company based on the following criteria:
  - The TIMEX FRANCE subsidiary marketed TIMEX timepieces in France and in Europe;
  - Its turnover nearly doubled from 1997 to 2000;
  - After a recapitalization in 1997, the subsidiary showed a positive net cash position of FF7.25M.

To conclude:

- The Judge considered that the overdrafts on current account did not entail unreasonable risks for the holding company.

- In this kind of context, in order to assess whether an overdraft on current account is an irregular management act or not, legal practitioners have to determine whether, in doing so, the holding company took "unreasonable risks".

- *What are, under French tax law, the consequences of such irregular management acts for companies subject to corporate tax?*

  - <u>For the holding company</u>:

    Non-payment of debt cannot be deducted from taxable result => increased corporate tax base.

  - <u>For the subsidiary</u>:

    The overdraft has to be accounted for in the subsidiary's tax base as earnings from investment capital.

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