

The “blow of accordion”: effects on corporate taxation

The “blow of accordion” is becoming more and more popular amongst French companies because it allows a parent company to financially support its subsidiaries. In practice, the “blow of accordion” consists in a reduction of the share capital to zero and a subsequent increase (or inversely).

Pursuant to a decision of January 22nd, 2010 (CE, 8th and 3rd ss sect., n°311339), the *Conseil d’Etat* has specified the tax consequences for a parent company of a multiple and subsequent “blows of accordion” whereby the parent company maintained unchanged its level of participation in the capital but with different subscription amounts.

After the three subsequent “blows of accordion”, the parent company sold the whole of its participation in its subsidiary.

The question raised by the *Conseil d’Etat* is then what would be the applicable tax regime on the capital gain (or loss) generated by the parent company ?

In this context, the *Conseil d’Etat* has specified the application of articles 38 quinquies of the appendix III of the French General Tax Code (CGI) and the article 39 duodecies of the CGI applicable to capital gain (or loss) taking into account an economic approach of the whole transactions pertaining to distress companies.

Capital gain (or loss) is equal to the difference between the sale price of the participation and the purchase price. The acquisition cost, pursuant to article 38 quinquies of the appendix III of the CGI, shall mean the initial cost of acquisition, increased by the amount of the potential subsequent capital increases

(which have been effected further to a reduction of capital to zero).

Pursuant to article 39 duodecies of the CGI, this capital gain (or loss) shall then be ventilated according to the respective duration of detention of the shares.

If the duration of detention exceeds 2 years, the capital gain (or loss) will be deemed as long term and if it is below 2 years, it will be deemed as short term capital gain.

In our case, the parent company has constantly kept its participation at the same level notwithstanding the three subsequent “blows of accordion”. Therefore, for the purposes of calculating the capital gain (or loss) regime, the *Conseil d’Etat* will consider that the capital gain will be deemed long and short term gains (or loss) depending on the respective duration of detention of the shares prior to their sale and will be calculated prorata the total subscription costs.

Long term capital gain are taxable at the applicable corporate tax (33,33 %) rate only on 5 % of the amount, the rest of the capital gain will be taxable at a rate of 18 %. Short-term capital gain will be taxable totally at the applicable corporate tax (33,33 %).

To conclude, it is worth mentioning that the position of the *Conseil d’Etat* is applicable provided that the level of participation of the parent company in its subsidiary remains unchanged notwithstanding the various “blow of accordion”.

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