Administrative court of appeal decision on the economic appreciation concept

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On 20 February 2024, the Luxembourg administrative court of appeal ("the Administrative Court" or "Court") *(Cour administrative, 20 février 2024, n°49388C)* rendered a decision in which it took position on a taxpayer's alleged economic ownership of some trademarks.

This decision concerns the appeal of joint cases issued during 2023[1] which we have already had the opportunity to analyze as part of our tax controversy series[2]. While this appeal decision largely aligns with the position of the Luxembourg administrative tribunal (the "**Administrative Tribunal**" or "**Tribunal**") – ultimately confirming the Luxembourg tax authorities' stance to deny the applicability of the IP exemption – it nonetheless dispels some uncertainties raised by the initial decision, which we will highlight in this article.

Case summary

The complainants are two Luxembourg companies ("**Company 1**" or the "**Licensee**", and "**Company 2**") which have been members of the same fiscal unity in accordance with article 164bis of the Luxembourg income tax law ("**LITL**") since 27 April 2015 – Company 2 being the integrating parent company of Company 1. In December 2015, Company 1 entered into an agreement with an affiliated US company (the "**Licensor**") and was granted the right to use some trademarks. As per the agreement, the Licensee was also allowed to sub-license the trademarks to affiliated companies, also resident in the European Union.

In the case under review, in June 2018, the tax office challenged Company 1's tax return for the fiscal year 2016 and denied its eligibility to the 80% intellectual property exemption embedded in the old article 50bis LITL on the trademarks agreement.

The case escalated and, following two unsuccessful administrative claims with the Director of the Luxembourg direct tax authorities ("**ACD**"), each complainant lodged an appeal with the Administrative Tribunal[3]. The administrative judge of first instance however ruled in favor of the Director and considered that, given that Company 1 could not be regarded as the economic owner of the trademarks, Company 1 could not benefit from the exemption pertaining to it. This ultimately led the claimants to lodge an appeal with the Administrative Court on 5 September 2023.

Context of the Decision

The overall alignment of the Administrative Court to the Tribunal's stance was reasonably expected given the detailed and convincing arguments the latter developed to uphold its position. That said, we were still waiting for the final decision to be issued as the Tribunal took quite a restrictive approach regarding the use of § 11 Steuranpassungsgesetz ("**StAnpG**") and the principle of economic appreciation (*principe de l'appréciation économique des opérations*) which the taxpayer attempted to rely on. Notably, one argument to reject the claim that Company 1 should be regarded as the economic owner of the trademarks was to consider that they should not be allowed to invoke the principle of economic appreciation of the transactions to contradict their own unequivocal documents. In that regard, the Tribunal stated: *"The principle, derived from paragraph 11 StAnpG, **aims solely to enable**, in tax matters, **the tax authorities and the administrative judge** to seek and analyze, beyond the legal appearance, the economic reality covered by the legal forms chosen by the parties to carry out a specific transaction, with a view to verifying whether the latter corresponds to the real intention of the parties."*[4]

In our initial article analyzing the Tribunal's decision, we wondered whether the above wording should be interpreted as suggesting that **the principle of economic appreciation of the transactions may from now on only be used by the ACD against a position taken by a taxpayer.** To our knowledge, this was the first time an administrative jurisdiction had expressed such a one-sided view regarding the application of §11 StAnpG and the principle of economic appreciation.

To support their position, the administrative judges of first instance mentioned another decision they rendered in 2016[5]. In this case, the above principle was referred to as follows: *"In tax matters the court cannot stop at the legal forms chosen by the parties to carry out a given transaction, but is called upon, beyond the legal appearance, to investigate and analyze the economic reality covered by the said legal forms. In fact, it is a principle of tax law that facts and legal acts must be interpreted and assessed according to economic criteria. For the rest, the legal qualifications put forward by the parties are only accepted by the tax judge insofar as they correspond to the real intention of the parties."*[6]

However, we were of the view that the above wording from the 2016 decision should not formally prevent a taxpayer from invoking the predominance of the economic reality of a transaction over its legal appearance (albeit not an easy task in practice as in most cases the taxpayer would still be assumed to have consented to the legal forms it opted for).

That being said, in the case under review, the Administrative Court does not adopt the same wording as the Tribunal with regard to the applicability of the principle of economic appreciation, even though it also concludes that the taxpayer could not benefit from the exemption of article 50bis LITL.

Decision of the Administrative Court

For the most part, the Administrative Court followed the Administrative Tribunal's reasoning. In short, to determine whether Company 1 might be eligible to the IP exemption, the Court principally reviewed the ownership of the trademarks in question.

As a preliminary remark, the Court emphasized that, in principle, the IP exemption should be solely granted to the legal owner of the IP rights and as such categorically rejected the claimant's argument according to which a mere beneficiary of a license agreement could also claim the benefit of the IP exemption. However, in cases where, based on the facts and circumstances, another person acts in a manner that effectively deprives the legal owner of its actual ability to use or dispose of the asset, that other person should be considered the economic owner.

As in this case the Licensor had retained the legal ownership of the trademarks (an aspect that was not challenged by the appellant), the Court proceeded to analyze whether Company 1 could nonetheless be regarded as the economic owner of them.

In this respect, aligned with the Tribunal, the Court recalled the so-called principle of economic appreciation of transactions according to which it should not be bound by the qualifications chosen by the parties to carry out a given transaction. Instead, it should go beyond legal forms and analyze the economic reality and the circumstances surrounding this transaction.

The Administrative Court emphasized, however, that to be applicable, such a principle requires the existence of uncertainties regarding the identity of the presumed owner. In other words, a taxpayer cannot invoke, based on this principle, an alleged economic reality, which is contradicted by the legal forms resulting from its own clear and unambiguous documents, and unsupported by any other evidence.

- In the case under review, the Court observed that the license agreement (which should in principle reflect the intention of the parties) expressly provides that the Licensor should remain the owner of the rights. Although it acknowledged that certain clauses may indeed look ambiguous, such as the relatively long duration of the contract (25-year term) or the renewal clause without additional payment, it ultimately ruled that those elements alone should not be considered sufficient to justify a requalification of the license and sub-license agreement as a transfer of the economic ownership.
- Moreover, as previously pointed out by the Administrative Tribunal, the agreements do not grant the Licensee an unconditional right to use or dispose of the trademarks such that the Licensor would lose control over them. Instead, prior approval of the Licensor is expressly required. In that regard, the Court ruled that it should not be presumed from the fact that some sublicense agreements were concluded without the Licensor's prior approval that the latter in fact intended to transfer ownership of the trademarks.
- Finally, the Court noted that the appellants were unable to provide additional evidence to demonstrate the alleged gap between the legal appearance of the license transactions and the economic reality. For this purpose, the Court clarified that it would have expected the appellants to explain the specific operation they intended to carry out and why the legal qualification ultimately applied did not in the end reflect their true intent[7] – witch they failed to do. Consequently, the Administrative Court rejected the appeal lodged by the taxpayers.

With regard to the applicability of the principle of economic appreciation of the transactions, and further to the above analysis, the Administrative Court stated: *"(…) the taxpayer cannot rely on this principle to justify an alleged economic reality based exclusively on its own allegations, but which are contradicted by the legal forms chosen and are not supported by any other element. It is in this sense that the first judges recalled that a **taxpayer cannot be allowed to use the principle of economic appreciation to contradict its own unequivocal evidence**."*[8]

This wording is from our perspective less strict than the one used by the Tribunal. Based on the above, it seems clear that a taxpayer cannot benefit from the application of the principle of economic appreciation in cases where the legal documents are unequivocal. On the other hand, it suggests that taxpayers could still use the above-mentioned principle in cases where the legal appearance given to a specific transaction is not clear from the documentation – as the Administrative Court did not explicitly rule that this possibility should be exclusively reserved to the tax authorities and judges.

To conclude, although the decision of the Administrative Court does not differ greatly from the position taken by the Administrative Tribunal, this case is important because it highlights that the principle of economic appreciation could also be a tool in favor of the taxpayer, at least in some specific situations, contrary to what had been ruled by the Administrative Tribunal in the first instance judgement, and should not be exclusively reserved to the tax authorities and judges. Notwithstanding the above, documentation supporting transactions is key as it will always be the primary source that the tax authorities review to assess the eligibility of a given tax treatment. Finally, the circumstances of the transactions, and the way the parties implement the existing provisions of the documentation, will also be key in determining the economic reality and what tax regime should be applied.

1) Tribunal administratif, 26 juillet 2023, n° 45706 et n°46555.
2) E. Lebas and V. Plateau, "Tax controversy series – Administrative court judgment on economic appreciation", AGEFI Luxembourg, October 2023 – Page 8.
3) As a result of the fiscal unity, Company 1 (the integrated company) has a nil taxable basis for corporate income tax and municipal business tax purposes. Consequently, the claim it filed was deemed inadmissible by the Director and subsequently by the Administrative Tribunal for lack of standing (*intérêt à agir*).
4) Translation of the French text by the authors: "*le principe, dégagé du paragraphe 11 StAnpG, vise uniquement à permettre, en matière fiscale, aux autorités fiscales et au juge administratif de rechercher et d'analyser, au-delà de l'apparence juridique, la réalité économique recouverte par les formes juridiques choisies par les parties pour réaliser une opération déterminée, en vue de vérifier si ces dernières correspondent à l'intention réelle des parties.*"
5) Tribunal administratif, 3 février 2016, n°35671
6) Translation of the French text by the authors: "*en matière fiscale la juridiction saisie ne saurait s'arrêter aux seules formes juridiques choisies par les parties pour réaliser une opération déterminée, mais elle est appelée, au-delà de l'apparence juridique, de rechercher et d'analyser la réalité économique recouverte par lesdites formes juridiques. En effet, il est de principe en droit fiscal que les faits et les actes juridiques doivent être interprétés et appréciés d'après des critères économiques. Pour le surplus, les qualifications juridiques avancées par les parties ne sont retenues par le juge de l'impôt que dans la mesure où elles correspondent à l'intention réelle des parties.*"
7) « *Tel que cela a été relevé à juste titre par la partie étatique, le contribuable qui entend prospérer dans sa démarche de voir requalifier une apparence qu'il a lui-même créée par les formes juridiques qu'il a choisies, et ce à travers le recours au principe d'appréciation économique, doit fournir la preuve d'une disparité entre la forme juridique et la réalité économique. En l'occurrence, il doit établir que le ou les auteur(s) de l'opération à requalifier entendaient réaliser une certaine opération d'un point de vue économique, qu'ils l'ont effectivement réalisée et que la qualification juridique retenue ne reflète finalement pas sa/leur volonté.* »
8) « *[…] le contribuable ne saurait se prévaloir, en s'appuyant sur ce principe, d'une prétendue réalité économique qui repose exclusivement sur ses propres allégations, mais qui sont contredites par les formes juridiques choisies et qui ne sont soutenues par aucun autre élément. C'est en ce sens que les premiers juges ont rappelé qu'il ne saurait être permis à un contribuable de se servir du principe de la réalité économique pour contredire ses propres pièces non équivoques.* »