

Tax controversy series

Administrative court of appeal decision on convertible bonds valuation for net wealth tax purposes

By Emilien LEBAS, Partner, International Tax, Tax controversy & dispute resolution leader & Valentine PLATEAU, Manager, International Tax, KPMG Luxembourg

On 17 July 2024, the Luxembourg administrative court of appeal (the Administrative Court) (Cour administrative, 17 juillet 2024, n°50199C) issued a decision in which it took position on whether, and under which circumstances, convertible bonds could be valued at fair market value (FMV) for the computation of unitary value based on §14 of the Valuation Law (Bewertungsgesetz – “BewG”).

Case summary

In the case under review, on 1 February 2019 the Luxembourg tax authorities challenged the unitary values, and consequently the corresponding net wealth tax charges, computed by the taxpayer in its 2016 and 2017 net wealth tax returns. In particular, the tax office considered that the participation held by the taxpayer in its subsidiary should be valued at FMV rather than book value. The former being higher than the latter, this automatically led to an increase of the unitary value of the taxpayer, and of its net wealth tax liability.

A particular feature in this case was that the appellant had issued convertible bonds (to finance its participation) which could, as per the terms and conditions (T&C) of the agreement, be either:

1. converted into shares in the taxpayer;
2. repurchased for a price corresponding to the nominal value of the convertible bonds or alternatively, upon the taxpayer's decision, to the FMV of the taxpayer's shares;
3. sold to a third party at FMV.

The appellant submitted its observations on 15 March 2019. Although it did not object to the tax office's position *per se*, it however maintained that since the shares it held were to be valued at FMV, its convertible bonds should be valued at FMV as well.

In short, the taxpayer attempted to explain that the FMV of the convertible bonds would have increased in the same proportion as the value of the shares it held in its subsidiary, and therefore it would be reasonable that the value of the bonds to be taken into account in the computation of its unitary value should correspond to the FMV of its own shares.



therefore that this approach should apply to convertible bonds as well (the latter simply having the additional feature of allowing the holder to become a shareholder of the issuing company under the terms and conditions set forth in the agreement).

As there are no specific provisions regarding the valuation method of convertible bonds, the Administrative Court, aligned with the Administrative Tribunal, referred to the general principle governing the valuation of debts, namely §14 BewG: “Capital receivables not mentioned in §13, and debts, must be valued at their nominal value, unless specific circumstances justify a higher or lower value. (...)”^{1,2}. In other words, according to this provision, the valuation at nominal value is the standard principle while valuation at FMV is the exception.

Slightly diverging from the position taken by the Administrative Tribunal which referred to *exceptional circumstances (circonstances exceptionnelles)*, the Administrative Court instead adhered to the original criterion set forth in the law, which provides that debt should be valued at nominal value unless the taxpayer is able to evidence specific circumstances (“*circonstances particulières*”, as opposed to exceptional) justifying diverging from the general valuation treatment of debt.

The administrative judge therefore undertook a factual analysis by delving into the agreement and observed that it includes several options that parties are at liberty to take or not. In the present case, the judge noted that the conversion was not the sole option as per the T&C of the agreement. For instance, the taxpayer could have elected to redeem the convertible bonds at their nominal value instead of converting them in case the FMV of the convertible bonds were higher than their nominal value.

Furthermore, no intention to convert the convertible bonds into shares had been expressed, nor had any conversion occurred as of 1 January of each relevant year (which, as recalled by the Administrative Court, should be the relevant date to assess the unitary value of a given tax year). On this basis, the administrative judge rejected the taxpayer's attempt to determine its unitary values as of 1 January 2016 and 2017 based on a hypothetical situation (the conversion of the bonds, which did not actually occur). Consequently, the Administrative Court (like the Administrative Tribunal), did not detect the existence of any spe-

cific circumstances that would justify an evaluation at FMV in deviation from §14 of the BewG.

In addition, the Administrative Court (and initially the Administrative Tribunal) rejected the appellant's argument referring to another piece of case law from the Administrative Tribunal³ and asserted that it could be transposed given that the situation at the time was fundamentally different from that in the present case, as the aim was to assess the wealth of the bond holder and not of the bond issuer. This analysis could highlight the fact that the FMV of an instrument can be different depending on whether the assessment occurs from the lender's or the borrower's point of view.

As a result, the Administrative Court confirmed the decision rendered by the Administrative Tribunal, denying the valuation of the convertible bonds at FMV.

Takeaways

Although the decision of the Administrative Court does not differ significantly from the position taken by the Administrative Tribunal, as discussed above, the case remains interesting as it deals with the highly technical topic of debt valuation and dispels some uncertainty around it.

The Administrative Court confirmed the reasoning that is to be consistently followed with respect to debt valuation for net wealth tax purposes, and clarified the criteria that may allow, on a case-by-case basis, taxpayers to diverge from the general rule requiring debts to be valued at nominal value.

In that regard, the position held by the Administrative Court provides some good news for taxpayers (although not so much for the claimant) as it decided not to go beyond the legislator's intention and reaffirmed the necessity to demonstrate **specific circumstances** justifying relying on debts' FMV, in line with the wording of the law. It thus effectively contradicted the more restrictive test (i.e., the existence of **exceptional circumstances**) retained by the Administrative Tribunal, leaving more room for the taxpayer to actually meet the requirement.

The case in question illustrates well why the exception provided by §14 BewG is attractive to taxpayers. However, taxpayers must be cautious before valuing the debts at anything other than the nominal value for net wealth tax purposes.

1) Tribunal administratif, 2 février 2024, N°46542.

2) Unofficial English translation. Original text in German: «(1) Kapitalforderungen, die nicht im § 13 bezeichnet sind, und Schulden sind mit dem Nennwert anzusetzen, wenn nicht besondere Umstände einen höheren oder geringeren Wert begründen. (...)»

3) Tribunal administratif, 15 mars 2000, N°11226.