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Belgian Court Ruling Illustrates Dangers Of Fiscal Engineering

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A 2002 tax ruling and its consequences for a Belgian company illustrate that fiscal engineering, however well planned, can turn against a company.

In a criticized judgment that made Belgium less attractive to potential investors and clients, the Ghent Court of First Instance on 14 November 2002 confirmed a tax claim of €58.1 million against Artwork Systems Group.

Artwork Systems NV is a relatively young but performing company that specializes in prepress software. Set up in 1992, it got a listing on NASDAQ Europe (then Easdaq). In 1997 the company announced that it had sold 2,000 licenses worldwide for its ArtPro software, and in 1998 Time Inc. invested in its ArtPro Repro software for editors of newspapers and magazines.

At the time of the initial public offering, it was not Artwork Systems NV, but the special-purpose vehicle Artwork Systems Group NV, that was listed on NASDAQ Europe. The shareholders sold their own shareholdings in Artwork Systems for the historical value of the company (a net value of €7.2 million), while the IPO gave Artwork Systems Group NV a market value of €167 million.

The tax authorities argued that the difference between the market value (the first share price on the stock exchange) and the net value of €116.5 million was a taxable profit for Artwork Systems Group NV.

The company appealed that decision, but in a 14 November 2002 judgment, a judge of the Court of First Instance of Ghent confirmed the tax assessment and said that when a company acquires shares of another company, it has to record them in its accounts at their market value or their actual value. (For prior coverage, see *Tax Notes Int'l*, 6 Jan. 2003, p. 21.) It stands to reason that the judge's decision was influenced by the structure set up by the shareholders. To avoid their own capital gains tax liability, they set up a complex holding structure involving Panamanian companies and Luxembourg and Belgian holding companies.

Nevertheless, the court relied on one of the primary rules of accounting law — namely, that a company's annual accounts must give a true and fair view of its assets, its financial position, and its profit or loss.[1] That means the company must record its assets at their acquisition value in its balance sheet, and if, in exceptional circumstances, that valuation does not lead to a true and fair view, it must derogate from the valuation rule and comply with the obligation to give that view,[2] the court said.

Artwork Systems appealed that decision and initiated proceedings before the *Conseil d'Etat* (Supreme Administrative Court) to have two opinions of the Belgian Commission for Accounting Standards declared null and void. In opinions 126/17 and 126/18, which were delivered separately from the court's decision, the commission reached a similar conclusion. Its opinions are not binding, but are generally accepted and are influential.

In September 2003 the first auditor of the *Conseil d'Etat* concluded that the appeal against the commission's opinions could not be upheld, because they are not binding. The full *Conseil d'Etat* has not taken a position yet, but it is expected to follow the opinion of its first auditor.

Although Artwork Systems has continued to be successful, investors have been avoiding its stock since the November 2002 judgment. Many analysts agree that the company is underperforming as a consequence of the tax claim. Even its transfer from NASDAQ Europe to Euronext Brussels has not raised the company's profile.

In late 2003 Artwork Systems Group NV announced that it had reached a settlement with tax authorities to end all pending litigation before the Ghent Court of Appeals and the *Conseil d'Etat*.

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[1] Article 2(3) of the Fourth Council Directive 78/660/EEC of 25 July 1978, based on article 54(3)(g) of the EC Treaty on the annual accounts of certain types of companies (the Fourth Company Directive).

[2] This refers to article 2(4) of the Fourth Company Directive.

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Artwork Systems Group accepted the principles laid down in the decision of the Court of First Instance and agreed on a figure for the valuation of the shares of Artwork Systems at €34,018,879. The company will pay €12,005,863 in corporate income tax. The majority shareholders have agreed to simplify their holding structure and to eliminate all offshore holding companies. However, at the company's general shareholders' meeting on 23 January, a group of small shareholders said they never would have invested in the company if they had known of the potential tax liability.

Artwork Systems has learned the hard way that a good settlement often is better than time-consuming litigation. However, leaving the decision of the Ghent Court of First Instance unchallenged creates legal insecurity for many other taxpayers.

Until a couple of years ago, when a company received an asset for free or at a discount, the principle that it could record that asset at its historical acquisition value was generally accepted. The company could show the asset at its real value on the balance sheet by subsequently recording a capital gain. Recorded but unrealized capital gains are not subject to corporate income tax as long as the revaluation reserve remains untouched.

On 18 May 2001 the Supreme Court reversed that theory and decided that a free acquisition resulted in a taxable profit for the actual value of the asset received. That is also the case law that inspired the Belgian Commission for Accounting Standards when it issued opinions 126/17 and 126/18 and prescribed that when a company has received assets for free or at a discount, it should record them at a fair value.

In the meantime, tax authorities are relying on the Artwork Systems decision, however criticized, to convince taxpayers to accept large tax bills. ✦

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