

France facilitating debt buybacks

A new tax change in France could change the debt-equity balance in the wake of difficulties caused by large LBOs

By Kevin Ley

A recent change to French tax rules may make it more attractive for companies whose debt is trading at a discount to buy it back for less than face value, although the scope of the scheme is likely to be limited.

The move comes as many private equity-owned companies are saddled with huge debts taken on during the large leveraged buyout deals of 2006 and 2007, while distressed debt investors are circling such portfolios in an effort to take control of them at a low price. Private equity firm PAI Partners for one could lose its \$361.2 million investment in French firm Monier Group, as a group of activist funds are pursuing a rival bid as part of a restructuring proposal.

Meanwhile French banks face fresh provisions for defaults from such indebted companies. “The French government is trying

to help out on as many fronts as it can, and one thing that is being faced is the increasing rate of LBO operations that are defaulting,” said Serge-Antoine Tchekhoff, managing partner of FTPA. “There are almost a quarter of the operations here in France of which the covenants are in default, so this is aiming at a rebalancing of the relationship between equity and debt.”

The new changes to French law, which emulate a similar adjustment in the US earlier this year, provides a more fa-

vourable regime for debt buybacks made between 23 April and 31 December 2010, according to SJ Berwin partners Fanny Combourieu and Maxence Bloch. The measure is intended to provide additional liquidity to French banks while encouraging French corporations to cut back their bank indebtedness.

The new provisions will permit indebted companies to buy back their medium or long-term debts from a bank at less than par, while part of the profit made by the borrower may be taxed over the next five financial years instead of being taxed immediately. But while the similar US measure defers taxation until 2013 and subsequently permits tax to be paid by installments over the next five years, under the French scheme not all of the tax may be postponed, and the company may have to pay an interest on the unpaid tax.

The application is subject to two conditions, one being that the borrower must increase its share capital during the financial year of the buyback, and the ratio of the borrower’s medium- to long-term debt and the total amount of its gross assets at the end of the financial year of the buyback must be reduced by at least 10 percent. Secondly, if at the end of one of the five financial years following the debt buyback this ratio is higher than the calculated ratio at the beginning of the financial year during which the borrower had bought back its debt, the tax payment will be accelerated.

However, the scope is also currently limited to medium- or long-term debts owed to banks, and does not apply to debt buybacks by banks themselves or where the debtor and creditor are related parties. While the measure might be widened in the future to cover all debt buybacks of medium- or long-term debt originally provided by a bank, Bloch says the limited scope of the measure makes it more “window dressing” than real reform.

“I don’t think it really serves a strong purpose, it is probably something that has been enacted to show the government is being active in respect to the big problems coming ahead for indebted companies,” he said. ■



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