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France tax alert

Finance bill 2017 and amended finance bill 2016 passed

On 20 and 22 December 2016, the French parliament adopted the amending finance bill for 2016 and the finance bill for 2017 (for prior coverage, see *World Tax Advisor* **article dated 14 October 2016**).

The government intends to continue to take steps to reduce the public deficit, while setting up a pay-as-you-earn (PAYE) system as from 2018 (one of the promises made during Hollande's presidential campaign) and refining a number of tax reduction measures benefitting both enterprises and individuals that were introduced by the government over the past few years. The finance bills also contain measures to ensure that provisions in the French tax code are in line with the French constitution and EU law. Significantly, a diverted profits tax (DPT) has been adopted to send a message to foreign companies attempting to avoid French corporate income tax.

The finance bills will enter into force once approval by France's highest constitutional court has been released.

This alert looks at the main measures in the bills that are relevant to foreign companies.

Corporate income tax rate reduction

The corporate income tax rate will be progressively reduced from the current 33.33% to 28% over the period 2017 to 2020. The existing 15% reduced tax rate will be maintained for companies whose turnover does not exceed EUR 7.63 million, but only for the first EUR 38,120 of taxable income, and in 2019 will be extended to apply to small and medium-sized enterprises (SMEs).

Provisional timetable

- **2017:** The reduced 28% rate will apply only to SMEs with turnover of less than EUR 50 million, but only on the first EUR 75,000 of taxable income.

- **2018**: The 28% rate will apply to the first EUR 500,000 of profits for all companies.
- **2019**: The 28% rate will be extended to apply to all profits of companies with annual turnover of less than EUR 1 billion (the threshold will be determined at the level of a tax-consolidated group, where applicable), and for companies with annual turnover of more than EUR 1 billion, but only for the first EUR 500,000 of profit.
- **2020**: The 28% rate will become the standard corporate income tax rate.

Extension of exceptional depreciation regime

Under the exceptional depreciation regime, companies subject to corporate income tax are entitled to an additional deduction from their taxable income, equal to 40% of the original cost (excluding financial expenses) of eligible assets that are used for the company's business. The regime originally applied to assets acquired or manufactured by the company between 15 April 2015 and 14 April 2016 and recently was extended to goods purchased or produced before 14 April 2017.

The scope of the exceptional depreciation regime now will be extended to allow goods ordered before 14 April 2017 to benefit from the regime, provided the order is accompanied by the payment of at least 10% of the total price and the actual acquisition takes place within 24 months of the order.

Enhanced tax credit for competiveness and employment (CICE)

The rate of the CICE will increase from 6% to 7% for 2017. The CICE is based on wages an entity pays to its employees over the calendar year. The wages paid are taken into account in calculating the CICE (i.e. the credit is calculated on the portion of gross payroll not exceeding 2.5 times the national minimum wage). The CICE generates a receivable against the French treasury, which may be offset against the entity's corporate income tax liability or refunded after three years.

Scope of exemption from 3% surtax on profit distributions

The exemption from the 3% surtax on profit distributions will be maintained but the scope of the exemption will be broadened to apply to distributions made by French subsidiaries to their foreign parent companies, provided a 95% ownership requirement is met, regardless of whether the foreign parent is resident within or outside the EU (for prior coverage, see the alert **dated 19 November 2016**). The new scope will apply to distributions made on or after 1 January 2017.

The current exemption from the 3% surtax applies only to distributions made within a French tax-consolidated group (which may only have French members). The exemption has been subject to criticism because it results in the different tax treatment of resident parent companies that directly or indirectly hold at least 95% of the capital of the distributing subsidiary (which qualify for the exemption) and nonresident parent companies in the same situation (which do not qualify for the exemption).

The constitutional court ruled on 30 September 2016 that the exemption from the 3% surtax violates the equality principle in the French constitution because the different tax treatment cannot be justified by the difference in situations or by reason of the public interest. Thus, to end the different treatment, the legislature decided to extend the exemption to apply to distributions made by French subsidiaries to their parent company, regardless of whether the parent company is French or foreign, resident within or outside the EU, provided a 95% ownership requirement is met. The foreign parent company must be able to meet the 95% ownership requirement (directly or indirectly) for being a member of the same tax-consolidated group as the distributing company had it been established in France.

In addition, the nonresident parent company must be subject to corporate income tax (equivalent to the French *impôt sur les sociétés*) and must be located in a country that has concluded a treaty containing an administrative assistance clause with France, excluding noncooperative states or territories (NCSTs).(An NCST is a jurisdiction that is not an EU member state and has not concluded a treaty with France (or with at least 12 other jurisdictions) that includes an administrative assistance provision regarding tax matters.)

The broadening of the scope of the exemption only eliminates the element of the surtax that the constitutional court found to be incompatible with the equality principle in the constitution. The government did not take the opportunity to fully revise the basic premise of the surtax, which may not stand up to the scrutiny of the Court of Justice of the European Union (CJEU) (particularly if the CJEU agrees with the recently released opinion of Advocate General Kokott who found that the Belgium fairness tax—which involved issues similar to those raised by the French surtax—to be partly incompatible with the EU parent-subsidiary directive); the CJEU is expected to rule on the French 3% surtax sometime in 2017 (for prior coverage, see *World Tax Advisor* **article dated 9 September 2016**).

New diverted profits tax

A new and innovative anti-abuse rule has been adopted, under which a nonresident company will be subject to corporate tax in France where it controls a French or foreign enterprise that conducts activities in France related to the sale of goods or the provision of services of the nonresident company. The related corporate tax will be assessed on the share of profits that would have been derived from activities carried out in France if not diverted from there because of an artificial arrangement. The rule also is designed to counteract the artificial avoidance of permanent establishment (PE) status. A dependent agent (within the meaning of the revamped definition in action 7 of the OECD BEPS project) acting for the foreign company and internet platforms (including peer-to-peer platforms) that sells goods or services of the nonresident company to French residents will fall within the scope of the rule.

The French tax authorities will have discretion as to whether to invoke the DPT rule during a tax inspection, although no further details about the procedure have been provided.

The new rule will apply where all of the following conditions are satisfied:

1) The nonresident company controls an entity carrying out the activities in France. This control may be by right (holding directly or indirectly more than 50% of the capital or voting rights of the company) or by fact;
2) The entity sells the goods or provides services of the foreign company in France; and
3) There are valid reasons to deem the French activities of the controlled entity (or those of another person that carries out activities in France linked to the sale of goods or the provision of services of the foreign company) as being aimed at the reduction or avoidance of tax in France.

However, there are two broad exceptions (“safe harbors”) to the anti-avoidance rule:

1) The nonresident company will not be subject to the DPT in France if it can prove that the above activities carried out in France are not designed to allow the abusive shifting of profits outside the scope of French taxation by showing the reality and economic substance of the transactions; and
2) A nonresident company established in another EU member state will not be subject to the DPT in France if the activities carried out in France by the controlled entity cannot be considered as an artificial arrangement intended to circumvent French tax law.

It is worth noting that, assuming neither of these exceptions is applicable, the definition of a permanent establishment in a relevant tax treaty (according to the current OECD model treaty) would prevent the application of the anti-abuse measure.

The effective scope of the measure should be limited because of the broad safeguard clauses, as well as the application of tax treaty provisions.

This measure, which was adopted by the parliament against the wishes of the government, will apply to financial years commencing on or after 1 January 2018, assuming the constitutional court upholds the rule. As drafted, the rule is unclear and difficult to understand, so it will be interesting to see whether the constitutional court concludes that the measure is consistent with the constitutional principle that the law be understandable.

Eligibility for participation exemption

Following a 3 February 2016 decision of the constitutional court, eligibility for the benefits of the participation exemption for dividends no longer requires that the parent company hold the voting rights of the distributing subsidiary, i.e. dividends from shares with no voting rights also will be eligible for the exemption.

The French tax authorities already changed their official administrative guidelines in this respect, with the changes taking effect on 3 February 2016.

The amending finance bill for 2016 provides for the abolition of the voting rights requirement, and even if the amended bill does not provide a specific effective date, the abolished requirement can be invoked as from 3 February 2016.

The above eligibility for the participation exemption for shares without voting rights will not have any consequences on the participation exemption for capital gains. However, a requirement is introduced that the parent company must hold at least 5% of the voting rights of certain shares of the subsidiary to benefit from the exemption. This rule applies to fiscal years beginning on or after 1 January 2017.

Codification of court decisions on rules applicable to companies in NCSTs

Two decisions of the constitutional court will be formally included in French tax law:

- The court ruled on 20 January 2015 that the denial of the participation exemption on long-term capital gains derived from the sale of shares in subsidiaries located in NCSTs is not contrary to the French constitution, provided the taxpayer is permitted to demonstrate that its investment in the NCST entity was not made for the purpose of avoiding French tax.

It should be noted that even if the amending finance bill for 2016 does not provide a specific effective date for the measure, the constitutional court's decision can be invoked as the effective date.

- In a decision issued on 25 November 2016, the constitutional court held that the 75% withholding tax that is imposed on dividends paid to a company located in an NCST is not contrary to the constitution, provided the taxpayer is permitted to demonstrate that the dividend distribution was not made for the purpose of avoiding or evading French tax.

Abolition of favorable tax amortization regime for software

For fiscal years starting on or after 1 January 2017, the acquisition of software will no longer benefit from exceptional amortization over a 12-month period. Instead, the "straight-line" method, based on the depreciation period of the asset, will apply (e.g. if the useful life of the software is five years, the annual straight-line depreciation rate will be equal to 20%).

Financial transaction tax increased and scope expanded

As from 1 January 2017, the rate of the French financial transactions tax will increase from 0.2% to 0.3%, and the scope of the tax will be extended to apply to intraday transactions as from 1 January 2018. Intraday transactions are considered speculative and they pose a risk to financial markets.

The entry into force for intraday transactions has been postponed to 2018 so that all players have time to update their systems and procedures to include intraday transactions within the scope and the basis of the tax.

Until 1 January 2018, taxpayers will continue to pay the financial transactions tax on the net buying position at the end of each day. However, all taxable transactions will be subject to a 0.3% rate as from 1 January 2017.

Contacts

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