

THE INWARD
INVESTMENT AND
INTERNATIONAL
TAXATION REVIEW

EIGHTH EDITION

Editor
Tim Sanders

THE LAWREVIEWS

THE INWARD
INVESTMENT AND
INTERNATIONAL
TAXATION REVIEW

EIGHTH EDITION

Reproduced with permission from Law Business Research Ltd
This article was first published in February 2018
For further information please contact Nick.Barette@thelawreviews.co.uk

Editor
Tim Sanders

THE LAWREVIEWS

PUBLISHER
Gideon Robertson

SENIOR BUSINESS DEVELOPMENT MANAGER
Nick Barette

BUSINESS DEVELOPMENT MANAGERS
Thomas Lee, Joel Woods

ACCOUNT MANAGERS
Pere Aspinall, Sophie Emberson,
Laura Lynas, Jack Bagnall

PRODUCT MARKETING EXECUTIVE
Rebecca Mogridge

RESEARCHER
Arthur Hunter

EDITORIAL COORDINATOR
Gavin Jordan

HEAD OF PRODUCTION
Adam Myers

PRODUCTION EDITOR
Martin Roach

SUBEDITOR
Charlotte Stretch

CHIEF EXECUTIVE OFFICER
Paul Howarth

Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK
© 2018 Law Business Research Ltd
www.TheLawReviews.co.uk

No photocopying: copyright licences do not apply.

The information provided in this publication is general and may not apply in a specific situation, nor does it necessarily represent the views of authors' firms or their clients. Legal advice should always be sought before taking any legal action based on the information provided. The publishers accept no responsibility for any acts or omissions contained herein. Although the information provided is accurate as of January 2018, be advised that this is a developing area.

Enquiries concerning reproduction should be sent to Law Business Research, at the address above.

Enquiries concerning editorial content should be directed
to the Publisher – gideon.roberton@lbresearch.com

ISBN 978-1-912228-09-6

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW

THE RESTRUCTURING REVIEW

THE PRIVATE COMPETITION ENFORCEMENT REVIEW

THE DISPUTE RESOLUTION REVIEW

THE EMPLOYMENT LAW REVIEW

THE PUBLIC COMPETITION ENFORCEMENT REVIEW

THE BANKING REGULATION REVIEW

THE INTERNATIONAL ARBITRATION REVIEW

THE MERGER CONTROL REVIEW

THE TECHNOLOGY, MEDIA AND
TELECOMMUNICATIONS REVIEW

THE INWARD INVESTMENT AND
INTERNATIONAL TAXATION REVIEW

THE CORPORATE GOVERNANCE REVIEW

THE CORPORATE IMMIGRATION REVIEW

THE INTERNATIONAL INVESTIGATIONS REVIEW

THE PROJECTS AND CONSTRUCTION REVIEW

THE INTERNATIONAL CAPITAL MARKETS REVIEW

THE REAL ESTATE LAW REVIEW

THE PRIVATE EQUITY REVIEW

THE ENERGY REGULATION AND MARKETS REVIEW

THE INTELLECTUAL PROPERTY REVIEW

THE ASSET MANAGEMENT REVIEW

THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

THE MINING LAW REVIEW

THE EXECUTIVE REMUNERATION REVIEW

THE ANTI-BRIBERY AND ANTI-CORRUPTION REVIEW

THE CARTELS AND LENIENCY REVIEW

THE TAX DISPUTES AND LITIGATION REVIEW

THE LIFE SCIENCES LAW REVIEW

THE INSURANCE AND REINSURANCE LAW REVIEW

THE GOVERNMENT PROCUREMENT REVIEW

THE DOMINANCE AND MONOPOLIES REVIEW
THE AVIATION LAW REVIEW
THE FOREIGN INVESTMENT REGULATION REVIEW
THE ASSET TRACING AND RECOVERY REVIEW
THE INSOLVENCY REVIEW
THE OIL AND GAS LAW REVIEW
THE FRANCHISE LAW REVIEW
THE PRODUCT REGULATION AND LIABILITY REVIEW
THE SHIPPING LAW REVIEW
THE ACQUISITION AND LEVERAGED FINANCE REVIEW
THE PRIVACY, DATA PROTECTION AND CYBERSECURITY LAW REVIEW
THE PUBLIC-PRIVATE PARTNERSHIP LAW REVIEW
THE TRANSPORT FINANCE LAW REVIEW
THE SECURITIES LITIGATION REVIEW
THE LENDING AND SECURED FINANCE REVIEW
THE INTERNATIONAL TRADE LAW REVIEW
THE SPORTS LAW REVIEW
THE INVESTMENT TREATY ARBITRATION REVIEW
THE GAMBLING LAW REVIEW
THE INTELLECTUAL PROPERTY AND ANTITRUST REVIEW
THE REAL ESTATE M&A AND PRIVATE EQUITY REVIEW
THE SHAREHOLDER RIGHTS AND ACTIVISM REVIEW
THE ISLAMIC FINANCE AND MARKETS LAW REVIEW
THE ENVIRONMENT AND CLIMATE CHANGE LAW REVIEW
THE CONSUMER FINANCE LAW REVIEW
THE INITIAL PUBLIC OFFERINGS REVIEW
THE CLASS ACTIONS LAW REVIEW
THE TRANSFER PRICING LAW REVIEW
THE BANKING LITIGATION LAW REVIEW
THE HEALTHCARE LAW REVIEW
THE PATENT LITIGATION LAW REVIEW
THE THIRD PARTY LITIGATION FUNDING LAW REVIEW
THE TRADEMARKS LAW REVIEW

www.TheLawReviews.co.uk

ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

A&L GOODBODY

ABOU JAOUDE & ASSOCIATES LAW FIRM

ÆLEX

AFRIDI & ANGELL

ANDERSON MÕRI & TOMOTSUNE

BAKER MCKENZIE

BIRD & BIRD ADVOKAT KB

BIRUNGYI, BARATA & ASSOCIATES

CASILLAS, SANTIAGO & TORRES, LLC

CHIOMENTI

CMS GRAU

D'EMPAIRE REYNA ABOGADOS

DLA PIPER NETHERLANDS NV

GALAZ, YAMAZAKI, RUIZ URQUIZA, SC (DELOITTE MEXICO)

GORRISSEN FEDERSPIEL

GREENWOODS & HERBERT SMITH FREEHILLS

GRETTE AS

HERZOG FOX & NEEMAN

KHAITAN & CO

KPMG

LOYENS & LOEFF

MOCHTAR KARUWIN KOMAR

Acknowledgements

PHILIPPE DEROUIN

POTAMITISVEKRIS

PYRGOU VAKIS LAW FIRM

QUEVEDO & PONCE

SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP

SOŁTYSIŃSKI KAWECKI & SZŁĘZAK

SRS ADVOGADOS

TOGNETTI ADVOCACIA

WOLF THEISS

CONTENTS

PREFACE.....	vii
<i>Tim Sanders</i>	
Chapter 1 AUSTRALIA.....	1
<i>Adrian O'Shannessy and Tony Frost</i>	
Chapter 2 AUSTRIA.....	16
<i>Niklas JRM Schmidt and Eva Stadler</i>	
Chapter 3 BELGIUM	25
<i>Christian Chéry and Marc Dhaene</i>	
Chapter 4 BRAZIL.....	55
<i>Silvania Tognetti</i>	
Chapter 5 CANADA.....	68
<i>KA Siobhan Monaghan</i>	
Chapter 6 CHINA.....	83
<i>Jon Eichelberger</i>	
Chapter 7 CYPRUS.....	98
<i>Georgia Papa</i>	
Chapter 8 DENMARK.....	113
<i>Jakob Skaadstrup Andersen</i>	
Chapter 9 ECUADOR.....	127
<i>Alejandro Ponce Martínez</i>	
Chapter 10 FRANCE.....	140
<i>Philippe Derouin</i>	

Contents

Chapter 11	GREECE.....	164
	<i>Aspasia Malliou and Maria Kilatou</i>	
Chapter 12	HONG KONG	180
	<i>Steven Sieker and Wenwen Chai</i>	
Chapter 13	INDIA.....	193
	<i>Surajkumar Shetty, Raghav Kumar Bajaj and Ishani Kundu</i>	
Chapter 14	INDONESIA.....	206
	<i>Mulyana, Sumanti Disca Ferli and Bobby Christianto Manurung</i>	
Chapter 15	IRELAND.....	222
	<i>Peter Maher</i>	
Chapter 16	ISRAEL.....	242
	<i>Meir Linzen</i>	
Chapter 17	ITALY.....	256
	<i>Paolo Giacometti and Giuseppe Andrea Giannantonio</i>	
Chapter 18	JAPAN.....	276
	<i>Kei Sasaki, Fumiaki Kawazoe and Kohei Kajiwara</i>	
Chapter 19	LEBANON.....	293
	<i>Souraya Machnouk, Hachem El Housseini and Ziad Maatouk</i>	
Chapter 20	LUXEMBOURG.....	306
	<i>Pieter Stalman and Chiara Bardini</i>	
Chapter 21	MALTA.....	323
	<i>Juanita Brockdorff and Michail Tegos</i>	
Chapter 22	MEXICO	334
	<i>Eduardo Barrón</i>	
Chapter 23	NETHERLANDS.....	356
	<i>Jian-Cheng Ku and Rinze van Minnen</i>	

Contents

Chapter 24	NIGERIA.....	371
	<i>Theophilus I Emuwa, Chinyerugo Ugoji, Adefolake Adewusi and Chioma Okonkwo</i>	
Chapter 25	NORWAY.....	384
	<i>Thomas E Alnæs and Kristina Haugland</i>	
Chapter 26	PERU.....	396
	<i>César Castro Salinas and Rodrigo Flores Benavides</i>	
Chapter 27	POLAND.....	411
	<i>Jarosław Bieroński</i>	
Chapter 28	PORTUGAL.....	443
	<i>José Pedroso de Melo</i>	
Chapter 29	PUERTO RICO.....	458
	<i>Miguel A Santiago Rivera and Alberto J E Añeses Negrón</i>	
Chapter 30	SWEDEN.....	478
	<i>Carl-Magnus Uggla</i>	
Chapter 31	TAIWAN.....	491
	<i>Michael Wong and Dennis Lee</i>	
Chapter 32	THAILAND.....	501
	<i>Panya Sittisakonsin and Sirirasi Gobpradit</i>	
Chapter 33	UGANDA.....	514
	<i>Birungyi Kagyenda Cephas and Oscar Kamusiime</i>	
Chapter 34	UNITED ARAB EMIRATES.....	522
	<i>Gregory J Mayew and Silvia A Pretorius</i>	
Chapter 35	UNITED KINGDOM.....	538
	<i>Tim Sanders</i>	
Chapter 36	UNITED STATES.....	562
	<i>Hal Hicks, Moshe Spinowitz and Robert C Stevenson</i>	

Contents

Chapter 37	VENEZUELA.....	584
	<i>Alberto Benshimol and Humberto Romero-Muci</i>	
Chapter 38	VIETNAM.....	597
	<i>Fred Burke and Nguyen Thanh Vinh</i>	
Appendix 1	ABOUT THE AUTHORS.....	611
Appendix 2	CONTRIBUTING LAW FIRMS' CONTACT DETAILS.....	633

PREFACE

The drive towards greater tax transparency has continued in 2017. The trend is driven by pressure on tax authorities to raise more revenue and increasing public disquiet about the well-publicised practices of some large multinationals and wealthy individuals, who apparently pay a disproportionately small sum in tax compared to the man in the street. Measures focus on stricter financial reporting and more rigorous compliance standards, coupled with a variety of attacks on tax avoidance and offshore structures.

One consequence of this is that business management, particularly boards of multinational companies, will need to focus more on tax matters and accept that more resources will need to be devoted to compliance and providing information to tax authorities than in the past. Tax authorities and governments expect that their approach will result in more tax being collected and bring about a change in corporates' tax practices. At this stage, one cannot predict with any certainty how business will respond, in particular whether those based in high-tax jurisdictions with increasingly onerous compliance burdens, may seek to relocate to jurisdictions with lower tax rates and a less expensive and time-consuming compliance obligations.

A challenge for the tax adviser in the coming years will be to engage with general business management, who have traditionally delegated tax matters to specialist departments, to make them aware of the challenges the new environment throws up and their obligations.

It is hoped that this volume will prove to be a useful guide to these obligations as well as to the tax rules in the jurisdictions where clients conduct their businesses. Each chapter aims to provide topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions. While specific tax advice is always essential, it is also necessary to have a broad understanding of the nature of the potential issues and advantages that lie ahead; this book provides a guide to these.

I should like to thank the contributors to this book for their time and efforts, and above all for their expertise. I would also like to thank the publisher and the team for their support and patience. I hope that you find the work useful, and any comments or suggestions for improvement that can be incorporated into any future editions will be gratefully received.

The views expressed in this book are those of the authors and not of their firms, the editor or the publishers. Every endeavour has been made to ensure that what you read is the latest intelligence.

Tim Sanders
London
December 2017

FRANCE

*Philippe Derouin*¹

I INTRODUCTION

Recently elected President Emmanuel Macron, supported by a substantial majority of the National Assembly (the French equivalent of the United States House of Representatives) has announced, and undertaken to follow, a path of reforms to be implemented at the early stage of his five-year term. In the aftermath of Brexit, the French government endorsed a plan of tax reforms meant to be plainly business-friendly, with two key directions: for corporations, on the one hand, by substantially reducing the French corporation tax rate, and, on the other, for natural persons, by applying a new ‘flat tax’ on financial income and capital gains and narrowing the wealth tax to real estate, thus excluding other assets.

Although still on the high tax side, France remains generally favourable to inward investment, especially where it creates or maintains jobs on French territory. A government agency, Business France, has been created to promote and facilitate international investment. It publishes a brochure that provides most of the relevant legal, regulatory and tax information. Another publication, the *France Attractiveness Scoreboard*, examines the indicators that position France among several Western countries to enable foreign investors to compare and make judgements between European countries competing to attract job-creating investment projects.

No substantial further changes are expected after the Finance Act for 2018 and the Amended Finance Acts for 2017 have been enacted before 31 December 2017. However, certain new tax compliance and anti-avoidance provisions are being implemented and some of them could be amended by the implementation of the Anti-Tax Avoidance Directive (ATAD I, EU 2016/1164, adopted on 20 June 2016) before 1 January 2019. Certain provisions of more than 80 double tax treaties signed by France could also be altered as a result of France’s signature and reservations on the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI).

II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

i Corporate

French law provides for several forms of corporate entities for business activities:

- a* the joint-stock corporation (SA), the shares of which may be offered to the public;
- b* the limited liability private company (SARL);

¹ Philippe Derouin, a member of the Paris Bar, owns his own law firm, Philippe Derouin.

- c the *société par actions simplifiée* (SAS), which is examined further below;
- d the limited partnership with stock (SCA); and
- e the *société européenne* (SE or European company).

For French tax purposes, all these entities are subject to French corporation tax (except where an SARL or SAS is closely held by individuals and has elected to be treated as a partnership). An SA must have at least two shareholders (seven if publicly traded) and three directors, and an SCA must have at least a general partner and three shareholders, who may be the three members of the supervisory board. Boards of directors (in an SA) or supervisory boards (both in an SA and an SCA) must be composed with a balanced representation of men and women. Where a business employs more than 1,000 persons, the board must include representatives of the employees. SARLs and SASs may have one single shareholder. For US tax purposes, only the SA is deemed a *per se* corporation; other French corporate vehicles may be regarded as partnerships or, if held by a single shareholder – which may be the case for an SARL or an SAS – as disregarded entities.

SAS

The SAS is a limited liability company that is often used as a corporate vehicle for wholly owned subsidiaries, intermediary holding companies and joint ventures, regardless of the nationality of the parties. One of the major advantages of the SAS is its flexibility and the wide latitude it offers to its shareholders in shaping corporate governance. The only major downside to this corporate form is that since the SAS is in essence a closely held company, it is prohibited from making public offerings of its shares. Should the investors contemplate an initial public offering of their French corporate vehicle at a later stage, the SAS would need to be converted into a public limited company (SA) to be floated on the stock market.

Subject to a limited number of legal requirements, the SAS is primarily governed by the terms and conditions of its articles of association. The articles govern matters such as the organisation of the management, and the amount and type of equity. Where an SAS is used as a joint-venture company, the articles may determine the allocation of the voting rights among the shareholders. A unanimous vote of the shareholders is also required with respect to certain matters.

Great flexibility is granted to the form that shareholders' decisions may take and the conditions applicable to making such decisions. In particular, the articles determine the manner in which decisions that require shareholder approval are to be taken.

While the articles can determine the persons competent to make decisions (e.g., they may provide that veto power be given to certain persons within or outside the company, such as a banker or important customer), decisions relating to certain essential matters may only be made by the shareholders.

ii Non-corporate

French law partnerships

Most French law partnerships are legal entities that are registered as such with the Business and Companies Registrar (RCS). Generally, the partners have unlimited liability, and are personally liable for income or corporation tax on their share of the income or profits of the partnership as if they had generated it themselves. Unless they have elected to be subject to French corporation tax, French partnerships are not subject to any income or corporation tax on their profits, but they are required to maintain separate accounts and file tax returns, and

may be subject to tax audit procedures. As a result of such audit procedures, some taxes may be assessed on the partnership (VAT, local taxes including the local economic contribution, payroll taxes, etc.), while other taxes may be assessed upon the partners only (income or corporation tax). Some withholding taxes are assessed on both, and may be challenged both by the partnership (viewed as a paying agent) and by the beneficiary of the relevant income.

For international tax purposes, where a French partnership is liable to or has elected to be subject to corporation tax, it may be regarded as a hybrid entity. In other situations, a French partnership can become a reverse hybrid where it is deemed to be a corporation in the country of (some of) its partners. Accordingly, French partnerships may cover the full spectrum from transparent to opaque via hybrid or reverse hybrid.

The most common forms of French partnership are:

- a* general partnership (SNC), in which all partners must qualify to carry out a trade in France and are jointly liable for the SNC's debts;
- b* non-trading partnership, which may not engage in commercial activities and which is mainly used for real estate investment and leasing, certain asset management activities such as portfolio holding and certain (regulated) professional activities;
- c* limited partnership (SCS), where the share of the profits accruing to limited partners is subject to corporation tax and deemed as dividends as and when distributed to them; and
- d* economic interest groupings (either French 'GIE' or European 'GEIE').

The *société en participation* is an unregistered partnership that does not enjoy separate legal personality. Generally, it is subject to the same tax treatment as a partnership provided the names and addresses of its members are disclosed to the French tax authorities. *Sociétés en participation* are commonly used as joint-venture vehicles in the construction industry, the performing arts and the publishing sector, and also to a certain extent in the financial sector.

iii Other French entities

Assets may be held and activities may be carried out through the French equivalent of common trusts, which are tax-transparent in most income and corporation tax aspects.

Certain investment trusts are tax-exempt, such as funds for collective investment in transferable securities or securitisation vehicles. Foreign trusts also may hold assets in France – either directly or indirectly through French or foreign entities – and accordingly be subject to certain disclosure obligations.

A new investment vehicle akin to a limited partnership, the *société de libre partenariat*, has been introduced. Like other investment funds, it is tax-exempt in France and partners may be taxable upon distribution, if and when this occurs.

Liaison offices: a presence without commercial activity

Liaison offices may conduct only a very limited range of non-commercial operations, such as prospecting, advertising, providing information, storing merchandise, or other operations of a preparatory or auxiliary nature. Such offices are not separate legal entities. Invoices must be issued by the head office, where any contracts must be signed.

Liaison offices are not permanent establishments for tax purposes. They are not subject to corporate tax or VAT, but must pay certain local taxes and social security contributions on the payroll. However, where commercial activities are conducted in France, in particular where any employee signs contracts on behalf of the foreign company and employer, where

a full manufacturing cycle is completed in France, or where a fixed place of business is maintained in France through which the company conducts all or part of its trade, the foreign company may be deemed to have a branch or permanent establishment in France. Companies wishing to ascertain their tax position may ask the tax authorities to rule in advance whether their establishment qualifies as a permanent establishment in France (the tax authorities are deemed to have given tacit consent if no reply is received within three months).

Distribution through sales intermediaries

A foreign company may also develop commercial activities in France through a variety of sales intermediaries without being deemed to be established in France, notably through individual sales representatives, independent sales agents (i.e., a self-employed individual or a company that acts on its behalf) and independent distributors.

A commissionaire (i.e., an undisclosed agent acting on behalf of the principal but in its own name) may have more important functions, risks and costs. The French Supreme Administrative Court held as a rule that a commissionaire cannot constitute a permanent establishment of its principal, unless the contractual provisions or the circumstances differ from a true commissionaire agreement. This rule will be reconsidered following the adoption of the new clauses inserted by the MLI. Article 12 of the MLI provides that an enterprise shall be deemed to have establishment where a person habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification for the transfer of goods or the provision of services by that enterprise. This would apply when the person is closely related to that enterprise and acts exclusively on its behalf.

French branch or permanent establishment

Branches of foreign companies may generally carry out all the operations of an industrial or commercial company in France subject to certain professional regulations. They must be registered with the RCS, and must be headed by a legal representative entitled to do business in France and whose identity and particulars must also be published with the RCS. In certain situations, the French tax authorities are inquisitive upon undisclosed permanent establishments, including where a French subsidiary performs certain duties of a related foreign company or where a foreign company is managed out of France. A growing number of contentious issues has arisen in this respect.

Branches are permanent establishments with regard to tax laws and must pay corporation tax, VAT, local taxes (including the local economic contribution) and social security contributions. The subsequent conversion of a branch into a separately incorporated subsidiary is possible, and must comply with the rules governing the sale or transfer of a business or going concern. Such transfer is generally subject to taxation except where rollover relief applies.

III DIRECT TAXATION OF BUSINESSES

i Tax on profits

Determination of taxable profit

French corporation tax

French corporation tax is assessed on the earnings determined by commercial accounts established under French generally accepted accounting principles (GAAP), subject to specific tax adjustments. Income and expenses are recognised on an accrual basis. Some financial instruments, and any outstanding foreign currency debts and receivables, are taxed on a mark-to-market basis.

Favourable tax adjustments include accelerated depreciation of equipment, certain immovable fixtures, and full and immediate depreciation of some IP acquisition costs; and participation exemption on dividends received (95 per cent exempt) and capital gains realised (88 per cent exempt) upon a substantial (i.e., at least 5 per cent) participation in French and foreign companies or partnerships (unless established in a non-cooperative state or territory (NCST)).

Unfavourable tax adjustments include:

- a* no deduction for amortisation of goodwill, trademarks and land;
- b* no deduction for most penalties;
- c* limited deduction (75 per cent) of net financial expenses;
- d* restricted or deferred deduction of financial expenses towards related companies (thin capitalisation), possibly resulting in reduced or forfeited deduction;
- e* conditional deduction of financial expenses on hybrid debt instruments and certain acquisition financing;
- f* restricted deduction of payments for services, including interest and royalties, to any entity domiciled or established in a low-tax country or in an NCST; and
- g* limited deduction for company cars and certain other expenses.

Territorial scope of corporation tax

Generally, French corporation tax applies to earnings from business enterprises carried out in France or the taxation of which is attributed to France under a double taxation treaty. French corporation tax also applies to any profits generated by controlled foreign corporations (CFCs) established in a low-tax country unless a *bona fide* commercial purpose test is satisfied. Different tests apply depending upon whether the CFC is located inside or outside the EU and, if outside, in an NCST (see Section IX.ii). ‘Low-tax country’ is defined as a country where corporate income tax is lower than one half of French corporation tax with surcharges (i.e., lower than 16.6 per cent or 18 per cent).

Capital and income

Income and capital gains are taxed at the same rate (currently 33.33 per cent plus surcharges) and can be aggregated, except for capital gains and losses realised upon the disposal of substantial participations, which are exempt or subject to special tax rates. A special lower rate (15 per cent plus surcharges) also applies to royalties and proceeds from the licensing or sale of patents and similar industrial property rights. Expenses directly related to such exempt or low-tax gains may only be deducted from such gains.

Losses

Losses may be carried forward indefinitely and survive a change of ownership, but not a cessation or substantial alteration of business. Each fiscal year, carried-forward losses may shelter the sum of €1 million plus 50 per cent of the current year's profits. Losses may be carried back for one year up to €1 million.

Rates

The standard rate of corporation tax currently is 33.3 per cent and will be gradually reduced to 25 per cent by 2022. For financial year 2018, a 28 per cent rate will apply to the first €500,000 of profits for all companies (with the remaining profits subject to the 33.3 per cent standard rate). In 2019, the standard rate applicable over €500,000 will drop to 31 per cent, and then to 28 per cent on the full profit in 2020, 26.5 per cent in 2021 and 25 per cent in 2022. In addition, a 3.3 per cent surcharge applies where the annual revenue (turnover) of a company exceeds €7.63 million, thus resulting in an effective rate peaking at 34.43 per cent in 2018.

Subject to certain anti-avoidance rules, qualifying dividends received and profits made on the sale of substantial participations are exempt, except for a recapture of costs equal to respectively 5 or 1 per cent of the dividend or 12 per cent of the gain, thus resulting in an effective tax charge of 1.67 or 1.72 (or 0.33) per cent on dividends and 4 or 4.56 per cent on capital gains.

Special tax rates apply to profits generated by the sale of shares in listed real estate companies (19 per cent); the royalties and proceeds from the licence and sale of patents, patentable innovations and manufacturing processes (15 per cent); and the gain on certain venture capital funds where they do not qualify for the participation exemption.

For any financial year closed between 31 December 2017 and 30 December 2018, a temporary surcharge will apply to companies with revenue (turnover) above €1 billion, and an additional surcharge will apply above €3 billion (subject to adjustments for the first €100,000 over each threshold). Each surcharge is equal to 15 per cent of the gross amount of corporation tax, before any tax credit or tax reductions. An instalment equal to 95 per cent of an estimate of the amounts due is payable at the same time as the last instalment of corporation tax. Corporations with a financial year ending on 31 December 2017 shall pay such instalment on or before 20 December 2017. The resulting effective tax rate for these companies (approximately 320) will amount respectively to 39.43 per cent and 44.43 per cent.

Tax credits

Under French domestic law, many incentives take the form of tax credits, the most important of which is the R&D tax credit, which amounts to 30 per cent of the qualifying expenditure not exceeding €100 million per year and 5 per cent for expenses in excess of such amount.

Except where CFC income is taxable in France, there is no unilateral relief for foreign tax. To the extent foreign-source income is taxed in France, and only where a double taxation treaty applies, foreign withholding taxes may be credited against French corporation tax pursuant to the relevant double taxation treaty (except for foreign withholding taxes on inbound dividends, which may be applied only on withholding taxes on outbound dividends, where the participation exemption applies). Where and to the extent the foreign tax credit

cannot be credited against French corporation tax, for instance because of a net loss or insufficient taxable profits, it cannot be deducted. Whether excess foreign tax credits may be carried forward is currently litigated and has been referred to the European Court of Justice.

Administration

Tax returns are due annually and must be filed electronically. Corporation tax returns filed by major companies must include certain information on the activities, assets and transfer pricing policy of the group, and certain information on major intragroup transactions. Country-by-country reporting is required from corporate groups that publish consolidated accounts and realise consolidated revenues in excess of €750 million per year.

Corporation tax is payable in quarterly instalments, the balance being payable upon filing of the tax return prior to the 15th day of the fourth month following the fiscal year end (or 15 May for corporations whose fiscal year coincides with the calendar year).

Generally, tax returns may be audited and taxes reassessed by the tax authorities up until the end of the third calendar year following the year when a tax was payable. Longer periods of limitation apply in certain cases. In certain situations, where the tax authorities are time-barred from reassessing an element of income or disallowing an expense, the tax may be reassessed on the first non-barred taxable year.

The tax authorities may challenge and set aside any tax avoidance scheme that is either a sham or exclusively tax-driven and seeks to benefit from an advantage contrary to the purpose of the law (general anti-avoidance rule) (see Section IX.i). Substantial penalties apply in such cases (80 per cent or 40 per cent).

Guidance and comfort may be sought from the tax authorities both on points of legal interpretation and how particular facts will be treated. Where formally given, such guidance or clearance is binding upon the tax authorities and the tax courts. Apart from a judicial review of administrative regulations and certain individual tax rulings, there is no effective way to challenge a tax position announced by the tax authorities that a taxpayer finds unsatisfactory.

Tax grouping

French tax laws enable corporate taxpayers belonging to the same group to elect for group taxation, resulting in the top French parent company becoming the sole corporate taxpayer for all members of the group and in the 99 per cent exemption of intragroup dividends.

Definition of a French tax group

The group can include only companies that are liable to corporation tax in France, and that are at least 95 per cent owned by the parent company, either directly or indirectly through intermediate companies that are members of the group or established in an EU jurisdiction. The 95 per cent-plus ownership condition must be satisfied for the full 12-month taxation period. Parent companies and qualifying subsidiaries may elect whether to be included in the integrated tax group, which may be modified each year.

Group taxable income

Under the French tax integration or consolidation, the group's taxable income is not the consolidated income of the group (where intragroup profits and losses would have been eliminated), but rather an adjusted combined or amalgamated income of the companies composing the group. Basically, it consists of the algebraic sum of the taxable income or losses

of all the group members determined as if each of them were independent taxpayers, subject to certain adjustments. Intragroup distributions of dividends trigger a 1 per cent recapture of costs (resulting in a 0.33 per cent tax charge).

As such, there are no transfers or surrenders of losses from one company of the group to another on terms to be mutually agreed. By operation of the law, all the tax losses shown by the members of the group are escalated – together with other tax attributes such as tax credits, either domestic or foreign – to the parent company of the group and sole taxpayer. The parent company may enter into a tax contribution agreement with each of its tax-integrated subsidiaries to determine the contribution of each subsidiary, and whether the subsidiary is compensated for the losses, tax credits and other tax attributes transferred to the parent company.

Exit charges

Some adjustments to group income tend to temporarily neutralise the tax effect of certain intragroup transactions or situations, but following the exit of a subsidiary or the termination of the group (including following the acquisition of the parent company, or a merger or demerger where the parent company does not survive), all relevant neutralised items are deneutralised and become taxable or deductible, as the case may be. They must be added to or deducted from the group taxable income for which the parent company is liable to corporation tax. Generally, exits from and termination of the tax group have a retrospective effect on the beginning of the current fiscal year. Where the group terminates as a result of a merger or acquisition of the parent company, the surviving companies of the group may be included in the tax group of the acquirer. Tax losses of the terminated group may be carried forward under certain conditions and restrictions. It is not uncommon for the target company and its ex-parent company to enter into an exit agreement to set certain consequences of the exit of the subsidiary from the tax group, especially with respect to tax losses and credits or other tax attributes.

ii Other relevant taxes

Business contribution on value added

As a partial substitute for the notorious and now removed local business tax, this business contribution on value added of 1.5 per cent is part of the local economic contribution (CET) and applies annually to the value added by any business established in France. This tax is deductible for corporation tax purposes.

Local taxes

Businesses established in France must also pay a business contribution on property, which forms the other part of the CET and is calculated, at local authority rates, on the rental value of all properties used for the business.

French or foreign owners of a property located in France are also subject to the real estate tax, based upon the rental value of the property. All such local taxes are deductible for corporation tax purposes.

Wealth taxes

Wealth tax on natural persons has been substantially narrowed by the Finance Act for 2018 to real property and shares in real property entities, except where such property is applied to a

business activity of the taxpayer. Non-residents and certain residents are liable to such annual French net wealth tax either on their worldwide assets or on their French assets only. The taxable threshold remains at €1.3 million of taxable assets and the rate escalates from 0.5 to 1.5 per cent where the total net assets exceed €10 million. Preexisting favourable tax regimes (e.g., the 'Dutreil' regime and regime applicable to investment in small- or medium-sized businesses) have been abolished and replaced by new ones, such as exclusion from the taxable basis of shareholding of less than 10 per cent. Assets held through a foreign trust are included in the taxable base and must be specially reported annually by the trustee.

Legal entities are not subject to a general net wealth tax in France. Potentially, a 3 per cent annual tax may apply to the fair market value of properties directly or indirectly owned by certain foreign entities. Where applicable, the tax is not deductible for corporation tax purposes. Most investors benefit from one or more of the many exceptions applicable, as the tax rule's aim is to discourage anonymous investment in France by presumed tax evaders.

Miscellaneous taxes

Many other taxes are applicable in France. Some have a very wide scope, such as the apprenticeship tax, based upon payroll in any industry or business sector, and the tax on corporate cars.

Other taxes are specific to certain industries (e.g., the payroll tax imposed at rates escalating from 4.25 to 13.6 per cent on businesses that are wholly or partially exempt from VAT such as insurance, banks, etc.) or certain forms of investment.

Value added tax

French VAT applies substantially in line with EU rules on VAT. The standard rate is 20 per cent. Reduced rates are 10, 5.5 and 2.1 per cent.

There are currently no grouping rules in France for VAT purposes except for consolidated payments.

Stamp duties, capital duties and registration taxes

Generally, French stamp duty applies at fixed flat rates on most corporate documents. There is no capital duty on the issuance of shares or other corporate instruments either for cash or for valuable property.

Registration taxes apply at proportional rates on most transfers of certain assets for a consideration or for the assumption of liabilities:

- a* real property: 5.09 per cent, possibly increased up to 5.8 per cent at local level;
- b* goodwill and equipment of a going concern, trademarks: 5 per cent;
- c* shares in unlisted real estate companies: 5 per cent; where made outside of France, the transfer of such shares must be reported by a notarial deed made in France;
- d* interest in an SNC, SARL: 3 per cent;
- e* shares in an unlisted SA, SAS: 0.1 per cent; and
- f* no tax is due on listed shares when no deed is established or executed in France.

A financial transaction tax applies at a rate of 0.3 per cent on the acquisition of shares and other equity instruments of listed French companies where the market capitalisation of the issuer exceeds €1 billion on 1 December of the preceding year. The list currently contains approximately 120 names. The tax currently does not apply to operations that do not result in an acquisition of shares (such as derivatives or contract for difference).

Where a deed is made to record a partition of assets among multiple owners who jointly owned them, a partition duty applies at a rate of 2.5 per cent uncapped.

Gift and inheritance taxes

France operates a very wide-reaching gift and inheritance tax system. Subject to the provisions of few double taxation treaties, French gift and inheritance taxes apply on assets worldwide where the donor or deceased is or was a resident of France, or where the heir or beneficiary is a resident of France. Where none of the donor, deceased, heir or beneficiary is a resident of France, French gift and inheritance taxes apply on assets located in France only, including French real property indirectly held through companies, trusts and partnerships, and also including shares in unlisted real estate companies.

There is no inheritance tax on transfers to a surviving spouse, but transfers *inter vivos* between spouses and any transfers to children and other descendants may be taxed at escalating rates of up to 45 per cent. Transfers to third parties are taxed at 60 per cent. Both formal and informal transfers are taxable.

IV TAX RESIDENCE AND FISCAL DOMICILE

Since French corporation tax is assessed on a territorial basis (i.e., on the net income generated by businesses carried out in France), and since there is no French net wealth tax on corporate bodies, corporate residence as such is of little relevance for French tax purposes, and there is little guidance and limited case law on the point. Corporate residence could be relevant for dividend withholding tax purposes.

Corporate residence was – and to some extent still is – relevant for certain stamp duties, distribution taxes or miscellaneous discriminatory tax provisions. These are fairly limited, since the French tax judges tend to interpret legislative provisions targeting the head office of an entity as concerning not the actual corporate head office but instead any permanent establishment in France. As a result, the French tax authorities traditionally have not argued that a corporation organised outside France is resident in France as a permanent establishment in France is sufficient to trigger corporation tax in this country. Recently, the French authorities have undertaken to challenge the residence of foreign letter box companies and claim that they have an effective place of management in France. Corporate residence is relevant mainly for double taxation treaty purposes. Corporate residence is essential for determining the law applicable to a corporate entity, as French law applies to entities with a corporate head office in France. The migration of corporate entities out of or into France may be organised under certain conditions (see Section IV).

Despite a mid-19th century statute apparently still in force but now of no practical effect, foreign corporate entities and certain foreign partnerships are entitled to enter into contracts and acquire assets in France, and also to appear and act before French courts. Subject to certain direct investment restrictions, they may also open and maintain branches or other forms of permanent establishment in France (see Section IV).

i Corporate residence

French corporate laws apply to corporate bodies with a head office in France. As a matter of law, the corporate seat is presumed to be located at the place indicated in the articles of association or, if proven different, at the place where the senior person or group of persons

(shareholders' meeting, board of directors) effectively make strategic and other major decisions for the company, including wherever the operations of the company and its current management are carried out in any other location or jurisdiction.

In substance, the test is similar to the place of effective management referred to in the OECD model for double taxation treaties and the commentaries thereof (at least before the 2008 revision), and to the centre of main interests under the EU regulation on insolvency proceedings.

Although there is no law, court precedent or administrative guidance on the issue, a single (or few) board meetings in France should not characterise a corporate head office in France, provided most other meetings are held and decisions made outside France. However, decisive board meetings in France could result in a permanent establishment in France. Similarly, a few board meetings held outside France should not be sufficient to characterise a corporate head office outside of France when most meetings are held and decisions made in France.

Inbound transfers of the corporate head office of a foreign entity into France are recognised under French civil, corporate and tax laws, and do not amount to the formation of a new entity provided the continuation of the migrating entity is also recognised under the corporate law of the jurisdiction of origin.

Outbound transfers of corporate head offices are less common and, except for companies organised as European companies, require the unanimous consent of all shareholders. As a domestic tax rule, the transfer of the corporate seat outside France generally triggers the consequences of a cessation of business, including the immediate taxation of profits and potential gains, and the deemed distribution of all profits. However, a transfer to another Member State of the European Union does not trigger such consequences: gains are recognised upon the assets effectively transferred outside France only and corporate tax may be spread over five years. No gains are recognised or taxed on assets that remain part of a French permanent establishment.

There are just a few examples of French listed companies that converted into a European company and moved their corporate seat to another EU Member State (e.g., Eurofins Scientific). A few other corporate migrations or inversions have resulted from cross-border statutory mergers (where the French target company disappeared) within the European Union, with the benefit of a conditional rollover relief of the actual or potential gains on the transferred assets (e.g., Stallergenes-Green in 2015, Technip-FMC in January 2017).

ii Branch or permanent establishment

Under French domestic tax laws, French corporation tax is assessed on the earnings from any enterprises operated in France, and on the income and gains arising from properties located in France or from investment in real estate companies or entities.

There is no statutory definition of an enterprise operated in France, and the tax courts hold that this implies a business activity:

- a* either conducted by an establishment, which includes the equivalent of a permanent establishment under the OECD model double taxation treaty and could extend to some fixed business installations that are excluded under the OECD model (see Section II for the exclusion of liaison offices);
- b* carried out by a dependent agent, also in terms similar to those of the OECD model (see Section II for the situation of independent intermediaries); or

- c which consists of a full commercial cycle of operations, such as the purchase and sale in France of merchandise, even in the absence of any physical presence in France. The reverse could not be verified where the decisions are made and the financial movements originate in France. In such cases, the tax authorities and courts consider the decision centre in France to be a place of management in France and, accordingly, a permanent establishment to which the operations of the company must be allocated.

Where a foreign entity realises earnings in France, these are deemed distributed abroad at the end of each fiscal year, and (unless the foreign entity is effectively managed from an EU Member State) they trigger a 30 per cent withholding tax, unless excluded or reduced by a double taxation treaty.

Where corporation tax does not apply under the above terms, withholding taxes apply in France to payments for services by French debtors to foreign residents (see Section VI).

If a double taxation treaty applies, protection from French taxation may be obtained where the presence in France either does not fall within the definition of, or benefits from an exception to, the relevant treaty provisions on permanent establishment and branch profits tax.

A subsidiary is not supposed to be a permanent establishment of its parent, but in some cases, it can be considered as a dependent agent and then triggers the issue of whether it has the legal authority to conclude contracts in the name of its parent. The Paris lower tax court ruled in favour of the taxpayer, namely Google, in a July 2017 ruling on the grounds that although a Google French subsidiary was a dependent agent of Google Ireland Limited, it lacked the legal authority to conclude contracts and, therefore, could not be characterised as a permanent establishment.

Taxable base

Both under domestic law and the relevant treaty provisions, the profits taxable in France are limited to the earnings attributable to the French operations or permanent establishment, but there are few precedents and little administrative guidance on the allocation of income between the French and the foreign establishment. It is commonly assumed that the OECD guidelines on the allocation of profits to a permanent establishment should apply. A legislative provision to include a 'diverted profit' taxation was quashed by the Constitutional Court.

V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT

There is no French tax incentive especially designed to encourage inward investment, and only a few French tax measures of a rather limited impact – such as the temporary deduction of losses made abroad by medium-sized enterprises or the now-terminated global consolidated tax regime – tend to favour operations outside the home jurisdiction. However, certain features of the French tax system – which apply to both domestic and inward investors – compare reasonably well with similar measures in other jurisdictions.

i Holding company regimes

There is no special tax regime for holding companies; however, as mentioned above, there is no capital duty and, for corporation tax purposes, both the participation exemption and the

tax consolidation provide substantial benefits to companies – including French permanent establishments of foreign companies – holding a substantial participation in French and (as far as participation exemption is concerned) foreign entities.

Participation exemption

Qualifying participations include shares in French and foreign corporations, and interest in certain French and foreign partnerships. However, shares in entities established in an NCST are excluded from the exemption, and interest in low-tax jurisdiction entities may also be excluded in certain circumstances.

Dividends that receive the 95 per cent exemption are subject to a minimum 5 per cent fully paid shareholding (including without voting rights), which is conditional on a two-year holding period (potentially extending either side of the dividend date).

An 88 per cent capital gains exemption applies under similar but not identical circumstances. The decisive criterion is the accounting treatment as ‘investment in subsidiaries’ under French GAAP or the 5 per cent minimum shareholding (with voting rights).

The participation exemption does not prevent an acquiring company from deducting both acquisition costs for the shares (which may also be amortised over a period of no more than five years) and financial expenses related to acquisition financing. However, under a specific provision known as the Carrez amendment, any deduction of financial expenses related to acquisition finance is conditioned upon demonstration that the decision-making and control of the acquired company was carried on in France or in a company subject to corporation tax in a European Union Member State or a Member State of the European Economic Area with which France has a tax treaty with full exchange of information.

Tax grouping

Where the acquiring company is a member of a consolidated tax group, the dividends received from other consolidated companies within the group are fully exempt, even when the conditions for the dividend received exemption are not satisfied. Tax deficits resulting from the deduction of acquisition costs and interest on acquisition financing may shelter the taxable profits of any consolidated operating company, including the target, an essential feature for leveraged acquisitions by financial investors such as private equity funds. Thin capitalisation rules – and anti-hybrid provisions – would apply as previously indicated where (part of) the acquisition finance is provided by the shareholders or related entities.

Further care should be taken to avoid the ‘Charasse amendment’ when the acquisition is made from investors who control the consolidated group. This special anti-abuse provision disallows group financial charges in proportion to the purchase price of shares in subsidiaries that were acquired from persons who control the group, subject to certain exceptions. Since control can result from a concert, it could also apply in circumstances where the vendors of the target receive an interest in the parent company giving them rights in the management of the group. A minority interest with clauses preserving their financial interests only should not result in such concert, and accordingly should not trigger the application of the Charasse amendment.

ii IP regimes

There is no special tax regime, such as ‘patent box’ companies, in France, but the standard provisions of French tax laws contain several incentives for R&D and IP.

R&D costs are deductible expenses. Acquisition costs of patents are not deductible but may be amortised over five years, even where the protection extends over a longer period.

R&D equipment is exempt from CET, the local business tax. There is also an R&D tax credit, which generally equals 30 per cent of the qualifying expenses up to €100 million, and 5 per cent for the portion of expenses that exceeds the limits.

There is a reduced corporation tax rate (15 per cent plus surcharges) on gains and royalties resulting from the transfer or licensing of patents, patentable inventions and related industrial know-how.

iii State aid

There is a variety of state aid available in France. Generally, the French authorities support investment projects that entail:

- a* investment and job creation by large companies in economically disadvantaged regions and regions undergoing industrial redevelopment, as are indicated on a map approved by the European Commission (the regional aid zones map);
- b* business R&D projects;
- c* professional training programmes for employees;
- d* job creation for defined populations;
- e* investment and job creation by small and medium-sized enterprises in all parts of the country; and
- f* protection of the environment.

iv Temporary tax credit on lower wages

As part of a plan to boost ‘competitiveness’, a tax credit applies on lower wages (below 2.5 times the legal minimum salary – currently at €1,480.27 per month). Although this measure is aimed at boosting the manufacturing industry, the credit applies to any economic sector and benefits mainly retail and postal services. The tax credit rate will reduce from 7 per cent to 6 per cent in 2018; it will be abolished in 2019 and be replaced by a decrease of employers’ contributions.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding on outward-bound payments (domestic law)

There are no withholding taxes on interest, except where it is paid either in an NCST or to an entity established or domiciled in an NCST. An NCST is blacklisted when it is outside the EU and does not meet international standards of exchange of information on tax matters. The blacklist is updated from time to time, and currently includes seven territories. New territories may become included, as the French tax administration is currently testing the effectiveness of information exchange with former NCSTs. Such was the case of Bermuda, Jersey and the British Virgin Islands in 2013. Bermuda and Jersey rapidly amended their legislation and practice, and were removed from the blacklist in early 2014. The British Virgin Islands took similar measures, and were removed in 2015. Panama was reintroduced in 2016 with effect on 1 January 2017. Where applicable, withholding applies at 75 per cent of the gross amount, except where the payer demonstrates *bona fide* commercial reasons for

the transaction. An administrative regulation has created a safe harbour for notes and other negotiable debt securities. At present, there is no safe-harbour rule for interest payments on any other debt instrument. Other withholdings include:

- a* 33.33 per cent withholding on royalties paid and other payments for services made to any non-resident with no establishment in France, 75 per cent withholding where paid in or to an entity established in an NCST;
- b* 12.8 per cent withholding on dividends paid to any non-resident individual or 30 per cent on dividends and other distributed income, including deemed dividends (at the grossed-up effective rate of 30/70) paid to other non-residents unless the payment is attributable to a permanent establishment, 75 per cent withholding on payments in an NCST;
- c* 30 per cent withholding on profits made in France by a foreign corporation and deemed to be distributed outside France;
- d* 33.33 per cent withholding on gains from the sale of any part of a substantial (25 per cent plus) participation in a French company by a corporation, 12.8 per cent withholding if made by a non-resident individual, 75 per cent withholding if paid to an NCST; and
- e* 33.33 per cent (or occasionally 75 per cent) withholding on gain from the sale of property in France, or from the sale of shares in companies whose principal assets consist directly or indirectly of property located in France by a corporation, 19 per cent withholding (plus social taxes of 17.2 per cent) if made by a non-resident individual.

ii Domestic law exclusions or exemptions from withholding on outward-bound payments

Interest and other exemptions

Safe harbour regulations are applicable to notes and other negotiable debt securities. An EU parent company exemption applies to interest, dividends and royalties paid to a direct EU parent company owning at least 10 per cent of the French payer company. As regards dividends, the exemption also applies under the participation exemption where the EU parent company owns at least 5 per cent of the French distributing company and is conditional upon a two-year holding period.

Reduced rates

Withholding applies at a rate of 12.8 per cent on dividends paid to individuals, and 15 per cent (instead of 30 per cent) withholding applies on dividends paid to not-for-profit institutions in the EU or the EEA.

No 'branch tax' applies on profits made in France by corporations having their place of effective management in an EU country.

A 19 per cent (instead of 33.3 per cent) withholding rate applies on capital gains made by non-residents on real estate located in France.

Foreign governments, central banks and foreign public financial institutions are exempt from withholding taxes on interest, dividends and capital gains.

iii Double tax treaties

France has an extensive network of 126 double taxation treaties. Most of them follow the OECD model; however, there are a few notable exceptions, such as those with Belgium, Monaco and some Gulf states.

Although the solution may vary from treaty to treaty and should be checked accordingly, qualifying residents of a treaty country receiving income from French sources generally enjoy an exemption from or a reduction of withholding tax charged on such income.

According to recent case law, legal entities that are not liable to, or exempt from, corporate income tax in their country of origin, such as offshore entities, pension funds and other investment funds may not qualify as residents of a treaty country and are excluded from tax treaty benefits except where a special clause applies.

VII TAXATION OF FUNDING STRUCTURES

French entities are commonly funded with an appropriate combination of equity (i.e., share capital, including preference shares) and debt (including convertible or exchangeable notes) from third parties and related parties. French tax courts have constantly ruled, subject to specific provisions that must be strictly construed, that enterprises can freely determine the manner in which they obtain their financing. In certain cases, the French tax authorities attempted to deny the tax deductibility of one part of the financial interest incurred on the grounds of the abnormal act of management, as they considered the gearing to be excessive and thought it was likely that the borrower would not be in a position to reimburse all its debts, and they argued that a more prudent debt-to-equity ratio should be retained. This argument has been rejected constantly by the State Council. As a result, a reassessment on the sole basis of an unbalanced debt-to-equity ratio is unlikely to succeed before French courts. Debt financing remains tax-favoured to the extent that interest expense is largely deductible (except for the 25 per cent ‘haircut’ on net financial expenses – see below) on an accrued basis, and there is no withholding tax on interest (unless at the 75 per cent dissuasive rate when paid in an NCST, or to a person domiciled or established in an NCST, in situations where the safe harbour on notes and other negotiable debt instruments does not apply).

i Thin capitalisation

There is no general thin capitalisation principle. Subject to dealings between related parties, French tax law does not impose any general debt-to-equity ratio on enterprises taxable in France.

Related-party loans limitation rules, and scope of the thin capitalisation and anti-hybrid rules

French thin capitalisation rules apply to all loans granted to any enterprise taxable in France either by a related enterprise or by a third party where they are guaranteed by a related enterprise. Enterprises are deemed related where one enterprise directly or through any interposed entity holds the majority of the share capital of the other, or in practice exercises decision-making power; or both enterprises are under the control of another single enterprise.

According to the administrative regulations, the rules apply to any enterprise carrying out a business in France, including permanent establishments of foreign corporations, and French or foreign partnerships to the extent that they or their partners are subject to corporation tax in France on their share of profits.

Impact of the thin capitalisation rules

Interest accrued on amounts loaned to an enterprise by a related enterprise would be denied where it exceeds any of the following limitations. Within these limits, interest deduction would apply subject to other limitations, including the above-mentioned 75 per cent deduction limits on financial charges.

Interest rate limitation

As far as loans granted directly by a related party are concerned, the rate of deductible interest is capped at the rate provided for in the French Tax Code (i.e., 1.80 per cent for fiscal years closed on or before 30 July 2017) unless it can be demonstrated that the borrowing could not have been obtained from independent financial establishments at a lower interest rate (documentary, benchmarking evidence is required); and the deduction in France is subject to a demonstration that the lender is taxable on the interest at income or corporation tax at a rate at least equal to one-quarter of the standard French corporation tax rate (i.e., 8.3 per cent).

Leverage limitation

The amount of deductible interest is capped at the highest of the following three limits:

- a* the average rate for loans entered into by an enterprise from related enterprises or guaranteed by any of them multiplied by 1.5 times the amount of the company's net equity;
- b* 25 per cent of pre-tax current profits, increased by interest paid on related-party debt and other disqualifying guaranteed loans, depreciation allowances and rents paid pursuant to financial leases that are allocated to the acquisition cost of assets purchased under such financial leases; or
- c* the amount of interest received from related enterprises.

Few exceptions are provided to the application of these three limits (e.g., financing operations within cash-pooling arrangements).

Worldwide group debt ratio

The above limits also do not apply if the borrower company can demonstrate that the consolidated leverage ratio of the group of companies to which it belongs is equal to or higher than its own leverage ratio for the relevant fiscal year. The worldwide group debt ratio is determined, for a group of companies (the group), through the comparison of the total amount of the debts of the enterprises within the group with the net equity of the group. Where applicable, international financial reporting standards may be relied upon.

ii Anti-hybrid provision

Interest paid with respect to a loan granted by a related company is deductible only if the debtor proves that the interest is subject to corporate income tax at least equal to one-quarter of the French corporation tax that would have been due had the lender been established in France (i.e., 7 per cent for the first €500,000, and otherwise 8.3 or 8.6 per cent, depending upon the circumstances of the creditor).

iii Acquisition finance

Under two specific anti-abuse provisions – the aforementioned Carrez and Charasse amendments – interest expenses related to the acquisition of participations may be disallowed in certain circumstances.

iv Deduction of finance costs

Capitalised interest deduction

The French Tax Code provides for specific deductibility rules in respect of loans comprising capitalised interest. These rules apply to redemption premiums, and the French tax authorities consider that the redemption premium includes capitalised interest. As a general principle, capitalised interest is tax-deductible on a yearly basis as and when it accrues; however, under these specific rules, when the aggregate of capitalised interest over the duration of the loan exceeds 10 per cent of the nominal amount of the loan, the capitalised interest must be apportioned and deducted on a yield-to-maturity basis.

Convertible bonds are explicitly excluded from such specific rules and deduction is allowed on a cash basis only.

v General limitation of net financial charges

After applying all the above rules, the excess, if any, of the deductible amount of financial charges over the total amount of financial income of the company (or the group in French tax consolidation) is fully deductible if lower than €3 million per year. Where this threshold is passed, then 25 per cent of such net amount of financial charges is permanently disallowed.

Tax treatment of other financing costs

Corporation tax

To the extent that they are incurred in the interest of the French enterprise, fees relating to the financing of the entity or any of its transactions are deductible for corporate income tax purposes during the fiscal year in which they are incurred. However, further to a global decision, bank fees may be activated and then amortised over the duration of the loans (either in proportion to the interest accrued or on a straight-line basis).

VAT treatment

Most acquisition and financing costs (e.g., auditors' fees, lawyers' fees, certain banks' commissions such as arrangement fees, depending on the global election of the invoicing banks) are subject to VAT. Other fees, however – in particular the majority of bank commissions – are VAT-exempt (e.g., underwriting and commitment fees).

vi Restrictions on payments

Dividends

Under French corporate law, dividends are decided by shareholders at general meetings and may not exceed the total of all distributable profits and unrestricted reserves:

- a* distributable profits consist of the profits for the year, less prior-year losses and sums that the law or the articles request be reserved, plus the unallocated retained earnings; and

- b the unrestricted reserves include capital surpluses such as issuance premiums and accumulated profits, except for the legal reserve (in SA, SAS, SCA, SE and SARL), the revaluation reserve and, where applicable, any reserves whose distribution is prohibited by the articles.

A second restriction is that no distribution may be made to shareholders when the net equity is or would become lower than the sum of the share capital and restricted reserves. Any dividend paid in excess of the limits described above would be deemed fictitious, and would trigger both criminal sanctions against the corporate officers and the civil liability of the shareholders to repay dividends where they knew or could not ignore the irregular nature of the operation. Dividends are generally paid in cash, but may be paid *in specie* where the articles of the company so provide.

vii Return of capital and share buy-backs

Corporate law

To return capital to some or all of the shareholders, a corporation may decide on a reduction of the share capital. Such a decision must be made by an extraordinary general shareholders' meeting on the basis of a qualified majority and pursuant to a special report from the statutory auditors. It may be enforced only after creditors have been given 20 days in which to object to the reduction of capital following the filing of the decision's minutes with the commercial court. A return of capital commonly results from a share buy-back followed by the cancellation of the acquired shares. A share buy-back programme may be carried out by the board of directors or the management board within a limit of 10 per cent of the share capital.

Taxation

A fixed stamp duty applies to a reduction in share capital; where shares are bought back, no transfer tax applies. Any sums paid to the shareholders are deemed a distribution of dividends up to the total amount of the tax reserves and retained earnings, and a return of original capital only if and to the extent all reserves have been depleted. Share buy-backs are not deemed a distribution of dividends, but a sale of shares that accordingly generates capital gains or losses to the shareholder. This tax treatment was enforced by the Constitutional Court of France in a decision of 20 June 2014 that found that the previous disparity of tax treatments that depended upon the legal form of share buy-backs was unconstitutional. Rollover relief is available to individual shareholders where shares are bought back in exchange for other shares under a public offer; a participation exemption applies to qualifying corporate shareholders.

VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES

i Acquisition

Asset or share deal

Generally, the acquisition of a local business in France is organised as a sale of shares in the operating business (or any holding company owning it) rather than a sale of assets both for corporate, civil and administrative law reasons and for tax reasons. On the tax side, a sale of assets triggers a substantial proportional transfer tax on the value of equipment and intangible assets, and also, where applicable, on property. In contrast, a share deal triggers reduced

transfer taxes (see Section III.ii). For corporation tax purposes, an asset deal generally triggers the recognition of taxable gains and deductible losses, the cost of which may be acceptable to the vendor only where taxable gains may be sheltered with deductible losses from prior years or from other retained businesses. A share deal generates no corporate taxation in France for the acquired company and reduced capital gains tax for the vendor. Most tax attributes of the acquired company (including any losses carried over) survive the change of ownership. The major downside of a share deal for the acquirers is that this does not result in a stepped-up value for the corporate assets, and accordingly does not uplift the basis for depreciation or amortisation and future capital gains. Certain corporate reorganisations may overcome all or part of this encumbrance.

Acquisition vehicle

Generally, a foreign investor acquiring a French business by the means of a share (or an asset) deal would use a French entity in order to take advantage of the tax deduction in France of the acquisition costs and the financial expenses related to the acquisition. Even where the French business is only one part of a global transaction, the consideration for which consists of shares or other financial instruments issued by a foreign company, it is tax-effective in France to use a local entity to carry out a leveraged acquisition and become the top entity of a consolidated tax group. The decision must be made prior to the original acquisition in order to avoid the Charasse amendment mentioned above, and the acquired company must be controlled from France or a Member State of the EU or the European Economic Area with which France has a tax treaty with full exchange of information.

Consideration for sellers

When contemplating the acquisition of a business in France, an investor should also consider the tax impact of the transaction upon certain individuals, and especially vendors, and upon the business's personnel, and especially the management, to offer tax-attractive terms for the transaction. Where the vendor is a corporate shareholder, it is to be expected that the capital gains would be 88 per cent exempt under the participation exemption irrespective of whether the acquisition price is paid in cash, shares or assumption of liabilities. Certain share-for-share – or assets-for-share – reorganisations qualify for rollover relief. Where the vendors are natural persons residing in France, a 'flat tax' applies at the rate of 30 per cent, being the total of income tax at 12.8 per cent and social taxes at 17.2 per cent, except where a rollover relief applies on certain share-for-share exchanges.

The personal taxation of the personnel also needs to be considered, especially on employee shareholding, restricted shares and stock-option schemes, which are considerably less tax-favoured in France than they used to be.

ii Reorganisation

Tax-favoured reorganisations

French tax law provides for rollover relief and stamp duty exemption on a series of corporate reorganisations substantially reflecting the provisions of EU Directive 2009/133 of 19 October 2009, as amended. As a result, the amalgamation of an acquired business with an existing French business can be achieved without adverse French tax consequences. The

major restriction is that any existing losses within the disappearing companies cannot be transferred unless approved by a tax ruling to that effect. Tax-free reorganisations encompass the following:

- a statutory mergers, including an upstream merger between a parent company and its wholly owned subsidiary, which may be carried out either under the merger laws (and accordingly may have a retroactive effect up to the first day of the current fiscal year) or under a Civil Code provision named ‘dissolution without liquidation’, the effect of which is delayed until the end of an objection period open to creditors and may not have a retroactive effect;
- b split-up or *scission*, where the tax-favoured treatment is conditional upon administrative approval, unless the divided company had at least two business activities, with each of the surviving companies receiving at least one complete branch of activity and the shareholders of the divided company receiving a *pro rata* share of the surviving companies’ stock; and
- c spin-off or partial division, where assets representing a complete branch of activity may be transferred in exchange for new shares on a rollover basis. Such shares may be distributed to the shareholders of the transferring company without triggering distribution taxes, but rather on a rollover basis. This exemption is subject to an administrative ruling.

Certain exchanges of shares may not be immediately subject to capital gains tax, but may rather be taxed upon the subsequent sale of the shares received in exchange (on a rollover basis).

Cross-border reorganisations

The favourable tax regime applies in France where foreign companies are involved in the reorganisation, provided that all of them are established in countries that have entered into a treaty with full exchange of information with France. Where, as a result of the transaction, assets are transferred by a French company to a qualifying foreign company, the rollover relief is subject to the effective allocation of the transferred assets to a French permanent establishment of the foreign acquiring company. Together with its last corporation tax filing, the French disappearing company must file a special statement with the French administration describing the motivations and consequences of the transaction.

French companies may participate in triangular mergers on a tax-free basis in France. There are several examples where French companies have taken part in reverse triangular mergers, with the French acquiring company being the surviving entity in the transaction. Participation by French companies in forward triangular mergers is less common but not unknown. There are only very few precedents for triangular mergers in which a French public company is either the target or the disappearing company: the formation of EADS in 2000 was a notable exception. Despite the implementation of EU Merger Directive 2005/56/EC, to date there have been only a couple of French public companies completing an outbound cross-border merger. More commonly, French public companies may be acquired on a rollover basis in a cross-border transaction by means of a public exchange offer.

iii Exit

See Section IV.i regarding the conditions for and consequences of a transfer of the company’s head office.

IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

i General anti-avoidance

The French tax system contains both a very general anti-avoidance rule, commonly referred to as an abuse of the law, and a series of specific anti-avoidance rules, some of which cover certain cross-border situations or transactions.

General anti-avoidance rule or abuse of the law

A statutory provision enables the tax authorities to set aside any legal instrument or scheme that is either fictitious (a ‘sham’ transaction or corporate entity), or exclusively tax-driven and seeking to benefit from a literal construction of any applicable rule contrary to the objectives of the rule’s authors. This provision applies to any French tax, and covers any set of rules such as French laws and regulations or double taxation treaties. In the past, French tax courts held that this does not extend to administrative guidance that is binding upon the administration and the judge.

When abuse of law is declared, the avoided taxes may be reassessed with interest, and a proportional penalty of 80 per cent, or 40 per cent where the taxpayer was neither the main initiator nor the principal beneficiary of the scheme. All of the parties to the contract or the scheme are jointly liable with the taxpayer for the payment of the interest and penalties.

Specific anti-avoidance provisions

Among the many specific anti-avoidance provisions contained in French tax law, some specially cover outward situations such as transactions with low-tax jurisdictions that have not entered into an extensive exchange of information agreement with France.

Favourable tax provisions, such as the rollover relief of mergers and other corporate reorganisations, do not apply where non-French entities are concerned in the absence of an extensive exchange of information agreement.

Dissuasive or punitive measures apply in relation to transactions involving NCSTs. Also, payment for services made, or to a person established, in a low-tax jurisdiction (i.e., a jurisdiction where there is no income tax or where the tax is lower than one-half of French corporation tax). In such cases, the deduction is not allowed for corporation tax purposes (and a 30 per cent withholding tax grossed up to 30/70 applies on the related deemed dividend) unless the taxpayer demonstrates a *bona fide* commercial reason.

Special disclosure requirement

Although the French tax authorities and the parliament have considered introducing disclosure legislation in France on several occasions in the recent past, there is currently no general obligation for any type of transaction (other than asset holding by a foreign trust and certain tax-favoured overseas schemes) or uncertain tax position.

French legal privilege rules prevent the authorities from accessing any correspondence between any individual or entity and its attorney. Other privileges could have the same effect, and no precedent indicates that the French tax authorities have tried to examine statutory auditors’ working papers.

ii Controlled foreign corporations (CFCs)

France has extensive CFC rules that may apply to any type of income generated by any branch or entity, including a trust, established or organised in a low-tax jurisdiction (as defined above).

The positive income generated by such branch or entity is taxable for the French corporate taxpayer that owns the branch or a controlling interest in the entity unless there is a *bona fide* commercial purpose.

'Control' generally means directly or indirectly holding more than 50 per cent of the share capital, financial rights or voting rights of the entity. A 5 per cent stake, however, would be deemed part of joint control where more than 50 per cent of the low-tax entity is held by other French enterprises or by related enterprises.

A safe-harbour provision applies for enterprises or entities established or organised in an EU Member State provided this is not part of an artificial scheme aimed at circumventing French tax legislation.

Where the entity is established outside the EU, the CFC legislation would not apply only where the profits are generated by an industrial or commercial activity carried out locally.

Further tests apply if the CFC is an intermediate holding company within a group or renders intragroup services.

Where CFC rules apply, the positive income of the entity is subject to French corporation tax in proportion to the direct and indirect interest of the French corporate taxpayer in the entity. Foreign tax credit is allowed for corporation tax in the jurisdiction where the entity is established, and for withholding taxes on interest, dividends and royalties from treaty countries.

iii Transfer pricing

France applies transfer pricing rules largely in line with the practices adopted in other major industrial countries and EU Member States.

The legal basis for this is a very short and general statutory provision, and there are no detailed regulations or administrative guidelines and a limited but increasing number of case law precedents.

Documentary obligations have been increased over time, with penalties that may reach 5 per cent of the profits transferred abroad.

The French tax authorities may enter into advance pricing agreements with French corporate taxpayers either unilaterally, bilaterally or multilaterally with other jurisdictions. Approximately 10 to 20 advance pricing agreements are concluded each year.

In the event of reassessments of transfer pricing with treaty countries, the mutual agreement procedure may be enforced under the terms of the relevant treaty and may result in corresponding adjustments being made. At the end of 2016, 794 applications with 53 countries were outstanding; 238 procedures had been completed over the year. Most of them wholly or largely eliminated double taxation; less than 10 procedures failed entirely. An arbitration procedure is available within the EU and also under certain double taxation treaties, especially with the United States, but it has rarely applied.

iv Tax clearances and rulings

Several provisions of French law enable the tax authorities to deliver clearances and rulings that are binding both upon them and the tax courts. Some have a very general scope, but do not create an obligation for the authorities to take a position. Others are more specific

and fix a deadline, after the end of which the administrative decision is deemed favourable. This applies, *inter alia*, to requests from foreign enterprises about whether a permanent establishment exists or not in France.

Specific rulings are also available on the taxable basis of international headquarters or logistics centres based in France.

No specific procedure exists in relation to the acquisition of a local business by a foreign investor, and it is not common practice to seek any.

X YEAR IN REVIEW

2017 has been the year of major changes in the French legal and fiscal landscape. The package of measures includes the scaled reduction of the corporation tax rate and the abolishment of the 3 per cent surcharge on distributed amounts for corporates; the flat 30 per cent rate on financial income and capital gains realised and the end of the annual wealth tax on assets other than real property owned by individuals.

The tax environment for business investment remains affected both by domestic rules (e.g., restricted use of net operating losses, general limitation of deductible net financial expenses and conditional deduction of acquisition financial expenses) and by measures inspired by the OECD base erosion and profit shifting initiative and the anti-avoidance package of the European Union. Compliance requirements constantly increase.

XI OUTLOOK AND CONCLUSIONS

The French tax environment is heading in a new pro-business direction. Recent and anticipated tax cuts should bring France closer to the current average of European tax levels. However, owing to heavy budget and debt constraints, the French government still has not undertaken this attractive approach in taxation. Whether the undertaken reforms are bold enough to catch up with international tax competition among OECD countries is to be verified.

ABOUT THE AUTHORS

PHILIPPE DEROUIN

Philippe Derouin

Prior to reviving his own law firm, Philippe Derouin had been a partner with multinational law firms, namely Skadden, Arps, Slate, Meagher & Flom LLP, Linklaters LLP and Gide for 30 years. He has vast experience in business, civil, corporate, administrative and international law. He focuses on taxation, particularly in relation to mergers and acquisitions, corporate reorganisations, financial instruments, structured finance, and project and asset financing, both domestic and international.

Mr Derouin is also active in litigation, including assisting in tax audits and litigation before courts in France and Monaco, the Court of Justice of the European Union and the European Court of Human Rights, especially in important tax cases relating to domestic and international tax issues (transfer pricing, double taxation treaties, European law). He gives expert advice in foreign tax credit cases before the US courts and other tax matters in international investment arbitration. He also handles contract and civil liability cases relating to taxation.

He is consistently ranked among the leading professionals in his field. A member of the Paris Bar for more than 40 years, he chaired the French branch of the International Fiscal Association in 2016–2017.

PHILIPPE DEROUIN

140, rue du Faubourg Saint Honoré

75008 Paris

France

Tel: +33 1 42 25 88 91

Fax: +33 1 42 25 88 44

philippe.derouin@cabinet-derouin.com

www.philippe-derouin.com

Law
Business
Research

ISBN 978-1-912228-09-6