Part Two: Country Surveys

Chapter 8: France

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8.1. General

8.1.1. Partnerships are half-transparent

Partnerships are at best described as half-transparent (*semi-transparent*) in the French income tax system.[1] Under article 8 of the general tax code (*Code général des impôts*, CGI), partnerships are liable neither to income tax nor to corporation tax[2] and the partners are deemed to personally realize their share of the partnership's profits and losses,[3] which they must report as part of their overall taxable income. However, under the French system, partnerships are not disregarded: they have accounting and filing obligations,[4] and audit procedures are carried on with the partnerships[5] even though the tax consequences are drawn with each partner separately. Transactions between the partnership and the partners are generally respected and trigger income taxation as if they would have been entered into with third (although related) parties. The disposal of shares or interest in a partnership is treated as the transfer of shares, not as a transfer of a portion of the partnership assets. The economic double taxation of a gain (or deduction of a loss) is avoided by an adjustment to the tax basis of the partners' interest equal to the net amount of undistributed tax profits and non-financed tax losses.

8.1.2. Case law and controversy

The principles summarized above mainly result from case law that has developed over the last 90 years, as very few legislative provisions address French income taxation of partnerships. Even the fundamental article 8 of the CGI is a mere codification of the case law that prevailed before the Second World War with respect to the general income tax.[6] Each major development of the case law on partnership taxation generated successive flows of controversy where the most extreme arguments have been put forward. According to one thesis, which this author favours, partnerships should essentially be regarded as flow-through entities under French tax law like in most other tax legislations, subject to certain common features determined at the aggregate level of the partnership.[7] According to the other main thesis which defends a "French exception" and is expressed as a French reservation to the 1999 OECD Partnership Report, partnerships should be regarded as tax subjects, to be distinguished from their partners,[8] and held as "residents" for international taxation purposes. This controversy resulted in, inter alia, conflicting private letter rulings on the application of double tax treaties to French partners in certain foreign (e.g. US vs UK) partnerships.[9]

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1. M. Cozian, *Images fiscales: transparence, semi-transparence, translucidité et opacité des sociétés*, LPA (*Petite affiches*), p. 5 (24 Jan. 1996); G. Carrez, Report on Finance bill (Amendment 2010 – Doc. AN no. 2998 t. 1 at art. 12); J. Boucher, opinion on *Conseil d'Etat* (CE), 28 Mar. 2012, no. 320570, *Vaillant*, BDCF 6/12, no. 77.
2. FR: CE, 11 July 1979, no. 2087, Dr. fisc. 1980, no. 1, comm. 4, opinion P. Lobry; FR: CE, plén. fisc., 27 July 1984, no. 37857, Dr. fisc. 1984, nos. 45-46, comm. 1942, opinion P.-F. Racine.
3. FR: CE, 28 Mar. 2012, *Vaillant*; RJF 6/12, no. 616, opinion J. Boucher, BDCF 6/12, no. 77.
4. Art. 60 CGI.
5. Art. L 53 French tax procedures code.
6. FR: CE, 5 Feb. 1925, Rec CE, p. 120, Rev. Impôts 1925, art. 1552, p. 135; and other similar precedents mentioned in Dr. fiscal, 1997, no. 50, p. 1443.
7. Ph. Derouin, *La transparence fiscale des sociétés de personnes ou faut-il dissuader les étrangers de participer à des sociétés de personnes françaises?*, Dr. fisc. 1997, no. 50, p. 1443 and no. 51, p. 1484; G. Gest, *Subsidiarité des conventions, fictions fiscales et associés non-résidents des sociétés de personnes françaises*, Dr. fisc. 2013, no. 24, comm. 32.
8. B. Gouthière, *Les impôts dans les affaires internationales, chapter 12 Les sociétés de personnes* (9th ed. 2012).
9. Cf. *rescrit* 2007-28 of 7 Aug. 2007 with private letter 122 CAB CR of 12 Oct. 2007, later reversed by *rescrit* no. 2012/35 of 22 May 2012.

8.1.3. Recent evolution

On outbound flows of passive income subject to withholding tax in France, the flow-through character of foreign partnership has been recognized in two steps. The *Conseil d'État* issued a leading decision[10] shortly after the 1999 OECD Partnership Report; the tax authorities issued comprehensive guidelines a few years later.[11]

With a view to further aligning the French system with the prevailing international analysis and withdrawing or reducing the scope of the French reservations on the 1999 OECD Partnership Report, the government endeavoured to codify and marginally amend the existing rules and principles. In the consultation process, the French branch of the International Fiscal Association made its suggestions and comments towards limited legislative changes.[12] Conflicting views within the French tax legislative department resulted in a more sophisticated bill,[13] which the parliament found so complex that it refused to examine it.[14]

No new legislative proposal has been brought forward since then and none is to be expected in the foreseeable future. The recent developments are limited to certain tax court solutions on several partnership issues, including in relation to double taxation treaties.[15]

The quasi-theological dispute as to whether a partnership is a "tax subject" that can be deemed a "resident" under the OECD Model subsists and is occasionally reflected in the motivation of certain court rulings. Fortunately it seldom influences the practical solutions that are generally accepted, save where the "French exception" occasionally results in surprising solutions,[16] generally unfavourable to French or foreign partners in French partnerships.[17]

8.2. Domestic law

French tax law provides no definition of a partnership to be treated as half-transparent for tax purposes. Article 8 et seq. of the general tax code contains a list of entities that are treated as partnerships for French income tax purposes; several other provisions supplement that list. The most important entities, in number or economic significance, are the following:

(1) "*Société civile*" or civil partnership, the basic and generic form of partnership under the French civil code, provided it carries on no commercial activity, other than property development.[18] *Société civiles* are commonly used in real estate investment, professional activities, asset holding etc.

(2) "*Société en nom collectif*" or general partnership.

(3) "*Société en participation*" or silent partnership, an unregistered general partnership, including financial syndicates, provided the partners' names and addresses are disclosed to the tax administration.[19] A well-known example of a *société en participation* in an international context is the *société en participation* between the two concessionaire companies of the Channel Tunnel, referred to in the France-UK DTT.[20]

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10. FG: CE, 13 Oct. 1999, no. 191191, *SA Diebold Courtage*, Bull. Joly 1/00, §10, p. 54, opinion G. Bachelier, note Ph. Derouin.
11. Inst. 29 Mar. 2007 4 H-5-07 now *Bofip*.
12. Ph. Derouin, *La tranparence fiscale des sociétés de personnes personnes ou la fin programmée du sac d'embrouilles*, in *Ecrits de fiscalité des entreprises: Etudes à la mémoire du professeur Maurice Cozian* (*Mélanges Cozian*) pp. 355-374 (Litec 2009).
13. Art. 12 Finance bill (Amendment) 2010.
14. G. Carrez, *supra* n. 1 and amendment CF 105.
15. FR: CE, 11 July 2011, no. 317024, *Quality Invest*, Dr. fisc. 2011, no. 36, comm. 496, opinion L. Olléon, note Ph. Derouin.
16. FR: CE, 18 May 2009, no. 301763, *SAS Établissements Chevannes Merceron Ballery*, Dr. fisc. 2009, no. 40, comm. 491, note B. Delaunay, where the *Conseil d'Etat* held that fishing in the high seas of the Indian Ocean was an activity carried on in France.
17. A.S. Courtel, French national report on «qualification of taxable entities and treaty protection», Subject 2 of 68th IFA congress in Mumbaï, cahiers vol. 99 b, p. 335 and foll.
18. Art. 239 *ter* CGI.
19. Failing full disclosure, the deduction of partnership losses from the partners income is disallowed (FR: CE, 21 Apr. 2000, no. 179092, *Gervais Danone*, Dr. fisc. 2001, no. 5, comm. 58, opinion G. Goulard).
20. Art. 9(3) UK-France DTT.

(4) "*Société de fait*" or "*sociétés créées de fait*",[21] or deemed partnerships, where the essential elements of a partnership are combined although the parties did not express the intention to create a partnership.[22]

(5) Certain limited liabilities entities with a single individual shareholder.

(6) Certain groupings, such as Economic Interest Groupings (*Groupement d'intérêt économique*, GIE or French EIG),[23] European Economic Interest Groupings (EEIGs),[24] public interest groupings[25] and certain agricultural groupings. Airbus Industries was originally created as a GIE and remained under this form for many years before being converted into an SA. Economic interest groupings were also commonly used in asset financing structures and nicknamed "*GIE fiscaux*" or "tax EIG" until the EU Commission criticized the embedded State aid and the French tax law was changed to reduce certain tax benefits.[26]

(7) Certain special forms of joint ownerships, excluding the "*indivision*".

(8) The French equivalent of limited liability partnerships for lawyers.[27]

Certain companies or corporations may elect to be treated as partnerships:

- SARLs or limited liability companies the members of which are exclusively close relatives;[28] and
- certain newly created SAs, SASs or SARLs with mainly individual partners, in order to enable them to deduct start-up losses from their taxable income.[29]

A limited partnership or "*société en commandite simple*" has a split tax status: general partners are treated as if they were partners in a general partnership but the profits attributable to the limited partners are liable to corporation tax and further liable to dividend taxation upon distribution. Accordingly, they are much less common in France than in other jurisdictions.

8.2.1. Legal aspects

Except for the deemed partnerships (*société de fait* or *société créée de fait*), partners generally enter into a partnership agreement, which may be either very simple or more sophisticated. The key documents for partnerships are their "*statuts*" (articles of association), which address (i) the powers granted to the manager(s) (*gérant*), (ii) the duration, (iii) the sharing of profits and (iv) a system for dispute resolution.

Except for both the silent or unregistered partnership (*société en participation*) and the deemed partnerships (*société de fait* or *société créée de fait*) which are not legal entities, all the above entities must be registered with the register of commerce and companies, as a result of which they enjoy full legal capacity.

Organization and operation of these entities are fairly simple. There are no legal requirements as to a minimum level of capital.

The main disadvantages of such structures are:

(1) Except for the shareholders of an SARL, SA or SAS, which may elect for partnership treatment, partners have unlimited liability for partnership debts. In the *société civile*, this unlimited liability is not joint and several but equals the "*prorata*" of each partner's contribution to capital. On the contrary, in the *société en nom collectif*,

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21. Art. 238 *bis* L CGI.
22. FR: *Cour administrative d'appel de Paris* (CAA Paris), 10 Apr. 2008, no. 06-2638, *Sefrioui*, RJF 12/08, no. 1379.
23. Art. 239 *quater* CGI.
24. Art. 239 *quater* C CGI.
25. Art. 239 *quater* B CGI.
26. Art. 39 C II CGI.
27. Art. 238 *bis* LA CGI.
28. Art. 239 *bis* AA CGI.
29. Art. 239 *bis* AB CGI.

société en participation and *société de fait* or *société créée de fait* with a commercial activity, as well as in GIEs, EEIGs, etc., partners are jointly and severally liable.

(2) Transfers of shares normally require the prior consent of all partners.

(3) Except in an SA or SAS, transfers of shares are subject to a 3% registration duty on the part of the sale price or value that exceeds an amount equal to EUR 23,000 multiplied by the percentage of the share capital transferred. As an exception, registration tax is due at the rate of 5%, uncapped and without any rebate, when the transferred shares are shares in an unlisted real estate company. The 5% duty is also applied on a broader basis, as it is assessed on the value of the assets under the sole deduction of the debts having financed the acquisition of the real estate property.[30]

The main uses of these structures are:

(1) A *société civile* is generally chosen as a vehicle for joint ventures in non-commercial activities and real estate activities (real estate investment, portfolio management, certain professional activities, etc.). Most of the tax treaty cases reported below relate to the taxation of foreign partners in French "*sociétés civiles immobilières*" or SCIs, i.e. civil partnerships investing in real estate.[31]

(2) A *société en nom collectif* is chosen for commercial activities when there is a limited number of partners who accept the joint and several liability and want to benefit from the half-tax transparency without meeting the conditions for tax consolidation.

(3) A *société en participation* is mostly used when one or several partners do not want to disclose either their participation in or the organization and governance of the joint venture.

(4) A *société créée de fait* is not generally intended to be a partnership but effectively displays the essential elements of a partnership.

(5) Groupings such as GIEs the purpose of which is restricted to developing the activities of its members or EEIGs, members of which must be European entities, but can include European subsidiaries from a non-European group.

(6) "*Sociétés en commandite simple*" (SCSs, limited partnerships). There are two types of partners in an SCS: one or more general partners (*associés commandités*) who are indefinitely, jointly and severally liable for the debts of the company and one or more limited partners (*associés commanditaires*) whose liability is limited to their contributions. Unless the articles of association provide otherwise, all general partners are managers of the company (*gérants*). However, the articles of association may provide for the SCS to be managed by one or more managers appointed among general partners or third parties. The limited partners must not interfere with the management of the company.

8.2.2. Tax subject: A combination of the pass-through approach and the entity approach

Like many other tax systems, although to a different extent, the French tax regime of partnership combines a look-through approach and a certain personality of the partnership.

French partnerships are not liable to either income tax or corporation tax on their income that is allocated to their partners, who in turn include their share of partnership profit in their taxable income. Losses made by a partnership may be deducted by the partners from their taxable income. Profits from a partnership may be sheltered by each partner's losses. Apparently, French partnerships would be similar to many other look-through entities and should not be regarded as a tax subject for income taxation.

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30. Art. 726 CGI.
31. FR: CE, 9 Feb. 2000, no. 178389, *Hubertus AG*, dr. fisc. 2000, no. 15, comm. 303, opinion J. Arrighi de Casanova, Bull. Joly 4/00, § 81, p. 402, note Ph. Derouin; FR: CE, 11 July 2011, no. 317024, *Quality Invest*; FR: CE, 13 Feb. 2013, no. 342085, *Barlow*.

However, French tax authorities and courts state as principles that entities governed by article 8 of the CGI are persons to be distinguished from their members ("*ont une personnalité distincte de celle de leurs membres*") and they carry on – or are deemed to carry on – their own activities,[32] although in many situations partnerships are a means to carry on a business or profession in common or to pool the results of their members' activities.

From these principles or assumptions it is sometimes assumed that such entities are tax subjects.

8.2.2.1. Determination of partnership income

Transactions between the entity and any of its members are recognized and taxed as such. When a member contributes an asset (in exchange for an interest in the partnership) or sells a good or performs a service to the partnership for a price or another consideration, a gain, profit or loss is recognized and included in the individual taxable basis of the relevant partner. Conversely, the price paid or owed by the partnership to its partner in consideration for the asset, good or service provided by him is deductible (or amortizable) from the partnership's income. It is not uncommon for partners in a French partnership to lend money or lease an asset to the partnership. Interests on the loan or lease payment are recognized for tax purposes; they are not deemed a supplementary allocation of partnership income. The only major exceptions relate to employment income of an individual partner (which is not deductible) or his spouse or tax-recognized companion (which is deductible only up to a very low amount).

Similarly, where the partnership transfers an asset or delivers a service to a partner, the price or fair market value, whichever is higher, is an element of the partnership income and could be deductible expense for the acquiring partner.

Where a partnership is the vehicle under which individual partners or some of them carry on their business or profession, their interest in the partnership is a professional asset.[33] Accordingly, the acquisition costs of such interest, and the cost of acquisition financing, incurred by each individual partner are deductible from the professional partner's income, i.e. his share of partnership income even though those costs are not borne by the partnership or shared with the other partners. A similar solution applies to certain professional expenses, such as partners' social security contributions and other costs, borne by each partner instead of being mutualized among the partners while being recorded as professional expenses of the partnership. All these costs and expenses are reported in the partnership's tax return with the allocation of net income of the partnership to each partner.

Each individual or corporate partner reports its net share of partnership income as a single amount in its own income or corporation tax returns and does not file a special tax return for its share of profits in the partnership.

8.2.2.2. Partners' taxation

Partners' shares in profit and losses of partnerships are aggregated into their net taxable income. Net losses of each partner may be brought forward or carried back, including where they derive from various partnerships.[34]

8.2.2.3. Accounting and tax obligations – Audit procedures

Accounting and tax filing obligations bear on the partnership.[35] As a result, it was held that a reserve for litigation risk must be booked and reported by the partnership in order to enable the partners to deduct their portion of reserve from their taxable basis and only a reserve booked by a taxable partner would be disallowed.[36]

A French partnership does not file a single tax return but as many tax returns as it has different tax categories of partners, namely:

- individual resident persons;

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32. FR: CE, 18 May 2009, no. 301763, *SAS Établissements Chevannes Merceron Ballery*; id., *Quality Invest*; *Barlow*.
33. Art. 151 *nonies* CGI.
34. CAA Paris, 30 Dec. 1997, no. 94-686, *Marshall Cavendish International*, RJF 3/98, no. 246, opinion M. Martel, p. 155.
35. Art. 60 CGI.
36. FR: CE, 5 Sept. 2008, no. 286393, *SNC Viver Promotion*, RJF 12/08, no. 1344, opinion E. Glaser in BDCF 12/08, no. 152. The court ruling does not explain how a *société en participation* could be a party to a civil litigation when it has no legal personality.

- business individuals or corporations or other entities liable to corporation tax in France (even if only on their share of partnership income);
- non-resident partners (occasionally with a further distinction between non-resident individuals and non-resident entities); and
- tax-exempt institutions.

Generally, each partner must also file a tax return reporting his share of partnership income as part of his overall taxable income. As a result, non-resident partners in a French partnership carrying on activities in France must file the usual income or corporation tax returns in France, even where such returns report a single entry, namely the share in the partnership's income of the year.[37]

The tax audit procedure is carried out with the partnership (article L 53 of the tax procedure code) and is an integral part of the tax procedure that ends with the taxation of each partner.[38] The partnership's manager has the power to answer questions and to discuss reassessments notified to the partnership, but it has no power to challenge them;[39] only the partners are entitled to challenge their ensuing taxation.

Accordingly, even in compliance and procedural matters, the tax personality of French partnerships is more uncertain that it would have seemed.

8.2.2.4. Gains or losses made upon the disposal of a partnership interest

Pointing toward the personality of the partnership, French tax law does not treat a partnership interest as a share in the assets and liabilities of the partnership but rather as an element of intangible property like any other share in a company or corporation.

However, because the partners include their share of partnership profits in their taxable income, irrespective of whether or not these profits are distributed, French tax courts have consistently held that the tax basis for the partnership interest must be adjusted by an amount equal to the net sum of undistributed profits and uncovered losses of the partnership attributed to the partner.[40]

French courts also hold that no depreciation of a partner's interest in, or debt on, a partnership may be deducted for French income tax purposes, at least to the extent that depreciation corresponds to past or future losses of the partnership.[41]

Here again, we find a combination of the look-through approach and the distinct personality of the partnership.

8.2.2.5. Tax exemptions in a partnership context

Exemptions generally apply on a flow-through basis. Partners may enjoy personal exemptions on the sale of real estate by a partnership.[42] They may also enjoy exemptions that apply to the activity carried on by the partnership.[43] The only notable exception relates to the exemption of agricultural cooperatives that was denied on their share of profits in a GIE[44] but the solution is probably superseded.

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37. FR: CE, *Quality Invest*.
38. FR: CE Ass., 22 July 1977, no. 384, Dr. fisc. 1978, no. 8, comm. 287, opinion B. Martin-Laprade; FR: CE Section, 8 Apr. 1994, no. 60405, *Touchais*, RJF 5/94, no. 679, p. 345, opinion F. Loloum p. 299.
39. FR: CE, 22 Jan. 1982, no. 21980, Dr. fisc. 1982, no. 19, comm. 1054; FR: CAA Paris, 5 Dec. 1996, no. 952684, *SCI Jan*, Bull. Joly 1997, p. 363, note M. Turon.
40. FR: CE, 16 Feb. 2000, no. 133926, *Ets Quémener*, RJF 3/00, no. 334, p. 223, opinion G. Bachelier, p. 203, Bull. Joly 5/00, § 117, p. 535, note Ph. Derouin; 9 Mar. 2005, no. 248825, *Baradé*, RJF 6/05, no. 564, opinion P. Collin, BDCF 6/05, no. 75.
41. FR: CE, 1 Apr. 2005, no. 254319, *SA Martell et Cie*, RJF 7/05, no. 669, opinion S. Verclytte, BDCF 7/05, no. 87.
42. FR: CE, 17 May 1989, no. 62678, *Rousset*, Dr. fisc. 1989, no. 46-47, comm. 2162, opinion. M. Liebert-Champagne.
43. Instr. 6 June 2007.
44. FR: CE, 27 Apr. 1994, no. 79604, *Fédération départementale des producteurs en lait, beurre et fromages fermiers du Nord*, Dr. fisc. 1994, no. 29, comm. 1390, opinion J. Arrighi de Casanova.

Strangely enough, the major exemptions where the flow-through approach of partnerships is denied relate to intra-group financial flows and result in two situations of economic double taxation, even in a domestic context: (i) a dividend-received deduction has traditionally been denied with respect to qualifying shareholdings held by a French corporation through a partnership being either a French GIE[45] or a foreign partnership[46] and (ii) thin capitalization rules apply to partnerships with corporate partners who are also partnership lenders, i.e. interests are taxed to the corporate partner/lender while interest deduction may be denied or delayed in the partnership.

8.2.2.6. Partnerships as paying agents on passive income

As far as passive income is concerned, the French system is more straightforward. Both for purposes of the EU Savings Directive and reporting and withholding under French domestic law, partnerships are mere paying agents. As a result, they are deemed to pay to their partners the interest, dividend, capital gains on real estate and other passive income at the same time they receive them.[47] Where a partnership only owns a portfolio of securities or receivables, it is not required to file any income tax return and may file only paying-agent statements.

8.2.3. Taxation of foreign partners in French partnerships

8.2.3.1. French-source income

Foreign partners – like domestic partners – are liable to income or corporation tax on their share of income or profit in the partnership as if they would have realized it themselves.

Business profits attributable to the activity of the partnership in France are taxable at standard income and corporation tax rates. The "branch tax" should not apply to foreign corporate partners.[48] Where a reduced rate applies to long-term capital gains – or royalties from patent and agricultural specialty – it applies equally to both domestic and foreign partners.[49] Net losses arising from the operations of French partnerships may be brought forward or carried back by foreign corporate partners under the same rules as apply to French corporations.[50]

Dividend, interest, real estate income and capital gains and other passive income from French sources are taxed, by way of withholding tax where applicable, to foreign partners in the same manners and at the same rates as if they would have been realized directly by them. No withholding tax applies on interest or portfolio capital gains under French domestic law (except at the deterring rate of 75% where paid to a black-listed non-cooperative state or territory).

Foreign tax-exempt partners should benefit from the same exemptions as would apply to similar French tax-exempt partners.

8.2.3.2. Foreign-source income (triangular situations)

Business profits from foreign sources should not be taxable to foreign partners even though they would be realized through a French partnership. Where corporate partners are involved, this is a result of the French territorial scope of corporation tax, even towards domestic corporate partners.[51] There is no law on the same point for foreign individual partners, but the practice seems well established with multinational partnerships organized under French law that have their main office in France and other offices and partners in various other jurisdictions. French resident partners are liable to income tax on their share of worldwide income of the partnership. Non-resident partners are liable to income tax in France on the partnership business or professional income from French sources only.

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45. FR: CE, 19 Oct. 1983, no. 33816, RJF 12/83, no. 1506, opinion J.F. Verny.
46. FR: CAA Versailles, 16 July 2012, no. 10 VE02621, *SA Artemis*.
47. Art. 244 *bis* A-2(c) CGI; arts. 75 and 79-4, annex II CGI; art. 41 *duodecies* G, annex III CGI; art. 4(2) EU Savings Directive and related international agreements.
48. BOI 4 H-1-03 now Bofip BOI-RPPM-RCM-30-30-30-10 no. 90.
49. FR: CE, 4 Apr. 1997, no. 144 211, *Kingroup*, RJF 5/97, no. 424, opinion F. Loloum, p. 298, Dr. fisc. 1997, no. 50, p. 1443, and no. 51 p. 1484.
50. FR: CAA Paris, *Marshall Cavendish International*.
51. FR: CE, 29 Mar. 1979, no. 4883, Dr. fisc. 1979, no. 8, comm. 346, opinion P. Rivière; 27 June 2008, no. 282910, *Progemo*, RJF 11/08, no. 1166, opinion L. Olléon, BDCF 11/08, no. 128.

The only controversial point relates to the taxation of foreign partners' share in the passive income from foreign sources flowing through a French partnership. Normally, no French taxation should apply provided the foreign partner does not hold its partnership interest through a PE in France. The French partnership would not normally be deemed a PE of the foreign partner and would be a mere paying agent. A French court decided differently more than 20 years ago[52] but this isolated ruling was highly questionable. The current legislative and regulatory environment would segregate passive income flowing through a partnership from business income of the partnership.[53]

The foreign partner should have no tax exposure in France on passive income from foreign sources of the partnership, except where the perception of passive income results from carrying on a business through a PE in France of the partnership, in which case the business profit allocation rule should apply.

8.2.4. Taxation of foreign partnerships

French legal and tax systems can be described as open and apply to foreign entities and institutions much in the same way as they apply to similar or equivalent French entities and institutions, unless a special statutory provision applies to foreign entities and institutions, which is very rarely the case.

As indicated by a learned member of the *Conseil d'Etat*:

> [W]hen confronted with a foreign entity that might be liable to tax in France, the tax judges identify which category of French taxable entity corresponds best to the foreign entity. French and foreign concepts being often different, judges proceed by approximation. To take a phrase from the OECD report, the judge may have to "force" a foreign entity into a French category. In this process, the judge also considers the foreign tax status of the entity.[54]

Where inbound interest, dividends and profits are concerned, article 120-2° of the CGI contains a non-limitative list of foreign entities regarded as partnerships, including general partnerships and the proceeds of limited partnerships benefiting general partners. The French tax authorities have indicated that certain foreign entities carrying on non-commercial professional activities can be deemed equivalent to French "*sociétés civiles*".[55] Such is the case of UK and US limited liability partnerships.[56]

On outbound income such as royalties, the *Conseil d'Etat* held that a Dutch CV was a flow-through entity after considering both civil and tax laws of the Netherlands, even though under French law the portion of profits attributed to the limited partners of a French s*ociété en commandite simple* would be liable to corporation tax. A court of appeals held that a US LLC should be deemed a partnership.[57]

Another court of appeals held that a Spanish *sociedad limitada unipersonal* (SLU), an entity comparable to a single member LLC, of which the single shareholder was a French resident, should be deemed a partnership and the French resident partner held liable to tax on business income generated by the SLU in France.[58]

UK partnerships are also deemed partnerships and more especially silent partnerships or the equivalent of a *société en participation*. Their foreign resident partners are liable to income tax in France on the profits generated by the PE of the partnership in France.[59]

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52. FR: CAA Paris, 19 Nov. 1992, no. 89-2733 *SA Rinsoz & Ormond*, Dr. fisc. 1994, no. 48, comm. 2017.
53. New art. 155 A CGI, as amended by Finance (Amendment) Act 2010.
54. O. Fouquet, *Sociétés étrangères transparentes et droit fiscal français*, Revue administrative 315, p. 264 (1999).
55. Rép. min. Montillot JOAN, 18 Jan. 1950, p. 305, Rev. Enreg. 1950, art. 12574, §191; Doc. Adm. de base 5 I 21 nos. 6 and 5, G 231 no. 6; Instr. 29 Mar. 2007, BOI 4 H-5-07; *Rescrit* 7 Aug. 2007, no. 2007/28 FP.
56. *Rescrit* no. 2007/28FP of 7 Aug. 2007; *Rescrit* no. 2012/35 of 22 May 2012.
57. FR: CAA Douai, 12 May 2011, no. 09DA01666, *Bonjonnier*, RJF 10/11, no. 1064.
58. FR: CAA Nantes, 28 June 2010, no. 09-653, *Guyot*, RJF 12/10, no. 1195.
59. FR: TA Paris, 27 Nov. 2008, no. 02-3419, *Neusinger*, RJF 8-9/09, opinion D. Perfettini, BDCF 8-9/09, no. 106.

The *Conseil d'Etat* also held that a deemed partnership (*société de fait*) resulted from a contractual agreement between French and Swiss stylists to exercise their profession in common and named by their initials. As a consequence, the Swiss partner was taxable in France on her share of the deemed partnership profits generated in her partner's studio in France.[60]

Where a tax audit is conducted with a foreign partnership, such as a US LLC, article L 53 of the tax procedure code applies with respect to its income from French sources.[61] Accordingly, the audit procedure is carried out with the partnership before the tax is assessed on each partner.

8.3. Tax treaty issues

France is probably one of the few (if not unique) jurisdictions that combines the following positions:

(1) French partnerships (i.e. partnerships organized under French law) are considered as French residents even though French partnerships are not liable to tax under French domestic law and French and foreign partners are taxable on their share of partnership income. French tax authorities and courts accordingly deny treaty benefits on French-source income to foreign partners even when they are residents in a treaty country.[62]

(2) Foreign partnerships are considered as flow-through entities when they are not liable to tax in their country of organization. Treaty benefits apply to foreign partners who are liable to tax in their country of residence, according to the treaty with the residence country of the partner. In order to do so, French tax authorities require a full exchange of information with both the residence country of the partners and the country where the foreign partnership is established.[63]

(3) France applies the relevant method for relieving double taxation on partnership income from foreign sources to partners residing in France according to the double taxation treaty in force between France and the source countries, disregarding whether the partnership is organized in France or in another country, provided there is a full exchange of information with that other country.[64]

As a result, France has made considerable progress since the reservations it made on the 1999 OECD Partnership Report, especially to the extent that foreign partnerships and outbound passive income are concerned. The situation is less satisfactory with respect to French partnerships with foreign partners.

8.3.1. Treaty entitlement

Under the current position of the French tax authorities and courts, an essential distinction must be made between French and foreign partnerships.

8.3.1.1. French partnerships and foreign partners

For treaty purposes, French tax authorities and courts would always regard French partnership as "liable to tax" in France and accordingly a "resident of France" for the purposes of the OECD Model and any double taxation treaty following this model.[65] This position is all the more unusual since, (i) for domestic purposes, partnerships are not liable to either income or corporation tax as described above (*see* sections 8.1.2. and 8.2.2.) and (ii) French courts tend to read the "subject-to-tax" or 'liable to tax" clauses in double taxation treaties much in line with international common law and article 31 of the Vienna Convention on the Law of Treaties, namely "with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose". As a result, "subject to tax" in the definition of resident in the UK-France treaty was construed as "potentially taxable" and withholding tax reduction was

60. FR: CE, 1 Oct. 2001, no. 214 463, *Anne de Solages*, RJF 12/01, no. 1588, opinion F. Seners, BDCF 12/01, no. 157.
61. FR: CAA Douai, *Bonjonnier*.
62. FR: CE, *Quality Invest; Barlow*.
63. Instr. 29 Mar. 2007, 4 H-5-07.
64. Instr. 29 July 2011, BOI 14 B-1-11.
65. FR: CE, *Quality Invest*; *Barlow*; CAA Paris, *Sefrioui*.

given to a non-domiciled resident in the United Kingdom on non-remitted income from French sources while "liable to tax" was construed as "effectively taxable" for the purposes of paying the defunct "*avoir fiscal*".[66]

Where special clauses in a double taxation treaty expressly deal with partnerships, French tax authorities and courts would construe them restrictively and unilaterally towards French partnerships:

(1) Article 7(8) of the France-Switzerland treaty was applied to justify the taxation of a property gain made by an SCI in France on the basis of the place of management being a PE in France.[67]

(2) More recently, all the special clauses in the successive versions of the US-France tax treaty of 31 August 1994, successively amended on 8 December 2004 and 13 January 2009, were found not to apply to French partnerships on the grounds that they were not flow-through entities.[68]

As a result of the above positions, French-source income realized by a French partnership would be deemed a purely domestic matter and foreign partners would be denied any entitlement to treaty benefits.[69]

8.3.1.2. Foreign partnerships

A foreign partnership that is not liable to income or corporation tax in the country where it is registered and has its head office would not be regarded as a resident of that country for the purposes of treaty benefits.[70]

Treaty benefits would apply to members or partners residing in the same country.[71]

More generally, the French tax authorities would look through foreign partnerships provided:

- the foreign partnership is located in a country with full exchange of information with France;
- the partners are resident of France or of a country with full exchange of information;
- French-source income flowing through the foreign partnership is deemed income of the partners both in the country of the partnership and in the residence country(ies) of the partners; and
- there is only one tier of partnerships,[72] although the French tax authorities have been prepared to review multiple-tier partnerships.[73]

8.3.2. France as State of Residence of the partners

Generally, France would grant double taxation relief to French-resident partners on foreign-source income from treaty countries flowing through French or foreign partnerships. No double taxation relief is applicable where the income is sourced outside a treaty country but foreign tax is deductible from the tax basis.

8.3.3. France as the State of Source

8.3.3.1. French partnerships

Where both the partnerships and the source of income are located in France, the situation would be regarded as purely domestic and no treaty relief would apply in France on either real property income or gains or business profits.

Treaty relief would apply on passive investment income from French sources flowing through a French partnership.

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66. FR: CE, 27 July 2012, no. 337656, *Regazzacci*, Dr. fisc. 2012/41, comm. 474.
67. FR: CE, *Hubertus AG*.
68. FR: CE, *Barlow*.
69. FR: CE, *Quality Invest*; id., *Barlow*.
70. FR: CE, *SA Diebold Courtage*.
71. Id. and Fouquet, relating to Dutch corporate partners of a Dutch CV; FR: TA Cergy-Pontoise, 3 July 2009, no. 07-5090, *Caceis Bank*, relating to Dutch individual beneficiaries of a Dutch foundation.
72. *Bofip.impôts* BOI-INT-DG-20-20-30 no. 130, 12 Sept. 2012.
73. Instr. 29 Mar. 2007, 4 H-5-07, no. 16 not reproduced in *Bofip.impôts*.

Where the partnership is located in France, foreign-source income would not be taxable in France to the extent that it corresponds to the share of foreign partners. Depending upon the type of income or capital gain, the situation would be considered at year-end or at each taxable event.

8.3.3.2. Foreign partnerships

Where a foreign partnership earns income from French sources: (i) French-resident partners are taxable in France on their worldwide income, including their share of income in the foreign partnership, subject to double taxation relief on income from foreign sources flowing from treaty countries and (ii) foreign partners would be liable to non-resident taxation, if any, on their share of partnership income from French sources. Subject to the conditions mentioned under section 8.3.1.2., treaty benefits would be available in France.

8.3.4. Triangular cases

Where France is the State of Source of income that flows through a foreign partnership in another country to a partner resident in a third country, treaty benefits may be available in France as mentioned under section 8.3.1.2.

Where France is the country where the partnership is organized while the income flows from another country and at least certain partners are not resident of France, then the French partnership would act as a mere paying agent and there should be no tax exposure in France for the foreign partners on their share of foreign-source income.

Lastly, where France is the State of Residence of the partners or some of them while the partnership is organized outside France and the partnership income is sourced outside France, then (i) only French partners would be liable to tax in France on their share of the foreign partnership's foreign-source income and (ii) double taxation relief should be available to the French partners both for partnership taxation (if any) and source taxation, under the relevant double tax treaties, within the limit of French income taxes applicable to such income.[74]

Both these points are now largely uncontroversial. However, a series of issues has arisen as to the combination of double taxation relief and family benefits (or some other French tax benefits). Contrary to ECJ case law,[75] French tax authorities and courts tend to reduce family tax allowances and deductions for alimony and certain tax-favoured expenses or investment pro rata the relieved foreign-source income.[76] This position is currently being challenged before French courts and the EU Commission.

8.4. Examples of the OECD Partnership Report

8.4.1. Example 1

France as State of Source of the interest (State S): France generally does not levy any withholding tax on interest paid to non-residents. The major exception applies to interest paid – on debt instruments other than notes – to an account open in a "black-listed" non-cooperative state or territory, in which case a 75% withholding applies because of the place of payment. However, where the beneficial owner is a resident of a treaty country, the French tax authorities agree to apply treaty relief. They also agree to look through the foreign partnership provided a full exchange on information applies. Case law on royalty payments to a Dutch CV is on the same line.[77]

France as State of Residence of the partners (and also the country where the partnership is registered) (State P): Interest flowing through the partnership is an element of the taxable income of each partner and double taxation, if any, is avoided by a tax credit under the treaty between France and State S, the State of Source of the interest.

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74. *See* Ph. Derouin, *Combinaison des conventions internationales. De l'indemnisation des emprunts russes aux situations fiscales triangulaires ou multipolaires*, comments upon CE Ass., 23 Dec. 2011, *Kandiryne de Brito Paiva*, Dr. fisc. 2012, no. 4, act. 48.
75. NL: ECJ, 12 Dec. 2002, C-385/00, *De Groot*; 28 Feb. 2013, C-168/11, *Beker and Beker*; BE: ECJ, 12 Dec. 2013, Case C-303/12, *Imfeld and Garcet*.
76. FR: CE, 26 July 2011, no. 308679, *de Türckheim*, and no. 308968, *Saucé*, Dr. fisc. 2011, no. 41, comm. 558, opinion L. Olléon, note Ph. Derouin.
77. FR: CE, *SA Diebold Courtage*, opinion G. Bachelier and comment by present author.

8.4.2. Example 2

France as State of Source of the interest (State S): As under example 1, there is no withholding tax on interest flowing out of France, unless payment is made in a black-listed non-cooperative state or territory.

France as State of Residence of the partners (State R): Same solution as under example 1 unless the partnership carries on a business through a PE in State P and the interest is attributable to that PE. Where income tax was also levied in State P where the partnership is organized, double taxation relief should also be available under the treaty with State P. Where applicable, the total of both credits should be limited to the amount of French income tax.

France as the partnership country (State P): The partnership should be regarded as a mere paying agent and no income taxation should apply, unless the partnership carries on a business through a PE in France and the interest is attributable to that PE.

8.4.3. Example 3

France as State of Source of the business income realized without a PE (State S): A withholding tax of 33 1/3% (or 75% if paid to a black-listed non-cooperative state or territory) should apply. No treaty relief would be available.

France as the partnership country (State P): Same solution as under example 2. Technically, the partnership would not be a paying agent but in substance the solution should be equivalent.

France as State of Residence of the partners (State R): Prima facie the resident members of the entity deemed a company or a corporation under French domestic law should not be liable to income tax in France in the absence of distribution. However it is uncertain whether France would consider the partnership as a hybrid. As mentioned in section 8.3.2., in characterizing a foreign entity, French tax authorities and courts would consider both the legal features and the tax treatment of the foreign entity in the country where it is established and registered and, if the foreign entity is deemed a partnership, whether it carries on a business by a PE in State P.

8.4.4. Example 4

France as the State of Source of the royalties (State S): France would consider the tax treatment of the partnership in State P and look through it to identify the partners as the beneficial owners of the royalties and accordingly grant them the relevant treaty benefits. The solution was confirmed by the *Conseil d'Etat* as early as October 1999 in its so-called "*Diebold Courtage*" ruling with respect to a Dutch CV.[78] Accordingly, the French government's reservations of January 1999 on this point in the Commentary of the OECD Model have been superseded; the French tax authorities aligned their official position in 2007.[79]

France as the State of Residence of the partnership and the partners (State P): The royalties should be taxable in the name of the partners, subject to credit relief under the treaty with State S.

8.4.5. Example 5

France as the State of Source of the royalties (State S): Treaty relief should apply as it should be irrelevant whether the partnership or the partners are deemed the beneficiaries since both are residents of State R.

France as the State of Residence of the partnership and the partners (State P): If the partnership is liable to corporation tax, then the royalties would be included in the taxable income of the entity, subject to credit relief under the treaty with State S.

If the partnership is not liable to corporation tax, the same solution as under example 4 would apply.

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78. FR: CE, *SA Diebold Courtage*.
79. Instr. 29 Mar. 2007, no. 4 H-5-07 Bofip.

8.4.6. Example 6

France as the State of Source of the royalties and the State of Residence of the partnership (State P): Under France's prevailing case law, the partnership would be deemed a resident of France. The matter would be deemed purely domestic and partners A and B would be liable to tax in France and would be denied any treaty benefit.[80]

France as the State of Residence of the partners: Same solution as under example 3.

8.4.7. Example 7

France as the State of Source of the dividends (State S): French withholding tax on dividends distributed to non-residents should apply at the domestic rate of 30% without any treaty relief.[81] As mentioned in the 1999 OECD Partnership Report, it is irrelevant whether partnership P would be regarded as transparent or opaque under French domestic law.

France as the state where the partnership is registered (State P): P should only have the reporting obligations of a paying agent and no income taxation should apply in France despite an ageing and isolated precedent.[82]

France as the State of Residence of the partners (State R): In the absence of effective distribution by partnership P to its members, no income should be allocated to them as a result of the dividend received by P, unless certain anti-avoidance rules apply.[83] Also, it is uncertain whether France would consider the partnership as a hybrid. As mentioned in section 8.3.2., in characterizing a foreign entity, French tax authorities and courts would consider both the legal features and the tax treatment of the foreign entity in the country where it is established and registered.

8.4.8. Example 8

France as the State of Source of the dividends (State S): Treaty relief would be available according to the terms of the double taxation treaty with State P, the country where the partnership is registered and taxable. No concurring relief would be available under the treaty with State R, the State of Residence of the partners.

France as the country of the partnership (State P): If the entity is liable to corporation tax, a dividend-received deduction should apply under the participation exemption where applicable. Otherwise, dividends would be liable to corporation tax and double taxation relief (tax credit) should be granted for the withholding tax, if any, assessed in State S according to the terms of the treaty with the source country.

France as the State of Residence of the partners (State R): In the absence of effective distribution by partnership P to its members, no income should be allocated to them as a result of the dividend received by P, unless certain anti-avoidance rules apply.[84]

8.4.9. Example 9

France as the State of Source of the dividends (State S): The current position of the French tax authorities is to deny the double eligibility of treaty benefits: in order to grant treaty relief to the partners under the treaty with State R, their State of Residence, the French guidelines require that the partnership is deemed transparent both in State P, its country of registration, and State R, the State(s) of Residence of the partners. Since this would not be the case in State P, only the treaty benefits available under the treaty between France and State P should apply. The French administrative position seems unduly restrictive but has not yet been challenged.

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80. FR: CE, *Kingroup*; *see also* id., *SAS Établissements Chevannes Merceron Ballery*; *Quality Invest*; *Barlow*.
81. Instr. 29 Mar. 2007, no. 148.
82. FR: CAA Paris, *SA Rinsoz & Ormond*.
83. Arts. 123 *bis* and 209 B CGI.
84. Id.

France as the state of the partnership (State P): The solution should be the same as in example 8 and the available tax credit should be the lower of the credit under the tax treaty between France and State S, the State of Source, or the tax effectively withheld in State S under the treaty between State S and State R if State S recognizes double treaty eligibility.

France as the State of Residence of the partners (State R): There is no precedent or administrative guideline.

(1) It is uncertain whether State P would be deemed a look-through entity since the French tax authorities and courts would consider its tax status in State P (*see* section 8.3.2.). As result, no income should be allocated to the partners in the absence of effective distribution to them, unless certain anti-avoidance rules apply.

(2) If despite the taxation of P in State P, French authorities or courts would still consider P as a flow-through partnership, then the dividend paid to P should be included in the taxable income of the partners, except (a) where the French partner is a corporation liable to corporation tax and the partnership carries on a business through a PE outside France to which the interest is attributable and (b) where double taxation relief is granted by the exemption method under the double taxation treaty between France and State P.

(3) If the treaty between France and State P provides for a credit method to avoid double taxation: (a) the withholding tax assessed in State S should be relieved by an equivalent tax credit under the treaty between France and State S, the State of Source; (b) the income tax assessed in State P should equally be relieved by an equivalent tax credit under the treaty between France and State P, and (c) the total of both credits being within the limits of the French taxation applicable to the dividend attributed to the partners.

(4) Failing any such credit relief, the foreign income tax would be allowed as a deduction on the taxable income under French domestic law.

8.4.10. Example 10

France as the State of Source of the dividend (State S): French dividend withholding tax would apply at the domestic rate of 30% and there should be no treaty relief under the administrative guidelines despite the treaty between France and State R, the State of Residence of the partners, because the French administrative guidelines require full exchange of information with both the partnership country P and the State of Residence, State R. This double requirement is not beyond criticism since full exchange of information with State R should be sufficient.

France as the partnership country (State P): The dividend received would be liable to corporation tax, subject to participation exemption if applicable, and no credit relief for any withholding tax assessed at source would be available in the absence of double taxation treaty with State S.

France as the State of Residence of the partners (State R): There is no precedent or administrative guidance and the solutions should be the same as under example 9.

8.4.11. Example 11

France as the state of the construction site (State S): There is no precedent or administrative guidance on this situation. As pointed out by the OECD Committee on Fiscal Affairs (CFA) in its 1999 report, the period of time spent by the two partners in France should be aggregated at the partnership level to determine whether it exceeds the time limit of the construction site under the double taxation treaty with State P. Corporation tax would apply to each foreign company at the standard rate of 331/3%, plus surcharges where applicable.

France as the State of Residence of the partnership and the partners (State P): As mentioned under section 8.2.3.2., French courts enforce the territorial scope of French corporation tax, including with respect to construction sites operated by a French partnership with corporate members.[85]

85. FR: CE, 29 Mar. 1978, no. 4883, RJF, 5/78, no. 230; FR: TA, Paris 11 Feb. 2009, no. 04-17065, *Compagnie générale de bâtiment et de construction*, RJF 7/09, no. 618, opinion K. Weidenfeld, BDCF 7/09, no. 83.

There is no specific precedent or administrative guidance on the determination of time spent by the partners on a site in a treaty country, but it may be assumed that France would follow the OECD CFA analysis and aggregate the time spent abroad at partnership level. Where the PE is recognized, income attributable to the foreign PE would be outside the scope of French corporation tax.

8.4.12. Example 12

France as the State of Residence of a partner and a state where the foreign partnership has a PE (State R): The solution is well established and confirmed by a series of private letter rulings, public rulings and administrative guidance on certain double tax treaties, namely:

(1) France would tax the full profit attributable to the fixed base or the PE of the partnership located in France. Non-resident partners would be liable to either income or corporation tax under the standard rules on their share of profits in the French fixed base or PE.

(2) French-resident individual partners would be liable to income tax in France on their worldwide income including their full share of net profits in the partnership. Double taxation would be avoided – under the exemption method or by a tax credit most often equal to French tax, depending upon the relevant treaty – both on partnership income arising in State P (according to the treaty between State P and France) and on partnership income attributed to PEs or fixed bases in third countries that have entered into a double taxation treaty with France.

Under a special clause of the France-US treaty, the tax credit on the US-source professional income should not result in the exemption of more than half of the partnership income allocated to a partner residing in France.[86] Where losses are realized in certain countries where the partnership is established, such losses are deductible in France for income tax purposes under French domestic law. When applying the treaty methods for avoiding double taxation, the French tax authorities attempted to allocate foreign losses to foreign income – either in priority or pro rata – but French courts have held that the methods for avoiding double taxation set in bilateral treaties apply country by country. Accordingly, the exemption and the special credit apply to the total of the net positive income of each treaty country and is not reduced by the losses incurred in certain other treaty countries.[87]

French tax authorities also attempted to assess income tax on the non-French-source income of the partnership on an amount increased by 25%, on the grounds that foreign tax bases could not be checked as easily as the tax basis in the PE or fixed base in France. This administrative practice was quashed by French courts for lack of support in domestic law and also is challenged for discrimination contrary to EU law and double taxation treaties. The European Commission has initiated an infringement action on the point.

France as the partnership state and the State of Residence of other partners (State P): The solutions are substantially the same.

(1) France would tax the full profit attributable to the head office and other domestic establishments of the partnership. Foreign partners would be liable to either income or corporation tax on their share of such profits deemed of French source.

(2) Despite the statement that French partnerships should be deemed resident of France for certain treaty purposes, the place of effective management of the partnership in France does not create any attraction of the income arising from foreign PEs. Foreign partners are not taxed in France on their share of profits generated in PEs located in third countries.

(3) Resident individual partners would be liable to income tax in France on their worldwide income and be entitled to double taxation relief under the relevant treaty clauses.

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86. Arts. 14 and 24 France-US tax treaty.
87. FR: CAA Paris, 9 May 2014, no. 11PA03316.

8.4.13. Example 13

France as the partnership state and the State of source of the business profits (State P): As mentioned in section 8.2., France generally would allow the deduction of financial charges on sums made available to partnerships, including by the partners or some of them on top of their partners' share. This deduction would not extend to the financial charges incurred by a partner for the acquisition of its share in the partnership. Where this deduction is allowed, it must be taken by each partner individually, even if out of its share of profit in the partnerships. The deduction would be limited under the current thin capitalization rules, arm's length rate, etc.

No withholding tax would normally apply in France on interest paid abroad, including the interest paid on the loan from the foreign partners.

Where State R would consider the interest on the loan as an extra share of profit in the partnership, this could result in non-taxation of such income. However, in such a situation France could apply its new anti-hybrid rule and deny the deduction of the financial charges.[88]

France as the State of Residence of the partners (State R): France would tax separately the interest on the loan and the share of business profit in the partnership accruing to the French resident partners. Double taxation relief – by way of either exemption or a credit equivalent to French tax – would be available to each partner on his share of business profits in the partnership. There are very few tax treaties where the credit relief is limited to the lower of the foreign income tax or French income tax attributable to the foreign-source business profits.[89] More commonly the credit relief on business profits, real property income, employment income, etc. available in France is equal to the French income tax on such income (as if the foreign income tax would always be higher); this method results in a quasi-exemption of the business profits of foreign sources in most treaty countries.

Where a withholding tax has been assessed on the interest it would be relieved by an equal tax credit in France.

Where State P would consider the interest on the loan as an extra share of profits in the partnership and disallow the deduction of interest on the partner's loan, this situation would generate double taxation of such income. There is no available information on whether or not such double taxation is relieved in France.

8.4.14. Example 14

France as the partnership state and State of Residence of the acquirer (State P): Under French domestic law, the sale of the partnership interest would not be deemed the sale of the assets of partnership P but rather akin to a sale of shares. Withholding tax on the gain would probably be excluded under the treaty with State R.

France as the State of Residence of the selling partner (State R): France considers that the alienation of an interest in a partnership, albeit a foreign partnership, is akin to the sale of shares in a company. The capital gain realized upon the alienation would be determined on the adjusted tax basis of the interest in the partnership plus or minus the net uncovered but relieved tax losses and undistributed tax profits attributed to the selling partner in relation to its interest in the partnership. Although there is no law, precedent or administrative guidance on the point, the adjustment should include foreign profits and losses, even though the double taxation of the foreign profits would have been relieved under domestic law as far as corporate partners are concerned or under a tax treaty by way of exemption or by a credit equal to French income tax, similar to an exemption.

Where State P considers that the capital gain is attributable to the assets in the partnership and those assets are business assets of a PE, double taxation relief should be granted in France under the relevant treaty; however, there is no precedent or administrative guidance on the point. In practice, French relief might well be limited both by the reduced French rate on long-term capital gains and by the potentially different methods for determining the gain/adjusted tax basis of the shares or interest in the partnership on the French side and the adjusted tax basis of the assets in State P.

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88. Art. 212 I (b) CGI and BOI-IS-BASE-35-50 15 Apr. 2014
89. Arts. 7, 14 and 22 Brazil-France treaty; arts. 7, 14 and 24 France-Hungary treaty.

8.4.15. Example 15

France as the partnership state and the State of Source of business (State P): Same analysis as under example 13 above.

France as the State of Residence of the partners (State R): Same analysis as under example 13 above.

8.4.16. Example 16

France as the State of Residence of one of the partners and the State of Source of the royalties (State R): The share of B, the resident partner, in the royalties would be liable to tax in France under French domestic law unless the resident partner is a corporate entity that carries on part of its activities through a PE in State P to which the royalties are attributable. Treaty relief should be applicable to the remaining part of the royalty corresponding to the share of non-resident partner A.

France as partnership state and the State of Residence of the other partner (State P): If P is liable to corporation tax in France, then the full amount of the royalties would be included in the taxable basis of P. Double taxation relief should be obtained through a credit equal to tax paid in State R, arguably including income tax on the share of royalty accruing to non-resident partner B, within the limits of French corporation tax.

If P is a French partnership, the royalty income would be included in the partnership's reported income. At least the part of royalty income corresponding to the share of resident partner A would be taxable in France (subject to treaty relief for any withholding tax paid in State R). It is uncertain whether the share of partner B residing in State R would also be taxable in France and if double taxation relief would be applicable.

8.4.17. Example 17

France as the partnership state and the State of Source of the royalties (State P): As in example 6 above, the partnership would be deemed a resident of France and the matter purely domestic. Either corporation tax would be assessed in the name of P if it is liable to – or has elected for – corporation tax under domestic law or income tax would be assessed on partners A and B, possibly at reduced rates applicable to certain royalties. No treaty benefits would apply in France.

France as the State of Residence of the partners (State R): As in example 6 above, France would include the royalties in the taxable income of both partners and should grant treaty relief (exemption or tax credit) under the terms of the relevant treaty.

The mere fact that income tax was assessed in the name of the partnership as a company in State R should not be an obstacle.[90]

8.4.18. Example 18

France as the partnership state and the State of Source of business profits (State P): As mentioned above, France would analyse the situation as purely domestic and the French partnership as a resident of France, even though it would not be liable to either income or corporation tax. The foreign partners would be liable to income or corporation tax in France on their shares of profits at the end of year 1 when they were realized. The distribution of part of these profits during year 2 would not be a taxable event in France.

The situation would be different if the partnership was subject to – or elected for – corporation tax in France. In such a situation, year 1 profits would attract corporation tax at the standard rate of 33 1/3%, plus surcharges and distribution in year 2 would attract both a supplementary corporation tax of 3% on the amount distributed and dividend withholding tax, the latter only being reduced under the relevant treaty with State R.

France as the State of Residence of the partners (State R): It is uncertain whether France would consider the partnership as a hybrid. As mentioned above (*see* section 8.3.2.), in characterizing a foreign entity, French tax authorities and courts

90. FR: CE Ass., 28 June 2002, no. 232 276, *Schneider Electric*, RJF 10/02, no. 1080, opinion S. Austry, BDCF 10/02, no. 120.

would consider both the legal features and the tax treatment of the foreign entity in the country where it is established and registered. As a result of such analysis, French tax authorities and courts could regard the entity as a company and not as a partnership. Accordingly, the partners would not be liable to income tax in year 1 with respect to their share in realized profits and would be liable to tax on distributed profits only in year 2. In such a situation, credit relief for withholding tax on distribution would be available in France under the relevant treaty with State R.

If, despite corporation tax liability of the entity in State R, France would consider the entity as a partnership and tax its partners on their share of business profits when realized in year 1, double taxation would be avoided under the relevant treaty (by way of exemption or credit equal to French tax amounting to a gain exemption). The mere fact that corporation tax was assessed on the partnership in State R should not be an obstacle for double taxation relief to the benefit of the partners in France.[91]

It is uncertain whether France would also grant credit relief for the withholding tax on the distribution in year 2. There is no law, precedent or administrative guidance on the point. However, under the legislation governing controlled foreign corporations (article 209B of the CGI) and personal foreign investment companies (article 123 *bis* of the CGI), credit relief is available also for withholding tax on distribution even though distributions are not taxable events in France in such circumstances. The solution should be similar for hybrid entities treated as a corporation abroad and as a partnership in France.

91. Id.