The Inward Investment and International Taxation Review

Sixth Edition

Editor
Tim Sanders

Law Business Research

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This article was first published in The Inward Investment and International Taxation Review - Edition 6
(published in January 2016 – editor Tim Sanders)

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Law Business Research Ltd

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Published in the United Kingdom
by Law Business Research Ltd, London
87 Lancaster Road, London, W11 1QQ, UK

www.TheLawReviews.co.uk

ISBN 978-1-909830-80-6

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

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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

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AFRIDI & ANGELL

BAKER & MCKENZIE

BIRIŞ GORAN

BRATSCHI WIEDERKEHR & BUOB LTD

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EDITOR'S PREFACE

The global economy has resulted in an unprecedented flow of capital, goods and services across international borders. Businesses need to be aware of the tax regimes that affect them in multiple jurisdictions and how such regimes interact. There are tax pitfalls to be avoided, but there is also scope for securing favourable tax results. Such tax benefits may sometimes arise as a result of artificial structuring and governments are actively legislating to combat abuses that erode their tax base. The current edition has a chapter dedicated to the OECD Action Plan on Base Erosion and Profit Sharing (BEPS), and individual chapters reflect areas where BEPS has already influenced or been introduced into domestic laws.

While it is easy to identify highly structured, artificial and abusive transactions at the extreme, there is a middle ground where with no complex structuring, or even with no structuring at all, benefits arise solely or primarily as a consequence of carrying on business on a normal commercial basis across borders, under different tax laws that apply different rates of taxation. How businesses operating in this middle ground will be treated as multiple jurisdictions introduce tax laws to protect their tax base is an area of concern, as widely drafted laws designed to ensure those guilty of the worst excesses will be caught can often be applied without great difficulty to those that are not the intended target.

The aim of this book is to provide a starting point for readers, and to assist businesses and advisers, each chapter providing topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions, with a chapter on the overarching potential impact of BEPS. 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
Skadden, Arps, Slate, Meagher & Flom LLP
London
January 2016

Chapter 11

FRANCE

Philippe Derouin[1]

I INTRODUCTION

After an unprecedented increase in corporate and household income taxation between 2010 and 2014, the pace of French tax reforms has slowed down and the French government has taken a more business-friendly position. France remains generally favourable to inward investment, especially where it creates or maintains jobs on French territory. A government agency, now named 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.[2] Another publication, the 'France attractiveness scoreboard', examines the indicators that position France among several Western countries in order to enable foreign investors to compare and make judgements between European countries competing to attract job-creating investment projects.[3]

The French legal and tax environment has considerably evolved over the recent past. No substantial further changes are expected as the Finance Bill for 2016 and the Amended Finance Bill for 2015 are both expected to be enacted before 31 December 2015. However, certain new tax compliance and anti-avoidance provisions are being implemented.

1 Philippe Derouin is a member of the Paris Bar and has his own firm. Previously he was with Skadden, Arps, Slate, Meagher & Flom LLP.

2 'Doing business in France' March 2015, available at sayouitofrance-innovation.com.

3 'France Attractiveness Scoreboard' latest edition December 2014.

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);
- *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 a SA) or supervisory boards (both in an SA and an SCA) must be composed with a balanced representation of men and women. Where the business employs more than 1000 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) in order 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 (the 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.[4]

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.

4 See also *Taxation of international partnerships,* IBDF, 2014, Chapter 8: France by Philippe Derouin.

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 has been introduced and is named a *société de libre partenariat*. Like other investment funds, it is tax exempt in France and partners may be taxable upon distribution, if and when it 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, or 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 or not 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.

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 French 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:

a accelerated depreciation of equipment, and certain immoveable fixtures, full and immediate depreciation of some IP acquisition costs; and

b 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 established in a low-tax country unless a *bona fide* commercial purpose test is satisfied. Different tests apply depending upon whether the controlled foreign corporation (CFC) is located inside or outside the EU and, if outside, in an NCST (see

Section IX.ii, *infra*). '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 (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 percent 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 is 33.3 per cent. In addition, a 3.3 per cent surcharge applies where the annual revenue (turnover) of the company exceeds €7.63 million, thus resulting in an effective rate of 34.43 per cent. Where the corporate sales or revenue – or the total sales or revenue of the companies that are members of a tax consolidated group – exceed €250 million, a further 10.7 per cent surcharge applies, resulting in an effective tax rate of 38 per cent.

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 .33) per cent on dividends and 4 or 4.56 per cent on capital gains.

Special tax rates apply to:

a profits generated by the sale of shares in listed real estate companies (19 per cent);

b the royalties and proceeds from the licence and sale of patents, patentable innovations and manufacturing processes (15 per cent); and

c the gain on certain venture capital funds where they do not qualify for the participation exemption.

An overall 3 per cent surcharge further applies to any distributed amounts irrespective of whether they are paid out of taxable profits (thus resulting in an effective tax charge of 36.34 per cent or 39.86 per cent) or out of exempt profits (thus resulting in a minimum corporate taxation of such profits).

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 (except for dividend withholding tax, where the participation exemption applies) pursuant to the relevant double taxation treaty.

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 by corporate groups which publish consolidated accounts and realize consolidated revenues in excess of €750 million per year has been introduced as an amendment to the Finance bill for 2016. 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 (GAAR) (see Section IX.i, *infra*). 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, 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 exemption of intra-group dividends.

Definition of a French tax group

The group can include only companies that are liable to corporation tax in France and 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 to be included or not 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 intra-group 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. Intra-group distributions of dividends are exempt from the 3 per cent corporation tax surcharge on distributed amounts but should trigger a 1 per cent recapture of costs (resulting in a 0.33 per cent tax charge), according to an addition to the amended 2015 finance bill.

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 in order to determine the contribution of each subsidiary, and whether the subsidiary is compensated or not for the losses and other tax attributes transferred to the parent company.

Exit charges

Some adjustments to the group income tend to temporarily neutralise the tax effect of certain intra-group 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 tax

As a partial substitute for the notorious and now removed local business tax, this business contribution on value added tax 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 the business contribution on property (CFE), 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.

Temporary tax on high remuneration of employees

Businesses operating in France, which paid individual remuneration (wages and similar income, attendance fees, participation, stock options, etc.) in 2013 or 2014, or paid compensation to other entities paying those remunerations, were liable to an exceptional tax at a rate of 50 per cent on the portion of the individual compensation exceeding €1 million. This exceptional tax was capped at 5 per cent of the corporate revenue for the year and no longer applies.

Wealth taxes

Natural persons only are subject to an annual French net wealth tax either on their worldwide assets, if resident in France, or on their French assets, if non-resident. The rate escalates from 0.5 per cent to 1.5 per cent where the total net assets exceed €10 million, but there are many exceptions. 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 or the tax on corporate cars.

Other taxes are specific to certain industries (e.g., the payroll tax imposed at rates escalating from 4.25 per cent 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 per cent, 5.5 per cent 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 the rate of 0.2 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 January each year. The list currently contains approximately 120 names. The tax does not apply to operations that do not result in an acquisition of shares (such as derivatives or CFD).

Where a deed is made to record a partition of assets among multiple owners who jointly owned them, a partition duty applies at the 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 neither 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 divided withholding tax purposes and also with respect to the 3 per cent additional corporation tax on distributed amounts.

Corporate residence was – and to some extent, still is – relevant for certain stamp duties, distribution taxes (including the corporation tax surcharge of 3 per cent on amounts distributed) 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 seldom try to demonstrate that a corporation is resident in France as it is sufficient to demonstrate that it has a permanent establishment 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, *infra*).

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, *infra*).

i Corporate residence

French corporate laws apply to corporate bodies with a head office in France.[5] The corporate seat is presumed to be located at the place indicated in the articles of association or, if different, at the place where the senior person or group of persons (shareholders' meeting, board of directors) effectively makes strategic and other major decisions for the company, including wherever the operation of the company and its current management are carried out in any other location or jurisdiction.[6]

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),[7] 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. 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

5 Articles 1837 of the Civil Code and L210-3 of the Commercial Code.

6 Cass. Civ. 7 July 1947 and other similar precedents.

7 Cass Ass. plén. 21 December 1990 Roval; and State Council 5 July 2010 No. 309 693 Pinacothèque d'Athènes.

taxation of profits and potential gains, and the deemed distribution of all profits.[8] 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.

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.[9]

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, *supra*, 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, *supra*, 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 the place of management in France and, accordingly, a permanent establishment to which the operations of the company must be allocated.[10]

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 the 3 per cent corporation tax surcharge and also a further 30 per cent withholding tax,[11] 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, *infra*).

8 Article 221-2 of the French Tax Code and CE 30 December 2002.

9 Article 209-1 of the French Tax Code.

10 CE 7 September 2009 Sté Stamping international.

11 Article 115 quinquies of the French Tax Code.

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.

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.

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 the French permanent establishment of foreign companies – holding 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 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.

Dividend received 95 per cent exemption is subject to a minimum 5 per cent fully paid shareholding with voting rights and is conditional on a two-year holding period (potentially extending either side of the dividend date).

Capital gains 88 per cent exemption applies under similar but not identical circumstances. The decisive criterion is the accounting treatment as *titres de participation* or 'investment in subsidiaries' under French GAAP.

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.[12]

The participation exemption also does not prevent the 3 per cent corporation tax surcharge to apply upon distribution of dividends by the parent company, even if made out of exempt dividends or gains from subsidiaries (a situation that is not beyond criticism and has triggered an infringement action from the EU Commission against France).

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 so-called 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 application of the Charasse amendment.

ii IP regimes

Again, 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.

12 See administrative comments on the database Bofip.impots.gouv.fr BOI IS-BASE-35-30-20130329.

iii State aids

There are a variety of state aids available in France.[13] 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 of €1,457.52 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.

VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

i Withholding 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 eight territories.[14] New territories may be included again, 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 is expected to be removed. 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.[15] At present, there is no safe-harbour rule for interest payments on any other debt instrument. Other withholdings include:

13 See the Business France document 'Doing business in France' at sayouitofrance-innovation.com.
14 Order of 17 January 2014.
15 Revenue Ruling 2010/11 of 22 February 2010, now available on the Bofip.impots.gouv.fr database: BOI.INT.DG.20.50 20140211 No. 990.

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 30 per cent withholding on dividends and other distributed income, including deemed dividends (at the grossed-up effective rate of 30/70) paid to any non-resident 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 19 per cent withholding on gains from the sale of any part of a substantial participation in a French company, 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.

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.[16] 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 21 per cent (instead of 30 per cent) on dividends paid to individuals domiciled in the EU or in an EEA country; 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’ and no 3 per cent corporation tax surcharge apply 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.

16 Id.

iii Double taxation treaties

France has an extensive double taxation treaty network.[17] Most follow the OECD model; however, there are a few notable exceptions, such as 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 the reduction of withholding tax charged on such income.

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 which must be strictly construed, that enterprises can freely determine the manner in which they obtain their financing.[18] 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 *acte anormal de gestion*, 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 the French courts. As a result of French common tax rules, 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; scope of thin cap 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:

17 The list of treaties in force as at 1st January 2015 between France and more than 120 countries or territories is available on the Bofip.impots.gouv.fr database: BOI-ANNX-000306.20151007.

18 Judgments of the State Council, 30 December 2003, No. 233894, SA Andritz and 11 April 2014, No. 344990, Bayerische Hypo und Vereinsbank.

a 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

b 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:

a the rate of deductible interest is capped at the rate provided for in the French Tax Code[19] (i.e., 2.18 per cent for the fiscal year closed on or before 30 December 2015) 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

b deduction in France is subject to the 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 the 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).

19 Article 39-1-3° of the French Tax Code.

Worldwide group debt ratio

These 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, IFRS 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., 8.3 per cent, 8.6 per cent or 9.5 per cent depending upon the circumstances of the creditor.[20]

iii Acquisition finance

Under two specific anti-abuse provisions – the aforementioned Carrez amendment and Charasse amendment– 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[21] 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 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.[22]

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20 BOI-IS-BASE-35-50--20140805.

21 Article 39-1-1° ter of the French Tax Code.

22 Article 212 bis of the French tax code, BOI-IS-BASE-35-40-20140430.

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).[23]

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:[24]

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.[25] Any dividend paid in excess of the limits described above would be deemed fictitious, and would trigger both criminal sanctions against the corporate officers[26] 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

In order 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

23 Article 39-1-1° quater of the French Tax Code.

24 Article L232-11 of the Commercial Code.

25 Article L232-11 al.3 of the Commercial Code.

26 Article L242-6-1° of the Commercial Code.

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 minute 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 the limit of 10 per cent of the share capital.[27]

Taxation

A fixed stamp duty applies to the 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 and does not trigger the 3 per cent corporation tax surcharge to the company. This tax treatment was enforced by the Constitutional Court of France in a decision of 20 June 2014 which 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; 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, *supra*). 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

27 EU Regulation 2273/2003 of 22 December 2003 and articles L225-209 and L225-209-2 of the Commercial Code.

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.

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 the vendors, and upon the personnel and especially the management, in order 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, two major issues need to be considered by any domestic or foreign investor: capital gains taxation (generally at the escalating income tax rate cumulating at 62.2 per cent – occasionally reduced to 34.5 per cent – for individual French residents) and wealth tax.

One also needs to consider the personal taxation of the personnel, especially on employee shareholding 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. Where the divided company is closely held or controlled, its major shareholders must undertake to hold such stocks for three years.

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.[28] Where, as a result of the transaction, assets are transferred by a French company to a foreign company, the rollover relief is subject to prior administrative authorisation.[29] No such authorisation is required for either 'inbound' or foreign-to-foreign reorganisations, even when certain assets are located, or certain shareholders are resident, in France. 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, there has been only one example of any French public company completing an outbound cross-border merger so far; a few others are in the process of taking place. More commonly, French public companies may be acquired on a rollover basis in a cross-border transaction by the means of a public exchange offer.

28 Article 210-0 A of the French Tax Code.

29 Article 210-C 2 of the French Tax Code.

iii Exit

See Section IV.i, *supra*, 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 where it 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.[30]

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.[31] All of the parties to the contract or the scheme are jointly liable with the taxpayer for the payment of the interest and penalties.[32]

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. For example, 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

30 Article L64 of the Code of Fiscal Procedure.

31 Article 1729(b) of the French Tax Code.

32 Article 1754V.1 of the French Tax Code.

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.[33]

Special disclosure requirement

Although the French tax authorities and the French parliament have considered introducing disclosure legislation in France upon 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

France has extensive controlled foreign enterprise (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.[34]

'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.[35] Further tests apply if the CFC is an intermediate holding company within a group or renders intra-group 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.

33 Article 238A of the French Tax Code.

34 Article 209B of the French Tax Code.

35 The French tax courts strictly construe this condition and require a detailed factual analysis – CE 28 November 2012 and Versailles 17 July 2013 BNP Paribas.

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,[36] and there are no detailed regulations or administrative guidelines and very few case law precedents.

Documentary obligations have been increased over the years,[37] with penalties that may reach 5 per cent of the profits transferred abroad.[38]

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. More than 600 applications with 53 countries were outstanding at the end of 2014; 123 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[39] 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.[40] 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 upon the existence or not of a permanent establishment 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

Several series of tax measures were introduced from 2011 to 2014 with a view to raising government revenue and reducing the budget deficit. Most of them affected individual taxation and substantially increased the tax burden on high-income residents of France,

36 Article 57 of the French Tax Code.

37 Articles L13AA, L13AB and L13B of the Code of Fiscal Procedure and Article 223 quinquies B of the French Tax Code.

38 Article 1735 ter of the French Tax Code.

39 Arbitration Convention of 23 July 1990.

40 Articles L80A and L80B of the Code of Fiscal Procedure.

such as impressive income tax surcharges (especially on earned income realised in fiscal years 2012 to 2014, where the aggregate marginal rate of taxation reached and occasionally exceeded 80 per cent); dividend and capital gain taxation (now subject to escalating income tax rates reaching 62.2 per cent); wealth tax amendments; inheritance duties, etc.

The tax environment for business investment was also affected, albeit to a lesser extent: restricted use of net operating losses, new corporation tax surcharges, general limitation of deductible net financial expenses and conditional deduction of acquisition financial expenses.

More recently the highest authorities stated that there should be no further tax increases and the end of year finance bills contain fewer tax provisions than in the recent past.

XI OUTLOOK AND CONCLUSIONS

The French tax environment had become extremely unattractive for high-income taxpayers, and especially for corporate managers and senior executives. Corporate taxation also increased but has not reached such punitive levels, and leaves France as an attractive place to invest. Hopefully, a reduction in public spending and a declared pro-business orientation should enable the French government to relax this tax grip in the medium term.

Appendix 1

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, then named Gide Loyrette and Nouel. 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, 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 he handles contract and civil liability cases relating to taxation.

He is consistently ranked among the leading professionals in his field, and is a member of the Paris Bar.

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