European Tax Newsalert

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Proposed 2013 French Budget includes significant corporate tax changes

In brief

The French government on September 28 released the first draft of the proposed tax measures that will be included in the 2013 Finance Bill. The French parliament begins debate on the bill October 16.

Most measures in the bill would apply to current and ongoing financial years. US groups with operations or subsidiaries in France should immediately and carefully review the potential impact of these new measures.

Key corporate tax measures in the bill that could affect US groups with French operations or subsidiaries are summarized as follows.

Note: The French government also announced a number of important tax measures affecting wealth tax and personal income tax, including provisions addressing the taxation of carried interest, stock options, capital gains, dividends and interest. The bill also includes provisions addressing other taxes, such as the tax on insurance companies and environmental taxes, as well as measures affecting the payment of the fifth corporate tax installment payable by 'large companies.' These other provisions are not discussed in this newsalert.

Additional limitation on interest deductibility

The bill would introduce a new limitation on the tax deductibility of interest costs for companies subject to corporate tax in France. This new limitation is in addition to existing limitations, such as interest-rate capping on related-party debt, thin-capitalization rules, and the so-called *Carrez amendment* that imposes conditions on interest deductions for qualifying participations acquired by a French company.

Under the new limitation, 15% of the 'net finance expense' of a company subject to French corporate tax would not be deductible. In a tax unity, this limitation would apply to the group's tax result. This is a permanent disallowance, so the disallowed interest cannot be carried forward.

Net finance expense is defined as the total finance expense incurred as a result of obtaining finance for the company, reduced by finance income received with respect to financing granted by the company. Finance expense includes a portion of the company's rental costs incurred under a lease or rental agreement longer than three months, to the extent that portion of that rent exceeds the amortization of the asset.

The new limitation would apply to both related- and third-party financing regardless of the of the financing's purpose.

The bill would introduce a safe harbor under which this limitation would not apply when the total amount of a company's net finance expense does not exceed three million euros. Similarly, in a tax unity, the safe harbor removes the limitation where the group's net finance expense does not exceed three million euros.

In addition, in a French tax unity this new limitation would not apply to the net finance expense portion related to financing transactions between members of the tax unity.

The new limitation would apply 'retroactively' to financial years ending on and after December 31, 2012.

For financial years starting on and after January 1, 2014, the percentage of nondeductible finance expenses would increase from 15% to 25%.

Changes to French participation exemption on capital gains

Under the current regime, long-term capital gains resulting from the disposal of participating shares benefit from a 90% exemption. The taxable portion of the capital gain — 10% of the net capital gain — is subject to corporate tax at the standard rate and can be offset by capital tax loss carryforwards.

The Finance Bill would change the basis of the capital gain's taxable portion without changing the exempt percentage, which would remain at 90%. The 10% taxable portion of the capital gain would now be based on gross capital gains. Therefore, companies would not be able to offset long-term capital losses against long-term capital gains.

Subject to confirmation, the new regime would apply to financial years ending on or after December 31, 2012.

Tighter rules governing tax loss carryforwards

Under the current rules, a company may carry tax losses forward indefinitely.

However, tax losses carried forward may offset only one million euros of taxable income per year plus 60% of the current-year taxable income that exceeds that amount. Remaining tax losses that cannot be used in a given year can be carried forward and offset against future taxable profits. Accordingly, companies with annual profits of more than one million euros are subject to tax on 40% of their profits despite available tax loss carryforwards.

Under the proposed rule, tax losses carried forward could offset only one million euros of taxable income plus 50% of the current-year taxable income that exceeds that amount (instead of the current 60%). As under the current rules, tax losses that cannot be used in a given year could still be carried forward and applied against future taxable profits.

The new regime would apply to financial years ending on or after December 31, 2012.

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