

French 2014 budget proposes new taxes and targets transfers of functions and hybrid financing

September 25, 2013

In brief

The proposed 2014 budget contains revenue-raising and anti-abuse provisions that would affect entities operating in France. Most of the proposed measures would apply to financial years ending on or after December 31, 2013. In some cases, the proposals would be effective before that date.

US groups operating in France should monitor the proposals' evolution and assess their potential impact.

The proposed budget also contains measures affecting individuals. These are not discussed in this newsalert.

In detail

On September 25, 2013, the French government released its 2014 draft Finance Bill which currently contains four main measures that would affect entities operating in France. The first Parliamentary debates on the proposed budget begin October 15 at the Assemblée Nationale. These proposals could be adopted before year end.

1. **New anti-hybrid financing/subject to tax rule**

The government proposes adding a new test to the existing rules governing interest deductions for related party financing.

Under the proposed rule, interest deductions would be

allowed only if the French borrower demonstrates that the lender is, for the current financial year, subject to a corporate tax on the interest income that equals 25% or more of the corporate tax that would be due under French tax rules. Where the lender is domiciled or established outside of France, the corporate tax determined under French law equals the tax liability that the lender would have owed had it been resident or domiciled in France.

Taxpayers must provide documentation to support the corporate tax calculation if requested by the French tax authorities.

The new measure would apply to financial years ending on or after September 25, 2013. In

addition, the measure would apply to existing financing.

2. **Transfer of risks and functions**

The bill would amend the transfer pricing rules to include a new provision applicable to business restructuring.

Enterprises operating in France would fall within the scope of this new transfer pricing provision if:

- They transfer one or more risks or functions to a related party
- They discontinue, either partially or fully, performing such functions or bearing such risks

- The transferor's '*excedent brut d'exploitation*' (EBE) (for a definition of the EBE, see comments below regarding the new EBE tax) accounted for during one of the two financial years following the transfer is less than 20% of the average of the EBES accounted for during the three financial years preceding the transfer.

These tests are cumulative.

Enterprises fulfilling the above tests must demonstrate that they received an arm's length compensation or indemnification equivalent to what they would have received from unrelated parties in similar circumstances. In the absence of appropriate compensation, the profits that should have been realized by the transferor would be reinstated in its taxable basis. This provision would shift the burden of proof to the taxpayer to demonstrate that the transfer's conditions are arm's length.

In addition, the enterprise must provide the French tax authorities, upon request, with all documents and information needed to compute the income realized before and after the transfer of risks and functions for each entity involved in the transaction, including the French or foreign beneficiaries of such transfer.

These new rules would not apply to isolated asset transfers or licensing provided such transfers or licensing are independent from any transfer of risks and functions.

The proposed measures would apply to financial years ending on or after December 31, 2013.

3. New EBE Tax

The government proposes to implement a new tax called '*Cotisation sur l'excedent brut*

d'exploitation' (EBE). This measure would offset the elimination of the minimum corporate tax based on gross income.

French and foreign companies operating in France and fully or partially subject to corporate income tax (as well as listed real estate companies) would be subject to the new EBE tax when their gross revenue for the calendar year for which the EBE tax is due (or for the last 12-month financial year ended during the calendar year) exceeds EUR 50M.

In a French consolidated tax group, the gross revenue would equal the sum of the gross revenues of all the French company members.

The EBE tax would equal 1% of the EBE, computed as follows:

a company's added value, which is the positive difference between certain elements of income and expense.

less

the wages, salaries and related costs as well as operating expense taxes (excluding corporate income taxes and taxes already deducted from the above added value computation).

The elements mentioned above include revenues, expenses and services from third party suppliers, certain depreciation charges and capital gains and losses realized upon asset disposals while operating the business. This added value would be determined without applying any specific caps

The gross revenue and added value determined when calculating the EBE tax are defined by the French Tax Code provisions relating to '*Cotisation sur la valeur ajoutee des entreprise*'

sur la valeur ajoutee des entreprise' tax.

The tax would be assessed and paid following corporate income tax rules and timelines. In a French tax consolidation, the French parent (head of the tax consolidation) would file and pay the tax. The tax authorities will create a specific filing for this new tax.

The EBE tax would not be deductible for French tax purposes.

The EBE would apply to financial years ending on or after December 31, 2013.

4. New temporary tax on high remuneration owed by French entities

Under the Bill, entities operating in France would be subject to a temporary tax on high remunerations owed in 2013 and 2014.

The tax would apply to the portion of the gross remuneration owed to each individual that exceeds EUR 1M. The gross remuneration owed for a given year would include:

- Wages, salaries, and similar items as well as cash, in-kind or fringe benefits
- Director's attendance fees and similar items
- Pensions and supplemental retirement allocations; indemnifications, allocations and other benefits granted upon retirement
- Amounts due pursuant to the French Labor Code, Book III, Part 3
- Grants of stock options, free award of shares and similar items
- Equity warrants for entrepreneurs

- Reimbursements due to other entities for any of the above categories.

The remuneration items listed above are included in the tax basis regardless of their payment date. As a general rule, the remuneration is included in the tax basis when it is accounted for as an expense. Stock options, free award shares as well as equity warrants for entrepreneurs are included in the tax basis during the year granted.

The tax basis generally corresponds to the amount recorded in the employer's books. Pensions and similar items will be computed differently if paid in annuity versus

granted in capital. For stock options and free award shares, the company could choose between the options' fair market value of the options determined in the consolidated accounts (such as IFRS), and 25% of the fair market value of the shares (attached to the options) at the decision date to grant the options, the free award shares or the equity warrant for entrepreneurs.

The new tax rate is 50%. The tax cannot exceed 5% of the French company's gross revenue realized for the year during which the tax is due.

For remuneration due in 2013, the tax will be due on February 1, 2014. For

remuneration due in 2014, the tax will be due on February 1, 2015.

The tax will be filed and paid before April 30 of the year for which the tax is due and according to a new model that the French Tax Administration will provide.

This tax should be deductible for corporate tax purposes.

The takeaway

US groups operating in France or transacting with French entities should carefully consider the impact of the above proposed measures on their existing or contemplated structures.

Let's talk

For a deeper discussion, please contact:

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