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FRANCE

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Draft Amended Finance Act for 2012 includes significant corporate tax increases

On July 4, 2012, the French Government disclosed the draft second Amended Finance Act for 2012. A first Amended Finance Act for 2012 was enacted in March 2012.

This Finance Act contains various measures that may significantly impact US and International groups with French operations or subsidiaries. The common goal of the proposed measures is to increase tax revenue either by creating or increasing taxes or by closing loopholes or structures that are perceived as "abusive".

Most measures would require immediate attention since they would apply to current and ongoing financial years.

We expect this bill to be enacted by late July or early August 2012.

The proposed measures could be amended slightly during parliamentary debate, but they will likely be approved since the government has a majority in both chambers. This newsalert summarizes measures applicable to US and International groups, and includes proposed edits by the Assemblee Nationale's Budget Committee.

New three percent tax on dividend distributions

In addition to the corporate income tax (CIT), the Amended Finance Act for 2012 introduces a new three percent surtax on dividend distributions or deemed distributions for tax purposes.

French and foreign companies subject to CIT in France would pay this tax, although there is an exception for companies that meet the EU “Small or Medium Enterprises” criteria, i.e., companies with less than 250 employees, with annual turnover of less than €50m or a total balance sheet of less than €43m.

This surtax would not apply to dividends paid to an EU parent that are exempt from withholding tax under the EU parent-subsidiary Directive or that are eligible for the 95% participation exemption when paid to a French parent (where the shareholding exceeds 10%).

In practice, this surtax would mainly be assessed on:

- distributions to individuals,
- distributions to French or EU companies with a shareholding of less than 10% in the distributing entity, and
- distributions made to government agencies.

Based on the draft proposal, significant uncertainty exists as to whether dividends paid to a non-EU parent (e.g., a US parent) holding more than 10% of the distributing company's share capital would be in the scope of this surtax.

In order to avoid discrimination between EU members and non-EU members, the Assemblee Nationale's Budget Committee introduced an amendment that repeals the above exceptions so that the three percent surtax would apply to any dividend or deemed dividend. The only exceptions would be for i) distributions between members of a French tax consolidation and ii) distributions in shares.

This surtax would also apply to foreign companies subject to branch tax in France (notably companies carrying out an activity in France through a permanent establishment). In this case, it would be assessed on the amount "remitted by the French establishment to the foreign head office". This concept will need clarification.

This surtax would apply to distributions made or payable on the new law's publication date.

More restrictions on tax loss carryforwards

Tightening the conditions to carry forward tax losses

Currently there is no limitation on the period of time a company can carry forward tax losses. However tax losses can be restricted for a "*profound change of activity*". The current statutes do not define this concept which, to-date, has been determined through case law.

The proposed bill further restricts tax loss carryforwards when a company changes or reorganizes its activities.

The new rules would define a "profound change of activity" that is significantly more restrictive than the one developed over time by case law. Notably this would include:

- Undertaking new activities that trigger, during the fiscal year (FY) of the undertaking or the following FY, an increase of more than 50% of a) the company's gross income, or b) the average number of employees and the company's gross assets.

- The complete or partial termination or transfer of one or more activities that trigger, during the FY of the event or the following FY, a decrease of more than 50% of a) the company's gross income, or b) the average number of employees and the company's gross assets.

The new statute disallows tax loss carryforwards upon disposal of the "production means" necessary to perform the business a) over more than 12 months or b) when this disposal occurs simultaneously to a transfer of the majority of the company's shares.

Finally, the bill would introduce a new advance ruling procedure to safeguard tax losses carried forward when activity changes are either temporary or essential to continue the activities and sustain jobs.

These changes would apply to FYs ending on or after July 4, 2012.

Tightening the conditions for transferring tax losses during mergers

The proposals introduce additional conditions for obtaining a ruling on tax loss transfers between two companies in a merger or partial business transfer.

Currently, French tax authorities cannot normally deny a ruling when the merger is justified by sound economic and business reasons.

Under the proposed rules, tax losses could be transferred only if the absorbing company carries on the activity received from the absorbed company for at least three years. This would imply that a) there is no significant reduction in the number of employees, customers and assets and that b) the nature and volume of activity remains stable.

In addition, the absorbed company would have to demonstrate that the activity that generated the tax losses has not changed significantly after the creation of the tax losses (no significant reduction in the number of employees, customers, and assets; also, the nature and volume of activity should remain stable).

The new law would also confirm a practical approach by the French tax authorities who, to-date, consistently have refused to grant rulings when the absorbed company was a holding company.

These new conditions would apply to FYs closed anytime after July 4th, 2012.

Controlled foreign company rules

The bill would amend the French controlled foreign company (CFC) rules such that the burden of proof shifts from the tax authorities to the taxpayer.

Under current law, normally the French tax authorities bear the burden for proving that an establishment or an entity established outside the EU and directly or indirectly controlled by a French company benefits from a "privileged tax regime". Similarly, the French tax authorities must also demonstrate either that the CFC does not carry out an actual commercial or industrial activity in its country of establishment or that a certain percentage of the CFC's income is passive or income from intra-group services. In any case, the French entity can overcome CFC taxation if it establishes that avoiding French tax is not the main benefit of locating the operations in that territory.

In order to enhance the efficiency of the French CFC rules to combat tax avoidance, the bill would reverse the burden of proof. French companies with an establishment outside of the EU or controlling directly or indirectly an entity established outside of the EU would have to demonstrate that the purpose and the benefit of having this establishment or this subsidiary is mainly non-tax. The benefit would be deemed mainly non-tax when the foreign establishment or entity effectively and primarily performs an industrial or commercial activity in its jurisdiction of establishment.

For EU establishments and subsidiaries, the regime should remain unchanged: French CFC rules do not apply unless the structure is an artificial scheme whose purpose is to overcome French tax rules. The burden of proof is normally on the French tax authorities.

This provision applies to FYs ending on or after December 31, 2012.

Non-deductibility of financial waivers of debt or subsidies

The proposed bill would disallow, for CIT purposes deductions for financial waivers of debt or subsidies provided by a French company to subsidiaries. However, waivers of debt and subsidies granted as part of commercial relationships should, subject to certain conditions, remain tax deductible.

These changes would apply to FYs ending on or after July 4, 2012 and thus may affect debt waivers made during the current tax year.

Non-deductibility of short-term losses on certain newly issued shares

The proposed measure would deny a capital loss deduction for a share disposal occurring less than two years after issuance when said shares had been issued in consideration for a contribution to a company with a negative net equity.

This measure is intended to avoid situations where a pre-sale equity contribution is not taxable at the recipient's level but the capital loss resulting from the share disposal is deductible at the shareholder's level.

These changes would apply to FYs ending on or after July 4, 2012.

Other measures impacting international groups

Advance payment of the exceptional 5% corporate tax surcharge

The fourth Amended Finance Bill for 2011 created a temporary and exceptional corporate income tax surcharge of 5% of the gross CIT liability (before utilizing any available tax credits) of companies whose turnover (gross income) exceeds EUR 250m. This surtax, in addition to the existing 3,33% surcharge, results in an effective French CIT rate of 36.10%.

Under current law, the surtax is due at the same time as the CIT liability. For companies with a FY ending on December 31, 2012, this surcharge is normally due by April 15, 2013.

In order to accelerate the "cash benefit" of this surtax for the French treasury, the bill proposes to establish an advance payment, so that it will be paid when large companies pay the fourth CIT installment, i.e., by December 15, 2012.

Anti abuse with respect to divestment schemes

The bill targets abusive divestment schemes involving the merger of a subsidiary into its parent (under the tax deferral regime) within two years following its acquisition.

The bill disallows the portion of the short-term capital loss equal to the dividends distributed tax-free by the absorbed entity since its acquisition.

This provision would apply to FYs closed on and after July 4, 2012.

Repeal of withholding tax on French-source dividends paid to UCITS

In order to address the consequences of the May 10, 2012 European Court of Justice (ECJ) judgment in the Santander case, under which the withholding tax applied to dividends paid to Undertakings for Collective Investment in Transferable Securities (UCITS) situated in other EU states was ruled to be contrary to EU Law, the provision has been removed. As a result the exemption which previously applied to French UCITS is extended to EU UCITS and to non-EU UCITS provided they are established in a jurisdiction that has a tax treaty with France against fraud and tax evasion.

Foreign UCITS must operate under conditions similar to those applicable under French law.

This exemption would apply to income distributed on or after the day the law is published.

Repeal of the enacted VAT rate increase

In March 2012, under Nicolas Sarkozy's government, the parliament adopted a first Amended Finance Bill for 2012 providing for a VAT rate increase from 19.6% to 21.2%. This increase was supposed to be effective October 1, 2012.

The proposed law intends to repeal this increase. As a result the standard VAT rate would remain 19.6%.

The bill doubles the tax on systemic risks due by certain financial institutions

This tax is due on systemic risks of financial institutions with compulsory equity funds of at least €500m. The draft provides for the payment of an additional contribution equal to the amount of tax on systemic risks already paid on April 30, 2012. This surtax would be due and payable on August 30, 2012.

In addition, the Assemblee Nationale's Budget Committee introduced an amendment providing that, effective January 1, 2013, the tax rate on systemic risks would increase from 0.25% to 0.50%.

The bill doubles the Financial Transaction Tax rate

The draft bill increases, from 0.1 to 0.2%, the rate of the Financial Transaction Tax which is due to become effective in France on August 1, 2012

Increase in employer and employee contributions on the granting of stock options and restricted stock

The tax on stock options and free grant of shares will increase. The social contribution borne by the employer will increase from 14% to 30%.
The social contribution borne by the employees will increase from 8% to 10%.

These changes would apply to options and stocks granted on or after July 11, 2012.

Conclusion

US and international groups with operations or subsidiaries in France should carefully review the potential impacts of these new measures, including impacts on profit sharing and deferred taxed assets.

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