

European Tax Newsalert

A Washington National Tax Services (WNTS)
Publication

France

December 23, 2011

New tax measures in the 2012 French Finance Act and the 2011 4th Amended Finance Act

On December 21, 2011, the French Parliament passed the Finance Act for 2012 and the fourth Amended Finance Act for 2011. These two Acts include a range of new tax measures that may have significant consequences for French companies and multinational corporations ("MNCs"). This Newsalert highlights these measures.

After final adoption, these two Acts may still be subject to the French Constitutional Court's judicial review. However, a Constitutional Court challenge must be made prior to year end since the budget must be agreed prior to that date.

1. Corporate income tax

Temporary corporate income tax surcharge

French companies are currently subject to corporate income tax at a standard rate of 33.33%. An additional tax of 3.3% applies to the portion of the gross corporate income tax liability that exceeds EUR 763k, before utilizing any available tax credits. Accordingly, the total effective corporate income tax rate in France may be as high as 34.43%.

The fourth Amended Finance Act for 2011 creates a temporary corporate income tax surcharge of 5% that will apply to the gross corporate income tax liability (before

utilizing any available tax credits) of companies that have a turnover (gross income) in excess of EUR 250m. Tax credits, other than those provided by a tax treaty, cannot be used to pay this additional tax. This tax surcharge will, when applicable, result in an effective corporate income tax rate of approximately 36.1%.

For a French fiscal unity, the turnover is calculated at the group level on an aggregated basis. This additional tax must be paid when the corporate income tax balance is due.

This measure will apply to fiscal years ending on or after December 31, 2011 until December 30, 2013.

Qualifying holding control test or so-called "Carrez Amendment"

This new Amended Finance Act measure creates an additional limitation on the deductibility of interest expenses for acquisitions of "qualifying holdings", where French companies acquiring qualifying holdings cannot demonstrate that they actually, and autonomously, make decisions regarding the qualifying holdings and, when these qualifying holdings are controlled or influenced, that they exercise this control or influence in France.

This measure will apply to fiscal years beginning on or after January 1, 2012.

For more information, please refer to our previous Newsalert "[France introduces new limitation on interest expense deductibility](#)" which cover this new tax measure.

Amendment to the anti-abuse rules relating to short-term capital gains and losses

Currently, under French tax law, companies may defer the taxation (deduction) of capital gains (losses) realized on transfers between two related entities of shares held for less than two years.

Under the Amended Finance Act's new provision, the tax deferral will no longer apply to capital gains, which will become immediately taxable.

Capital losses will still be subject to the deferral and companies must attach a new schedule to their corporate tax return reporting these capital losses. Failure to file this schedule will trigger a 5% penalty on the undisclosed capital losses.

This measure will apply to fiscal years beginning on or after January 1, 2012.

Carry-back of tax losses

Under this provision the new rules on the carry-back of tax losses included in the 2nd Amended Finance Act for 2011 will apply to:

- losses incurred in fiscal years ending on or after the date of entry into force of the 2nd Amended Finance Act 2011 (i.e., September 21, 2011) ("year one"), and
- losses carried forward from the fiscal year preceding year one.

Therefore, the new rules on the carry-back of tax losses apply to:

- i. losses arising in the future, and
- ii. losses carried forward from previous years.

This article clarifies the impact of the recent amendment of loss carry-back regime on existing accumulated losses.

Limitation on royalty deductions

Currently, for related party transactions, a licensee can fully deduct the royalty expense due on licenses of patents, patentable inventions, improvements and processes for industrial plants, provided it can demonstrate that it makes effective use of such license (sub-licensing is considered an effective use of the license). In the meantime, the royalty income is taxed at the reduced rate of 15% in the hands of the licensor when the latter is established in France.

Finance Act for 2012's new measure provides that a full deduction for the royalty expense may only be allowed if the licensee can demonstrate, and properly document, that i) the use of the license results in added value over the entire licensing period and that ii) such use is real and does not constitute an artificial scheme aimed at avoiding application of French tax law.

In addition, sub-licensing income may currently be taxable at a reduced 15% tax rate provided;

- the original licensor cannot benefit from the reduced tax rate on the royalty income (i.e., a foreign company);
- the licensee can demonstrate and properly document that the sub-licensing transaction results in added value over the sub-licensing period; and
- the sub-licensing transaction is real and not tax abusive.

Under the 2012 Finance Act's new measure, the licensee's royalty expense may no longer be deducted from its result taxable at the standard corporate tax rate, but instead must be deducted from the sub-license royalty income that is taxable at the reduced corporate tax rate.

These new measures will apply to fiscal years beginning on or after October 13, 2011.

Taxation of mutual and pension funds

Section 88 of Amended Finance Act for 2006 aimed to reform the taxation of mutual and pension funds, bringing them within the scope of corporate income tax and transfer pricing. However, they remained exempt under the so called "*gestion des contrats solidaires et responsables*".

The implementation of this measure, initially scheduled for January 1, 2008, has been postponed each year due to the need to prove to the European Commission that it did not constitute state aid.

Since the provision was declared incompatible with EU law in early 2011, the Amended Finance Act for 2011 proposes to progressively subject these institutions to corporate tax—without exception.

Therefore, mutual and pension funds should be subject to corporation tax and business taxes (CFE and CVAE) with a 60% corporate tax exemption for 2012 and 40% for 2013, and a 60% business tax exemption for 2013 and 40% for 2014.

Consequently, these institutions will be fully subject to all of these taxes in 2015.

2. Transfer duty

Disposal of shares ("actions")

Currently, under Article 726 of the French Tax Code, the disposal of shares ("actions") of French companies, such as Societe Anonyme ("SA") or Societe par Actions Simplifiee ("SAS"), which are not listed, are subject to 3% transfer duty on the shares' fair market value, with a payment cap of EUR 5,000 per transfer.

The new measure removes this cap and a new calculation method replaces the current 3% flat rate. The new rate applies as follows:

- 3% for the portion of the purchase price below Euro 200,000
- 0.5% for the portion of the purchase price between Euro 200,000 and Euro 500,000,000
- 0.25% for the portion of the purchase price above Euro 500,000,000

The new rule should apply to transfers of shares effective January 1, 2012.

The taxation of sales of shares in SA, SAS or SCA which qualify as real estate companies for transfer duty purposes remains unchanged: a 5% transfer duty is due on the transferred shares' value (subject to the change described below).

Several exceptions may apply, especially for a company's acquisition of its own shares, for transfers between companies belonging to the same French tax group, or for contributions benefitting from the French favorable merger regime (this exception is currently not clear).

Foreign tax credit on transfer duties

Currently, all transfers of shares in French companies must be registered in France, even if the deed has not been executed in France. In addition, all transfer duty paid in foreign jurisdictions, by the parties on such a transfer, cannot be offset as a foreign tax credit against the amount of the transfer duty also due in France.

The 2012 Finance Act's new measure provides that the compulsory registration duties paid outside of France on the transfer of shares (such as "SA", "SAS") may now be offset as a foreign tax credit against the amount of transfer duty that is also due in France.

Disposal of shares in real estate companies

Currently, the disposal of shares in French or foreign companies that qualify as real estate companies for transfer duty purposes are subject to a transfer duty of 5%. This transfer duty is based on the fair value of the shares. In practice, the taxable basis may be significantly reduced where the company whose shares are transferred is highly leveraged.

The new measure included in the 2012 Finance Act provides that the taxable basis on the disposal of shares in real estate companies (except shares in "SCPI") should now be determined based on (i) the fair market value of the real estate assets or rights (including shares in real estate companies) or (ii) the liabilities related to the acquisition of such real estate assets or rights and the fair market value of all other

assets. All other liabilities will accordingly be excluded from the taxable basis computation. This measure may therefore create an additional transfer duty cost due to the fair market value increase calculated by this new method.

This new measure will apply to shares sold on or after January 1, 2012.

3. Statutory employees' profit sharing

Currently, the utilization of tax losses carried forward in the statutory employees' profit sharing computation is limited to the tax losses carried forward that were generated during the last five years (unless the company concluded a profit sharing agreement that is more favorable than the statutory profit sharing).

The Finance Act for 2012's new measure accounts for the recent change on the utilization of tax losses carried forward and removes this limitation.

This new measure will apply to fiscal years beginning on or after September 21, 2011.

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