France: Draft finance bill introduces flat rate withholding tax for investment income

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In brief

The draft finance bill for 2018 (PLF 2018) introduces a number of proposed changes that if enacted, promise to impact mobile employees and their employers. Most notably:

- a flat tax rate will apply to investment income, levied at source by payors
- the wealth tax will be replaced by a tax on real estate property
- the dwelling tax applicable to a principal residence will gradually decrease
- income tax rates will be indexed to the inflation rate and increase by 1%
- the worker's premium awarded to low-income earners will be gradually re-evaluated by 80 € per month.

Enactment of this bill is expected to occur December 22, 2017 – changes would generally apply as of January 2018 if enacted, with a few provisions applying to 2017 income. Mobility programs should consider the potential impact to equalization costs for mobile employees working or residing in France.

In detail

Creation of a flat rate withholding tax applicable to investment income

PLF 2018 introduces a flat rate tax (PFU) applicable to investment income would be put in place as of January 1, 2018.

The overall rate for the PFU is set at 30%, including income tax at 12.8% and social surtaxes (CSG, CRDS, additional social withholdings), whose rates are raised to a total 17.2% due to the 1.7% increase in the CSG rate provided for in the draft social security finance bill for 2018.

The income subject to the PFU generally includes:

- **All investment income** (interest, distributions, dividends and similar revenues), including interest from housing savings plans and accounts (PEL, CEL) opened in 2018. Until now, interest from a PEL was exempt from income tax for the first twelve years. The tax regime which applies to the PEA/PEA-PME is maintained and the interest from the Livret A, LDD, and LEP savings accounts are still be exempt. The standard 40% deduction applicable to dividends subject to the 30% PFU is eliminated, unless an election for taxation at the progressive income tax rates is made.

- **The revenues from life insurance contracts related to premiums paid as from September 27, 2017 when the total in the contract exceeds 150,000 €** (the PFU applies on a pro-rata basis to the income related to the total exceeding this threshold). The income related to the cash-out of life insurance contracts with respect to premiums paid before September 27, 2017 is still treated according to current legislation.
- **Capital gains from the sale of shares, parts and other income and assimilated gains** (notably, this includes capital gains from the sale of shares and gains from fixed-term financial instruments). At the same time, the reduction for the holding period is eliminated as of 2018, except as applicable to sales of shares in a PME subscribed to within ten years of the creation which benefit from a 'reinforced' reduction for the holding period if the shares were acquired before January 1, 2018. Similarly under conditions, an abatement set at 500,000 € applicable to capital gains realized by senior executives of PME at retirement is provided.
- **Certain capital gains and debts within the scope of the Exit Tax provisions**.

Real estate income (rental income and gains from real estate sales) is not subject to the PFU and remains subject to the current tax regime (with the increase in the social surtax rate to 17.2%).

The PFU for investment income is generally implemented as follows:

- The exceptional contribution on high income (CEHR) applicable to a fraction of fiscal reference income at a rate of 3% or 4% is still applicable in addition to the PFU at 30%.
- Like the current flat rate withholding, the PFU is withheld at source by the payers of the income (or self-assessed by the taxpayer if applicable) on the interest and dividends paid to individual taxpayers fiscally domiciled in France.
- Taxpayers with lower income will, if they so choose, be able to opt for taxation of all of the income subject to the PFU at the progressive income tax rates. In this case, the abatement of 40% on dividend income remains applicable. It should be noted that this option is applicable to all the income subject to the PFU without the possibility of making a partial option. It will be up to the taxpayer to determine the impact of the PFU to their situation before making the election for the progressive rates, keeping in mind that the application of the PFU should be beneficial for taxpayers whose income reaches the 14% tax bracket.
- As a result of the implementation of the PFU, the rate of withholding applicable to dividends paid to individual taxpayers fiscally domiciled outside of France is adjusted to 12.8%.

As a result of the elimination of the reductions applicable to capital gains from the sale of shares for the holding period, the regime applicable to 'Macron' free shares is modified again. The PLF 2018 does not provide for the application of the PFU to acquisition gains from free shares. However, for grants authorized by an Extraordinary Shareholders Meeting decision as from the date the finance law is applicable, a 50% reduction will be applicable to the fraction of the acquisition gain which does not exceed an annual threshold of 300,000 € (value of the shares at the final acquisition date), without any need to meet a minimum holding period, contrary to the current regime.

Finally, the capital gains from the sale of the free shares (difference between the sale price and the market value of the shares at the final acquisition date) is subject to the PFU.

For more information about the treatment of 'Macron' free shares as well as BSPCE (a special category of stock options) under PLF 2018, please see PwC France eAlert.

The IFI replaces the ISF

Article 12 of the draft finance bill for 2018 introduces a major revision of the wealth tax (ISF) applicable in France since 1982.

Beginning January 1, 2018, the ISF is replaced by a tax on real estate property (IFI). Provided for in Article 964 of the Income Tax Code, the IFI is applicable to real estate property held for personal purposes and not attributed to the professional activity of the owner.

The threshold for taxation remains at 1,300,000 € and the rate of tax is the same as for the ISF currently. Also, the 30% reduction on the value of the principal residence is maintained. However, the scope of application and the taxable base for the IFI is significantly reduced; only non-professional real estate property is taxable, leading to the exemption of financial assets (notably cash, shares and options) and of other mobile assets and goods. At the same time, the regime for exemption of professional assets is re-defined and re-centered on real estate property.

Scope of application and taxable base re-centered on non-professional real estate property

The IFI applies to all non-professional real estate property assets, whether held directly or indirectly via a company or special investment vehicle, regardless of how many intermediate entities exist between the taxpayer and the real estate property asset.

In the case of an indirect ownership, only the value of the real estate property holdings of the representative company is subject to tax, without reference to the notion of the percentage of real estate property in the total holding. However, real estate property held indirectly by the taxpayer will not be taken into account when the taxpayer holds less than 10% of the capital of the company.

The five-year exclusion from the taxable base for property held outside of France for new French residents (old article 885 of the Income Tax Code) is maintained. Similarly to individuals fiscally domiciled outside of France, individuals who have not been domiciled in France during the five years preceding their arrival on French territory will only be taxed on their real estate assets in France, until December 31st of the fifth year following the year of their arrival in France.

Reduced deductible debts

Further to the modification of the taxable base, the deductible debt is limited to the taxes related to taxable real estate assets, excluding income tax (i.e., real estate tax).

Another restriction is provided regarding the deductibility of acquisition debt related to assets subject to the IFI. In fine loans will only be deductible based on an annual depreciation coefficient, in order to limit any fiscal advantage obtained from certain real estate acquisition schemes using important debt. As for intra-family loans and those made by companies related to the taxpayer, they will be excluded from the deductible debts.

A general ceiling for deductible debt is introduced when the value of the taxable assets exceeds five million Euros and the amount of debt is more than 60% of this same amount; the amount of debt exceeding this threshold will only be allowed for deduction up to 50% of the excess debt.

Other important changes

The tax reduction for gifts to certain organizations is maintained - only the gifts made until December 31st of the year preceding the taxation point would be taken into account (until now, such gifts could be made until the wealth tax return filing deadline).

As a result of the focus of the IFI only on real estate assets, the tax reduction called 'ISF-PME' introduced in 2007 by the TEPA law is eliminated. However, payments made under this provision between the 2017 ISF return filing deadline (included in the income tax return or via a separate return) and December 31, 2017 would still give rise to a tax reduction for the 2018 IFI.

The ceiling equal to 75% of income applicable to IFI and income tax as well as the anti-abuse 'cash box' introduced by the 2017 finance law are maintained.

Also, the method for declaration of the IFI is aligned with the one applicable to declaration for income tax purposes.

Finally, it should be noted that the draft text includes the definition of active holding companies as per administrative comments.

Gradual decrease in dwelling tax (Taxe d'Habitation) applicable to the principal residence

A gradual decrease in the dwelling tax applicable to a principal residence is proposed to be applied over a three year period starting with the 2018 tax year – this change was a campaign promise made by the President. 80% of all households are expected to be exempted from the payment of this tax by 2020 as a result.

This new decrease in tax will be applicable to households whose fiscal reference revenue does not exceed 27,000 € for a single taxpayer, increased by 8,000 € for each of the first two half parts for dependents, then by 6,000 € for each additional half part. In order to avoid detrimental impacts of the ceiling, a progressive decrease would be provided for households whose fiscal reference revenue is between these limits and 28,000 € for a single taxpayer (increased by 8,500 € for the first two half parts for dependents) that is 45,000 € for a couple (increased by 6,000 € per additional half part for dependents).

For eligible households, the decrease will amount to 30% in 2018 and then to 65% in 2019.

Increase in the thresholds applicable to micro-company tax regimes

The draft finance bill provides for an increase in the income ceilings used for application of the micro-BIC (Industrial and Commercial Benefit) and micro-BNC (Non Commercial Benefit) regimes. These ceilings will increase from 82,800 € for sales activities to 170,000 € and from 33,200 € for service activities to 70,000 € (including non-commercial activities). These new ceilings would be applied starting with 2017 taxable income.

Income tax rates indexed to the inflation rate

The income tax brackets and the thresholds for taxation will be increased by 1%.

The worker's premium awarded to low-income earners will be gradually re-evaluated by 80 € per month. 20 € will be re-evaluated as soon as October 1, 2018.

The takeaway

The estimated 2018 finance bill enactment schedule is as follows:

- Discussion (1st part): October 17, 2017 to October 23, 2017
- Vote (1st part): October 24, 2017
- Discussion (2nd part): As from October 31, 201
- Vote of the complete Act: November 21, 2017

The estimated date of enactment is December 22, 2017. Mobility professionals should watch whether this bill becomes law and if there are any further changes to its provisions.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your Global Mobility Services engagement team or the following professional from PwC Société d'Avocats in France:

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