

2019 draft French budget includes ATAD and BEPS provisions

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In brief

The French government released the draft budget for fiscal year 2019 ('the draft budget') on September 24, 2018.

The draft budget notably includes corporate tax measures designed to transpose into French law Articles 4 and 6 of EU anti-tax-avoidance directive 2016/1164 dated July 12, 2016 (ATAD) with respect to interest limitation and general anti-abuse rules. It also proposes to amend the French tax consolidation and participation exemption regimes and to reform the French patent box regime pursuant to the nexus approach of OECD BEPS Action 5.

The French Parliament will now start to review, debate and amend the entire draft budget. This legislative phase will last several weeks before they vote on and enact a final budget. Enactment typically happens at the end of December.

If enacted as proposed, most of the measures will apply for tax years beginning on or after January 1, 2019, and could affect multinational enterprises (MNEs) with French operations or subsidiaries.

In detail

Proposed transposition of ATAD Article 4 on interest limitation into French law

The proposed transposition implies that, as soon as 2019, France will waive the exemption that the EU Commission granted in July 2018 (referring to the EU exemption that allows France to maintain its current rules until 2024).

The proposed transposition also would repeal the following rules:

- The so-called 'rabet' (25% haircut limitation)

- The 'Carrez Amendment' (anti-abuse rule preventing an interest deduction related to a controlling interest acquired by a French entity when such interest is controlled and managed outside of France, the EU, or an European Economic Area (EEA) Member State)
- Current thin capitalization rules.

However, the following limitations would continue to apply:

- Interest rate limitation (for interest payments to related parties according to the rate provided in Article 39-1-3 of the French Tax Code)
- French 'anti-hybrid'/'subject-to-tax' rules provided by Article 212 (I)(b) of the Code
- The so-called 'Charasse Amendment'

The proposed French ATAD limitation provides the following:

For standalone entities

The deductibility of net financial expenses would be limited to the higher of EUR 3M or 30% of the entity's 'tax' EBITDA.

The net financial expenses (non-exhaustive list) would notably take into account related and third-party interest, foreign exchange losses on financings, interest paid on hedging contracts, guarantee fees, debt-related costs, etc.

- A safe-harbor provision would be available for entities that are members of a consolidated group for financial accounting purposes (for example, IFRS). It would allow an additional deduction equal to 75% of the net financial expenses not deducted pursuant to the above limitation, provided that the entity's equity-to-assets ratio is equal to or higher than the equity-to-assets ratio of the consolidated group.
- A thin capitalization exception to the main limitation and to the safe-harbor rules above would apply.

Should interest payments made to related parties, as defined under French law, exceed:

Related-party interest multiplied by 1.5 times the equity of the entity divided by the annual average debt of the entity

then the net financial expenses of the entity (related and third-party expenses included, as defined above) would only be deductible up to the higher of EUR 1M or 10% of the 'tax' EBITDA of the entity (instead of EUR 3M or 30% EBITDA above limitation). The group consolidated safe harbor

also would not be available in this situation.

Non-deductible financial expenses could be carried forward with no time limit and deducted in the future under the same conditions.

Unused interest capacity that cannot be deducted in a current tax period could be used during the following five tax years, but only against the financial expenses related to those tax years.

For entities that are members of a French tax group

A tax group would be regarded as a stand-alone entity for purposes of the new limitation.

The tax group's net financial expenses, which are the sum of the group members' stand-alone net financial expenses, therefore would be deductible up to the higher of EUR 3M or 30% of the group's tax EBITDA, based on the group's tax result.

The safe-harbor provision available for entities that are members of a group consolidation for financial accounting purposes (for example, IFRS) also would apply when the French tax group is part of such group consolidation.

The thin capitalization exception described above also would apply to a French tax group based on the tax group's debt-to-equity ratio. Accordingly, it would limit the net financial expense deduction to the higher of EUR 1M or 10% of the tax group's EBITDA.

The group consolidated safe harbor would not be available in this tax group thin capitalization situation.

Carryforward and unused capacity rules provided for stand-alone entities would apply in a tax group situation.

Specific rules would cover entities entering and exiting a French tax group.

The new ATAD limitation does not include a grandfathering provision.

This new limitation would apply for tax years beginning on or after January 1, 2019.

Proposed transposition into French law of the ATAD Article 6 general anti-abuse rule

A new Article 205 A would be added to the French Tax Code. It provides:

“For purposes of determining the corporate tax liability, shall be ignored an arrangement or a series of arrangements which, having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

An arrangement or a series thereof is regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality”.

The proposed transposition would not amend the existing domestic French general anti-abuse rules ('GAARs'), established under Article L.64 of the Tax Procedure Code.

This new provision would apply for tax years beginning on or after January 1, 2019.

Amendments to the French tax group regime

Following recent decisions by the Court of Justice of the European Union (CJEU), the French government proposes to amend the French tax group regime and align it with EU law.

This reform would modify:

- The participation exemption on dividends.

Currently, a general 95% exemption is available with respect to dividends eligible for the participation exemption regime.

Such exemption is increased to 99% for distributions made by a tax group member entity or to distributions made by a company established in the EU (or certain EEA Member States), provided such company would fulfil the conditions to be a member of a French tax group if it were established in France.

Under the proposed reform, the 99% participation exemption regime would be extended to distributions received by a company that is not a member of a tax group from a company established in the EU (or certain EEA Member States) provided the two companies would fulfil the conditions to set up a tax group if the distributing company were established in France.

Pursuant to the proposed reform, the 99% participation exemption would not be granted in the event the French entity is not a member of a tax group based solely on the absence of required elections and formalism needed to set up a tax group.

The tax treatment applicable to dividends not eligible for the participation exemption regime also is proposed to be aligned with the regime that applies to eligible dividends, and is therefore eligible for the 99% participation exemption regime.

- The participation exemption regime applicable to long-term

capital gains would be increased from 88% to 95% for all companies, whether or not they are members of a tax group. This increased exemption would be balanced by a repeal of the current tax group elimination (i.e., non-taxation) of an intra-group sale of participations.

- Subsidies and debt waivers granted between members of a tax group would no longer benefit from the tax group 'neutralization' regime.

These proposed provisions would apply for tax years beginning on or after January 1, 2019.

Reform of the French patent box regime

In order to comply with OECD recommendations (BEPS Action 5), the draft budget proposes to modify the existing French patent box regime (the preferential tax regime that applies to royalties, capital gains related to patents, and assimilated IP rights) and apply the principle of a 'nexus approach.' A nexus approach consists of using expenditures as a proxy for substantial activity and ensuring that taxpayers can benefit from a preferential IP regime only in the jurisdiction where they engage in research and development and incur actual expenses on such activities.

Currently, income and gains from patents and assimilated IP rights benefit from a reduced tax rate of 15% for entities subject to corporate tax. No requirement applies with respect to the location of the R&D activities, whether or not in France.

Under the proposed new rule, the preferential corporate tax rate would remain at 15%.

Income from patentable inventions (not patented) would no longer be eligible for the preferential regime.

However, copyright protected software would be eligible for the new regime, provided it did not generate income before January 1, 2019.

The preferential tax rate would apply to the net licensing income (or sub-licensing, etc.), determined by the difference between:

- The income generated from eligible assets during the financial year and
- R&D expenses directly related to these assets and incurred, directly or indirectly, by the company during the same financial year.

A special provision would apply for the first tax year during which the net income is calculated to take into account previous eligible expenses.

In order to include the nexus approach, the net income then would be calculated annually based on the following ratio:

- Numerator: 130% of R&D expenses directly related to the creation or development of the intangible asset, directly incurred by the taxpayer or by unrelated companies and
- Denominator: all R&D or acquisition expenses directly related to the intangible asset and directly or indirectly incurred by the taxpayer.

Specific rules would apply for tax groups.

The regime would be subject to formal election and the taxpayer would need to prepare a defense file in case of a tax audit.

The new patent box regime would apply to tax years beginning on or after January 1, 2019.

Increase of the last corporation tax installment for large companies

The last installment for large companies is calculated based on the estimated profits for the year. For installment payments for tax years beginning in 2019, this last installment would correspond to the difference between the amount of installments already paid and:

- 95% (instead of 80%) of the estimated profit for the year for companies whose turnover is

between EUR 250 million and EUR 1 billion

- 98% (instead of 95%) of the estimated profit for the year for companies whose turnover is between EUR 1 billion and EUR 5 billion.

Companies with a turnover of more than EUR 5 billion would not be subject to any change, with the last installment already calculated at 98% of the estimated profit for the year.

The draft budget contains other tax proposals that are not covered in this Insight.

The takeaway

MNEs operating in France should consider the impact of the draft budget with respect to their international financing flows, IP nexus, and future cash repatriation. Enactment of such proposed provisions could occur by the end of December 2018.

Let's talk

For a deeper discussion of how this might affect your business, please contact:

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