
French Constitutional Court strikes down 3% distribution tax exemption for consolidated taxpayers

October 4, 2016

In brief

The French Constitutional Court on September 30, 2016, ruled that the 3% distribution tax exemption available to members of a French tax consolidation is unconstitutional because it creates an unjustified difference in treatment between entities that are a part of a French tax consolidation and those that are not.

The ruling is expected to result in the application of the distribution tax to all French companies, even if they belong to a French tax consolidation.

Unless the French legislature rules otherwise, the decision of the Constitutional Court will effectively repeal the distribution tax exemption as of January 1, 2017.

In detail

Under current French law, dividends and other distributions, including deemed dividends, paid by entities subject to French corporate income tax (CIT), are subject to a 3% tax.

The tax is borne by the company making the distribution. It is not an expense of the shareholders or partners. The tax is not deductible for CIT purposes.

The tax applies to distributions made to all types of beneficiaries — such as corporations and individuals — located in France or in any foreign

jurisdiction, including in the European Union.

However, the tax does not apply in several cases, most notably with respect to distributions made between members of the same French tax consolidation (*integration fiscale*).

The French Administrative Supreme Court (Decision #399506 dated June 27, 2016), referred the issue to the French Constitutional Court on June 30, 2016. The referral was based on a question that Societe Layher SAS raised regarding the application of the wording “*between companies of the*

same tax group pursuant to Section 223 A” as provided by Section 235 ter ZCA of the French Tax Code, which grants a distribution tax exemption to companies that are part of the same French tax consolidation.

The French Constitutional Court ruled that the distribution tax exemption is unconstitutional, reasoning as follows:

- It creates an unjustified difference in treatment between entities that are part of a French tax consolidation and those that are not. A French

subsidiary with a foreign parent cannot elect into the consolidation regime if the parent entity is not subject to French CIT.

- The distribution tax is a separate and distinct levy from the French corporate income tax. Since the French tax consolidation provisions concern only CIT, the exemption is therefore unrelated to the French tax consolidation regime.
- The tax was enacted to generate additional tax revenues, which does not by itself justify a difference in treatment between tax consolidated entities and those that are not.

The Constitutional Court decided to postpone the effects of its decision until January 1, 2017, to avoid a retroactive impact on taxpayers that were exempt prior to the decision.

As a result of the ruling and unless the French legislature amends the law before then, the 3% distribution tax will apply to dividends paid by French companies, on or after January 1, 2017, whether or not they are members of a French tax consolidation.

The takeaway

The French Constitutional Court ruling does not affect prior distributions made by French companies within a tax consolidation.

With respect to future distributions, the French Parliament may choose to amend the distribution tax provision as currently drafted. Absent any amendment by the French Parliament, the distribution tax will apply to distributions made between members of the same French tax consolidation beginning January 1, 2017.

Pursuant to a press release from *Agence France Presse* earlier this week, the French government has indicated that it will consider the French Constitutional Court ruling in the 2016 Amended Finance Act to be enacted before December 31, 2016.

The French Constitutional Court ruling is separate and unrelated to the current challenge at the European Union level regarding the general incompatibility of the French distribution tax with European law. Companies therefore should continue to consider the opportunities to file refund claims on such basis.

Multinational enterprises (MNEs) operating in France should consider the impact of this ruling with respect to their deferred tax liabilities on French earnings in their French groups, as well as with respect to their distribution policy and entity rationalization plans.

Let's talk

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

International Tax Services, United States

Guillaume Barbier
+1 (646) 471-5278
g.barbier@pwc.com

Laurent Samson
+1 (646) 313-5735
samson.laurent@pwc.com

International Tax Services, France

Guillaume Glon
+33 156 574 072
guillaume.glon@pwcavocats.com

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