

Main Tax Provisions of the French Finance Acts (Finance Act for 2014 and Amended Finance Act for 2013), and the Act Against Tax Evasion and Financial Crime, Enacted in 2013

January 31, 2014

Non Contractual Document – For Information Purposes

www.mwe.com

Boston Bruxelles Chicago Düsseldorf Francfort Houston Londres Los Angeles Miami Milan Munich New York Orange County Paris Rome Silicon Valley Washington, D.C.
Alliance stratégique avec MWE China Law Offices (Shanghai)

© 2012 McDermott Will & Emery. Les entités suivantes sont collectivement désignées "McDermott Will & Emery", "McDermott" ou "la Firme": McDermott Will & Emery LLP, McDermott Will & Emery AARPI, McDermott Will & Emery Belgium LLP, McDermott Will & Emery Rechtsanwälte Steuerberater LLP, McDermott Will & Emery Studio Legale Associato et McDermott Will & Emery UK LLP. Ces entités coordonnent leurs activités via des contrats de prestations de services. McDermott bénéficie d'une alliance stratégique avec MWE China Law Offices, cabinet d'avocats distinct.

The following Acts were passed by the French Parliament at the end of 2013:

- The Amended Finance Act for 2013
- The Finance Act for 2014
- The Act Against Tax Evasion and Financial Crime (the “**Anti Tax Evasion Act**”)

The purpose of this presentation is to outline and comment on the main changes introduced by these Acts

Please note that the content of this presentation remains subject to French tax authorities’ guidelines to be issued in the future

For any question regarding these changes, please contact the authors of this presentation (see page 28)

Below is a list of abbreviations used throughout this presentation:

- CIT: Corporate Income Tax
- EBITDA: Earnings Before Interest, Taxes, Depreciation, and Amortization
- EEA: European Economic Area
- EU: European Union
- FTA: French Tax Authorities
- FTC: French Tax Code
- FY: Fiscal Year
- NCSTs: Non Cooperative State and Territories
- UCITS: Undertakings for Collective Investment in Transferable Securities

1. Taxation of French Resident Business Entities

- 1.1. Increase of CIT Rate Applicable to Large Companies
- 1.2. Anti-Abuse Rules on Hybrids and Artificially Leveraged Structures
- 1.3. 50% Tax on Compensation exceeding €1 million
- 1.4. Distributions by French REITs
- 1.5. Transfer Pricing Documentation
- 1.6. Disclosure of Cost Accounting and Consolidated Accounting in the Course of Tax Audits
- 1.7. Recovery of Taxes During a Mutual Agreement Procedure

2. Taxation of French Individuals and Non French Residents

- 2.1. Capital Gains on the Sale of Shares
- 2.2. Distributions of Capital Gains by French Investment Vehicles
- 2.3. Amendment of the Exit Tax
- 2.4. Capital Gains on the Sale of Real Estate Assets

3. Miscellaneous

- 3.1. Creation of a Public Register of Trusts and Increase of the Penalties Applicable to Trustees
- 3.2. Other Relevant Information

4. Main Measures Invalidated by the French Constitutional Court

- 4.1. Transfer Pricing Requirements Regarding Business Restructuring Transactions
- 4.2. New Definition of the Abuse of Law
- 4.3. Disclosure of Tax Optimization Schemes to the FTA

Summary Table

Authors

1. Taxation of French Resident Business Entities

1.1. Increase of CIT Rate Applicable to Large Companies

Background:

- An additional tax of 5% assessed on the amount of CIT due by French companies whose turnover exceeds €250 million was introduced by the 4th Amended Finance Act for 2011
- The Draft Finance Act for 2014 initially provided for a new tax of 1% assessed on the companies' EBITDA
- The new tax on EBITDA was finally cancelled during the parliamentary debates following the criticism of the measure expressed by French companies, and instead an increase of the rate of the additional tax was adopted

Changes resulting from the Finance Act for 2014 (applicable to FYs ending on or after December 31, 2013):

- The additional tax rate is increased from 5% to 10.7%.

Comments:

- The effective aggregate CIT rate applicable to companies whose turnover exceeds €250 million is increased from 36.1% to 38%
- This effective CIT rate is computed notwithstanding the application of the 3% tax on dividend distributions
- Within a tax consolidated group, the €250 million threshold is assessed on the sum of the annual turnovers realized by each member of the group

1.2. Anti-Abuse Rules on Hybrids and Artificially Leveraged Structures (1/2)

Background:

- The tax deductibility of financial expenses is subject to the following limitations:
 - The thin-capitalization rule: this rule limits the tax deductibility of interest incurred on loans granted or secured by related parties
 - The *Amendement Charasse* rule: this rule limits the tax deductibility of interest incurred by a company in connection with the purchase of shares in a company, where (i) the target company and the purchaser belong to the same group and (ii) the target company joins the tax consolidated group of the purchaser
 - The *Amendement Carrez* rule: this rule limits the tax deductibility of financial expenses incurred by a company in connection with the purchase of shares in a company, where both the decisions related to the shareholding and the control or influence over the acquired company are not effectively made or exercised in France
 - A general deduction limitation rule: this rule limits the tax deductibility of financial expenses incurred by companies whose net financial expenses exceed €3 million during a relevant FY, in which case those expenses are subject to a cap equal to 75% as from January 1, 2014

New limitation resulting from the Finance Act for 2014 (applicable to FYs ending on or after September 25, 2013):

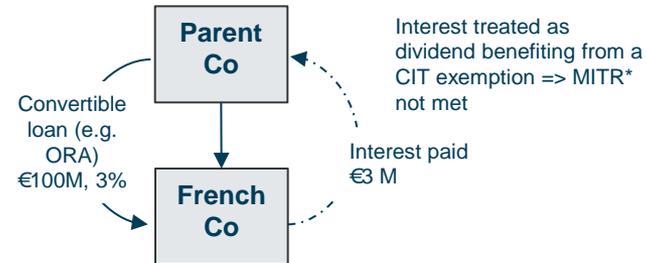
- The tax deductibility of interest incurred by French companies on loans granted by French or foreign related party creditors requires the taxpayer to demonstrate, upon request of the FTA, that the related party creditor is subject, in respect of that interest, to an income tax that is at least equal to 25% of the income tax that would be computed pursuant to French standard income tax rules (the “**Minimum Income Tax Requirement**”)
- Where the creditor is established abroad, the income tax computed pursuant to French standard rules is the income tax it would have been liable for in respect of the interest had it been established in France
- Where the creditor is (i) a tax transparent French partnership or investment fund, or (ii) a tax transparent foreign partnership or investment fund established in the EU or in a State that has entered into a treaty providing for administrative assistance with France and that is not an NCST, the Minimum Income Tax Requirement would be assessed at the level of the partnership’s, or investment fund’s, related party shareholders
 - If the Minimum Income Tax Requirement is not met at the level of at least one of the related party shareholders, the entire amount of interest due by the French company to the partnership or investment funds would not be deductible
 - Where the partnership, or the investment fund, has no related party shareholders, the new limitation rule would not apply
- Two companies are viewed as related parties where (i) one of them holds directly or indirectly at least 50% of the share capital of the other, or exercises control over the other, or (ii) they are 50% held directly or indirectly, or controlled, by a third company

1.2. Anti-Abuse Rules on Hybrids and Artificially Leveraged Structures (2/2)

Comments:

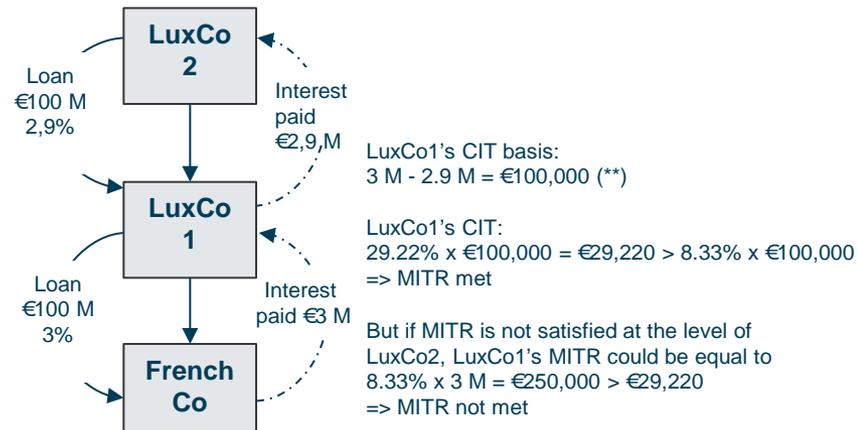
- The scope of the Minimum Income Tax Requirement at the creditor's level is unclear and will need to be clarified by the FTA in their guidelines
- It is likely that, based on declarations by the French Government, the Minimum Income Tax Requirement would be fulfilled, where (i) the income tax rate in the creditor's jurisdiction is at least equal to 8.33% (i.e. 25% of the French CIT rate), (ii) the interest received by the creditor is not exempt in application of the relevant legislation, and (iii) there is no tax credit or allowance that would bring the effective tax rate applicable to the interest below 8.33%. In this scenario, the new limitation would essentially apply to "hybrid" instruments (see Example 1 in the opposite chart)
- However, unless provided otherwise in their guidelines, it cannot be excluded that the FTA appreciate the Minimum Income Tax Requirement with reference to the creditor's CIT basis (as opposed to the relevant CIT rate applicable to the interest), such CIT basis being computed as if it had been established in France, i.e. after application of all the deduction limitation rules provided for by French tax rules, including this new limitation rule
 - In this scenario, the new limitation rule would also apply to loans granted in the context of "mirror loan" financing structures
 - Under "mirror loan" financing structures, the Minimum Income Tax Requirement test would potentially imply to determine the CIT basis of all successive creditors in the chain of ownership as if they had been established in France (see Example 2 in the opposite chart)
- In any case, French companies should carefully review, and potentially reconsider, their financing structures to make sure that they are not impacted by the new limitation rule

Example 1: Application to "hybrid" instruments (likely scenario)



Interest not deductible from FrenchCo's taxable income

Example 2: Application also to "mirror loan" financing structures (unlikely scenario):



Interest deductible from FrenchCo's taxable income provided that MITR is satisfied at the level of LuxCo2

* MITR: Minimum Income Tax Requirement

** Interest treated as taxable interest on the hands of LuxCo1 but only on a margin

1.3. 50% Tax on Compensation exceeding €1 million

Background:

- The French Constitutional Court struck down the provisions of the Finance Act for 2013 introducing a 18% surtax assessed on individuals' income exceeding €1 million, which would have brought the marginal effective income tax rate up to 75% (including social taxes)

New temporary 50% Tax on high compensation introduced by the Finance Act for 2014:

- French entities (including businesses, companies or partnerships, as well as French permanent establishments of foreign companies) are subject to a temporary tax assessed on high compensation paid in 2013 and 2014
- The tax is assessed at the rate of 50% on the portion of compensation that exceeds €1 million, and is capped at 5% of the entity's turnover
- The taxable compensation include the following elements:
 - The gross amount (i.e. employee social security contributions included) of wages, bonuses, compensation in kind and directors' attendance fees
 - The gross amount of sums attributed in respect of incentive plans, profit-sharing plans and employee savings plans
 - Regarding stock options, restricted stock and equity warrants for entrepreneurs ("BSPCEs"):
 - In respect of stock options and BSPCEs: the tax is assessed on (i) the fair market value of the options as recorded in the entity's consolidated accounts or (ii) 25% of the fair market value of the underlying shares at the time of the attribution, at the election of the taxpayer
 - In respect of restricted stock: the tax is assessed on (i) the fair market value of the shares as recorded in the entity's consolidated accounts or (ii) the fair market value of the shares at the time of the attribution, at the election of the taxpayer
 - Pension and all similar retirement advantages attributed by the entity, for the following amounts:
 - If paid in annual installments: the gross amount of the pension booked in the account for the relevant year
 - If paid as a lump sum: 10% of amount of the pension
 - Reimbursements made to other entities in respect of any of the above mentioned elements
- Except for stock-options, restricted stock and BSPCEs, the 50% tax applies to compensation booked in the accounts of the company during the calendar year; as regards stock options, restricted stock and BSPCEs, the compensation (estimated as mentioned above) is subject to the 50% tax in respect of the calendar year of attribution
- The 50% tax is due by February 1, 2014 and February 1, 2015
- The 50% tax is deductible from CIT (except from the 10.7% additional tax, see page 5) and is recovered pursuant to the rules applicable to VAT

Comments:

- French companies may consider implementing split payroll arrangements in respect of high compensation, but those arrangements would have to be closely monitored

1.4. Distributions by French REITs

Background:

- French REITs are exempt from CIT in respect of the following income items:
 - Income from the lease or the sub-lease of real estate properties, provided that 85% of the income is distributed to the REIT's shareholders before the end of the FY following the one during which the income is realized;
 - Capital gains realized on the transfer of certain real estate assets to unrelated parties (real estate properties, rights under real estate leasing contracts, shares of subsidiaries subject to the REIT tax regime and of certain real estate partnerships), provided that 50% of the capital gains are distributed to the REIT's shareholders before the end of the 2nd FY following the one during which the capital gains are realized;
 - Dividends received from subsidiaries subject to the REIT tax regime, provided that those dividends are fully distributed to the REIT's shareholders during the FY following the one during which the dividends are received
- Mandatory distributions made by French REITs, as defined above, are exempt from the 3% tax on distributions from January 1, 2013 to December 31, 2013

Changes resulting from the Amended Finance Act for 2013:

- The percentage of mandatory distributions to be fulfilled by French REITs in order to be exempt from CIT is increased to (i) 95% in respect of income derived from the lease or sublease of real estate properties, and (ii) 60% in respect of eligible capital gains
- Mandatory distributions realized by French REITs are exempt from the 3% tax on distributions on a permanent basis
- As from December 31, 2012, French permanent establishments of foreign REITs established within the EU are in any cases subject to the branch tax in France:
 - Under the previous definition, the branch tax applied to French permanent establishments of EU REITs, which were exempt from CIT in their jurisdictions (the EU branch tax exemption is only applicable to EU companies subject to CIT without being exempt); however EU REITs which, without being exempt from CIT, were not effectively subject to CIT on the profits realized by their French permanent establishments, were eligible to the branch tax exemption;
 - The branch tax is now applicable to French permanent establishments of EU REITs which (i) are exempt from CIT in their jurisdictions or (ii) despite not being exempt from CIT in their jurisdictions, benefit from a special exemption on the profits realized by their French permanent establishments

1.5. Transfer Pricing Documentation (1/2)

Background:

- French companies (i) whose annual turnover or gross asset value exceed €400 million, or (ii) which are related to a French or foreign entity exceeding one of those thresholds, or (iii) which are part of a French tax consolidated group which includes a company exceeding one of those thresholds, are required to prepare transfer pricing documentation to be made available to the FTA in case of tax audit

Changes Resulting from the Anti Tax Evasion Act (applicable to FYs for which the deadline for CIT filing falls on or after December 8, 2013):

- French companies subject to the transfer pricing documentation requirements are also required to file annually simplified transfer pricing documentation (see table page 11)
- This transfer pricing documentation will have to be filed within 6 months following the deadline for filing CIT returns (which is the end of the 3rd month following the end of the FY or May 5 for FYs ending on December 31)

Changes Resulting from the Finance Act for 2014 (applicable to FYs ending on or after January 1, 2014):

- As part of the complete transfer pricing documentation to be made available to the FTA in case of tax audits, companies concerned by such requirements are required to provide tax rulings related to companies established outside France and granted by their respective tax authorities
- The tax rulings that should be provided to the FTA are the ones which (i) bind the foreign tax authorities and (ii) concern the relevant foreign related company, even though not directly in relation with the transfer pricing policy

Comments:

- French companies required to prepare transfer pricing documentation should plan their preparation, review them on an annual basis, and take specific care in describing intragroup transactions
- In practice, French companies may face difficulties in obtaining the communication of foreign tax rulings, in particular where (i) the tax ruling is given to a foreign related company which is not controlled by the French company or (ii) the tax ruling contains a confidentiality provision

1.5. Transfer Pricing Documentation (2/2)

Information to be included in the complete and in the simplified transfer pricing documentation:

Information required	Complete transfer pricing documentation to be made available in case of tax audit	Simplified transfer pricing documentation to be filed annually
General information about the group of the French company		
Overview of the business conducted by the group, including any change occurred during the FY	Yes	Yes
General description of the legal and operating structures of the group and identification of the companies involved in intra group transactions with the French company	Yes	No
General description of the functions exercised and risks assumed by companies of the group where they affect the French company	Yes	No
Description of the main intangible assets in connection with the French company's business	Yes	Yes
Description of the transfer pricing policy of the group	Yes	Yes, including the changes occurred during the FY
Tax rulings granted to foreign entities of the group by their respective tax authorities	Yes	No
Information specific to the French company		
Description of the French company's business, including any changes occurred during the FY	Yes	Yes
List of intragroup transactions, indicating the nature and the level of income paid or received	Yes	Yes, where the aggregate amount of income paid or received per nature of transaction exceeds €100,000
List of the cost sharing agreements, and copy of the tax rulings granted to the French company with respect to transfer pricing	Yes	No
Presentation of the arms length transfer pricing method(s) implemented by the French company	Yes, including an analysis of the functions exercised, the assets used and the risks assumed by the French company, and an explanation of the selection and the application of the transfer pricing method used	Yes, but limited to the indication of the main transfer pricing method used and the changes occurred during the FY
Where the transfer pricing method used requires it, an analysis of the comparables selected by the French company	Yes	No

1.6. Disclosure of Cost Accounting and Consolidated Accounting in the Course of Tax Audits

Background:

- During the tax audit of a business entity, the FTA are entitled to request copies of all documents supporting the financial statements and the CIT returns filed by the taxpayer

Changes resulting from the Finance Act for 2014 (applicable to tax audits notified as from January 1, 2014):

- The following business entities are required to make their cost accounting statements (if any) available to the FTA in the course of a tax audit:
 - Businesses whose annual turnover is higher than €76.2 million or €152.4 million if their main activity is the sale of goods, articles, furniture or commodities, or the lease of residential premises;
 - Businesses whose gross asset value exceed €400 million;
 - Companies which hold more than 50% of the share capital or the voting rights of a company or a partnership satisfying any of the above mentioned criteria;
 - Companies whose share capital or voting rights are more than 50% held, directly or indirectly by a company or a partnership satisfying one of the above mentioned criteria;
 - Companies which are part of a French tax consolidated group which includes at least one company satisfying one of the above mentioned criteria
- The establishment of cost accounting statements is not mandatory; the burden of proof that the company actually keeps cost accounting statements lies on the FTA
- In addition, companies that are required to establish consolidated accounts under French commercial law must make those consolidated statements available to the FTA in the course of a tax audit

Comments:

- In the absence of formatted cost accounting statements, the scope of the information the FTA will be able to require is unclear
- The disclosure of the consolidated accounts to the FTA would allow them to obtain information on foreign subsidiaries which fall in the consolidation perimeter of the French consolidating business entity

1.7. Recovery of Taxes During a Mutual Agreement Procedure

Background:

- A taxpayer may request, following the reception of a tax reassessment notice from the FTA, the opening of a mutual agreement procedure with a foreign tax authority in order to eliminate the double taxation generated by the tax reassessment (in practice, a transfer pricing reassessment)
- In this case, the statute of limitations for the recovery of the reassessed tax is interrupted until the third month following the notification to the taxpayer that the mutual agreement procedure succeeded or not
- As a result of this interruption, the FTA were not entitled to recover the reassessed tax until the end of the mutual agreement procedure

Changes resulting from the Finance Act for 2014 (applicable to mutual agreement procedure launched as from January 1, 2014):

- The interruption of the statute of limitations for the recovery of taxes is abrogated, as a result of which the FTA are now entitled to recover the reassessed tax during the course of the mutual agreement procedure

Comments:

- Taxpayers who introduce a claim against the tax reassessment may ask a deferral of taxation. However:
 - The deferral of taxation would usually be subject to the furnishing of guarantees;
 - The introduction of a claim during a mutual agreement procedure may not be allowed by the relevant tax treaty

2. Taxation of French Individuals and Non French Residents

2.1. Capital Gains on the Sale of Shares

Background:

- As a result of the Finance Act for 2013, capital gains realized by French resident individuals on the sale of shares were supposed to be subject, in 2013, to progressive income tax rates (with a marginal rate of 45%), after the deduction of a rebate equal to (i) 20% for shares held for at least 2 years, (ii) 30% for shares held for at least 4 years, and (iii) 40% for shares held for at least 6 years
- By exception, favorable tax regimes were available, subject to certain conditions, for capital gains realized (i) by entrepreneurs, (ii) by managers in the context of retirement, (iii) upon the sale of shares between family members, (iv) upon the sale of shares of young innovative companies and (v) which were reinvested in companies or in investment funds whose main assets consisted in shares of companies

Changes resulting from the Finance Act for 2014:

- General tax regime: capital gains realized as from January 1, 2013 are subject to income tax at progressive rates, after deduction of a rebate equal to (i) 50% for shares held for at least 2 years, and (ii) 65% for shares held for at least 8 years
 - As regards investments realized through investment funds: capital gains realized on the sale of shares held in investment funds, as well as capital gains distributed by investment funds (during the liquidation period or not), benefit from the rebate to the extent that the assets of the investment fund are composed as to at least 75% of shares of companies (or rights with respect to shares)
 - This restriction of the benefit of the rebate does not apply to: (i) capital gains realized on the sale of shares of private equity funds (FCPRs and FPCIs), (ii) capital gains distributed by those private equity funds or by real estate investment funds (“FPIs”), and (iii) carried interest
- Favorable tax regime: subject to certain conditions, the following capital gains are subject to income tax at progressive rates after the deduction of a rebate equal to (i) 50% for shares held for at least 1 year, (ii) 65% for shares held for at least 4 years, and (iii) 85% for shares held for at least 8 years:
 - capital gains realized as from January 1 2013 on the sale of shares in small and medium enterprises (“SMEs”) acquired by sellers within the 10 year period following the formation of the SMEs;
 - capital gains realized as from January 1, 2014 by managers of SMEs in the context of retirement (such gains are also eligible for a fixed €500,000 rebate);
 - capital gains realized as from January 1, 2014 on the sale of shares of a company between the members of the same family group if the family stake exceeds 25%

Comments:

- The capital gains tax regime provided for by the Finance Act for 2013 will never apply
- Capital gains are also subject, on 100% of their amounts, to (i) social taxes at the aggregate rate of 15.5% (a portion of which, i.e. 5.1%, can be offset against the income tax due the following year) and (ii) an additional income tax assessed at the rate of 3% on income exceeding €250,000 (€500,000 for couples), and 4% on income exceeding €500,000 (€1,000,000 for couples)

2.2. Distributions of Capital Gains by French Investment Vehicles

Background:

- Until December 31, 2012, only French FCPRs and French investment companies in risk capital (SCRs) were legally allowed to distribute, prior to the liquidation period, capital gains realized on the sale of their assets
- Distributions of capital gains by French SCRs to non resident shareholders were subject to a 45% withholding tax in France, subject to the availability of a specific exemption provided for in the FTC, and to the application of tax treaties
- Since January 1, 2013, the right to distribute capital gains before the liquidation of the fund was extended to all French investment funds, but the tax treatment of those distributions to individuals and non-residents was not specified

Changes and clarifications resulting from the Finance Act for 2014 (applicable as from January 1, 2014):

- Distributions of capital gains by French SCRs to non French resident shareholders are subject to a 30% withholding tax in France, subject to the availability of a specific exemption provided for in the FTC, and to the application of tax treaties
- Distributions of capital gains by French or foreign investment funds to French resident shareholders are subject to income tax at progressive rates, unless a specific exemption is otherwise available (for distributions of capital gains by FCPRs and FPCIs, carried interest, etc.)
- Distributions of capital gains realized by French investment funds to their non resident shareholders are subject to a 45% withholding tax in France, where the shareholder has indirectly held, through the fund, at least 25% of the financial rights in the relevant French company at any time during a 5-year period preceding the sale of the shares by the fund
- Non French resident taxpayers may claim the repayment of the excess of the amount of the withholding tax on the amount of French income tax they would have paid on the distribution if they had their tax residence in France

Comments:

- With regard to capital gains distributed by French investment funds, resident shareholders subject to income tax at progressive rates, as well as non French resident shareholders subject to the 45% withholding tax in France, may benefit from the rebate for holding period provided for under the general tax regime applicable to capital gains (see page 15)
- Non French residents established in a NCST are subject to a 75% withholding tax on (i) distributions of capital gains by SCRs, and (ii) distributions of capital gains realized by French investment funds on the sale of a French company, irrespective of the percentage of financial rights indirectly held, through the fund, in the relevant French company

2.3. Amendment of the Exit Tax

Background:

- Individuals who transfer their tax residence outside of France and who have been French tax residents during at least 6 years in the 10-year period preceding the transfer are subject to income tax and social taxes (the “**Exit Tax**”) on unrealized capital gains recognized on shares or similar rights (i) representing, directly or indirectly, at least 1% of the financial rights in a company, or (ii) whose value in the aggregate exceeds €1.3 M
- The payment of the Exit Tax is however deferred until the effective sale of the shares or similar rights in the relevant company if the taxpayer (i) transfers his tax residency in the EU, to Norway or to Iceland or (ii) provides guarantees for the payment of the Exit Tax (the “**Payment Deferral**”)
- If the taxpayer has not transferred his shares or similar rights in the relevant companies after a 8-year period following the transfer of his tax residence outside of France, the Exit Tax on the unrealized capital gains is either reversed or repaid, as the case may be (the “**Permanent Relief**”)

Changes resulting from the Amended Finance Act for 2013 (applicable as from January 1, 2014):

- The scope of the Exit Tax is broadened:
 - Individuals who transfer their tax residence outside of France are subject to the Exit Tax on shares or similar rights held, (i) representing, directly or indirectly, at least 50% of the financial rights in a company, or (ii) whose value in the aggregate exceeds €800,000
 - The scope is also extended to interests held in UCITS
- The following events no longer trigger the end of the Payment Deferral:
 - The gift of shares on which unrealized capital gains were recognized upon the transfer of tax residence, to the extent that the taxpayer transferred his tax residence in the EU, in Norway or in Iceland (if the taxpayer transferred his tax residence in another State, he may be able to demonstrate that the main purpose of the gift was not to avoid the payment of the Exit Tax)
 - Subject to certain conditions, the contribution of shares on which unrealized capital gains were recognized upon the transfer of tax residence to a company controlled by the taxpayer (which benefits from a tax deferral under French tax rules)
- In case of transfer from France within the EU, to Norway or to Iceland, with a Payment Deferral, capital losses realized by a taxpayer on the subsequent sale of shares within the scope of the exit tax can be offset against the following capital gains realized in the year during which the shares are sold and any of the following 10 years:
 - Capital gains realized by the same taxpayer upon the sale of other shares within the scope of the exit tax
 - Other French source capital gains subject to the French withholding tax
 - Where the taxpayer has transferred his tax residence back to France, capital gains realized on the sale of shares subject to French income tax at progressive rates
- The period for obtaining Permanent Relief is increased from 8 to 15 years

2.4. Capital Gains on the Sale of Real Estate Assets

Background:

- Capital gains realized by individuals on the sale of real estate assets (other than their main residence) are subject to an income tax at a flat rate of 19% and to social taxes at the aggregate rate of 15.5%, after deduction of annual rebates which rate depends on the duration of ownership (the “**Holding Period Rebates**”) computed as follows :
 - 2% for the 12 years following the 5th year of ownership
 - 4% for the 7 years following the 17th year of ownership
 - 8% for the 6 years following the 24th year of ownership

Changes resulting from the Finance Act for 2014:

- As from September 1, 2013, capital gains realized on the sale of real estate assets (other than building plots) are eligible for the following Holding Period Rebates:
 - For the computation of income tax basis: (i) 6% in respect of the 16 years following the 5th year of ownership, and (ii) 4% in respect of the 22nd year of ownership (leading to an income tax exemption after a 22-year period of ownership)
 - For the computation of social taxes basis: (i) 1.65% in respect of the 16 years following the 5th year of ownership, (ii) 1.60% in respect of the 22nd year of ownership, and (iii) 9% in respect of the 8 following years (leading to a social taxes exemption after a 30-year period of ownership)
- From September 1, 2013 to August 31, 2014, a 25% temporary rebate is applicable to capital gains realized on the sale of certain real estate assets
 - The 25% temporary rebate does not apply to the sale of building plots and shares of real estate companies
 - The 25% temporary rebate applies for income tax and social taxes purposes
- Capital gains realized on the sale of building plots remain subject to the 2%, 4% and 8% Holding Period Rebates mentioned above, for income tax and social tax purposes

Comments:

- The draft Finance Act for 2014 excluded capital gains realized on the sale of building plots from the benefit of the new Holding Period Rebates, but this provision was invalidated by the French Constitutional Court
- As a result, those capital gains are still subject to the Holding Period Rebates which were in force before the implementation of the Finance Act for 2014

3. Miscellaneous

3.1. Creation of a Public Register of Trusts and Increase of the Penalties Applicable to Trustees

Background:

- The Amended Finance Law for 2011 introduced a definition of trusts for French tax purposes, and made them subject to a set of *sui generis* tax rules for income tax, gift tax, inheritance tax and wealth tax purposes
- The Amended Finance Law for 2011 also created specific disclosure requirements imposed on trustees of trusts (i) whose settlor and/or beneficiary is a French resident for tax purposes, or (ii) whose assets include assets located in France
 - An “event filing” is required upon the constitution, the modification or the termination of the trust, in which the trustee must disclose, in particular: (i) the identification of settlors, beneficiaries and trustees, (ii) the terms of the trust, (iii) the nature of the event that gave rise to the event filing and (iv) an estimation, on the date of the event that gave rise to the event filing, of the value of the assets and rights transferred to or distributed by the trust
 - A “yearly filing” is required on or before June 15 of each relevant year, in which the trustee must disclose, in particular: (i) a detailed identification of settlors, beneficiaries and trustees, (ii) a list of assets, rights and capitalized income held in trust, together with their fair market value, as at January 1 (limited to French assets if the settlor and all beneficiaries are not resident of France for French tax purposes)
- Failure to comply with any of the above mentioned requirements will subject the trustee to a penalty equal to the greater of €10,000 or 5% of the trust’s assets’ value

Changes resulting from the Tax Evasion Act (applicable as from December 8, 2013):

- The disclosure reporting requirements are extended to trusts of which the trustee is a French resident, irrespective of the tax residence of the settlor and the beneficiaries, and irrespective of the location of the trust assets
- A public register of trusts is created, compiling part of the information disclosed by trustees, i.e.: (i) identification of trust, (ii) identification of trustees, settlors and beneficiaries, and (iii) date of constitution of the trust
- The penalty applicable to trustees who fail to comply with their reporting obligations is increased to the greater of €20,000 and 12.5% of the trust assets’ value

Comments:

- The procedure for consulting the public register of trusts will be further detailed by decree, to be issued in 2014
- As from January 1, 2014, a decree dated October 23, 2013 also requires trustees to provide the mandatory information on new special forms published by the French tax authorities, to be completed in French. Until now, trustees were permitted to submit this information on plain paper and in any language
- The opportunity to terminate trust agreements should be considered where the trustee, the settlor or one of the beneficiaries are French residents, or where the trust’s assets include French assets

3.2. Other Relevant Information (1/2)

French CIT Rates:

- The standard rate is 33.1/3%
- French companies (other than SMEs) whose CIT liability exceeds €763,000 are subject to an effective CIT rate of 34.43%
- French companies whose turnover exceeds €250 million are subject to an effective CIT rate of 38%
- French companies (other than SMEs) are also subject to a 3% tax assessed on dividend distributions, which may increase the effective CIT rate of large companies to approximately 40%

Amendments to the NCSTs list:

- On August 21, 2013, the British Virgin Islands, Bermuda and Jersey were added to the NCSTs list, effective from January 1, 2014
- However on January 17, 2013, Bermuda and Jersey were removed from the NCSTs list with retroactive effect as of January 1, 2014, considering the fact that those jurisdictions had significantly improved their cooperation with the FTA since August 2013

French VAT Rates:

- The standard rate of 19.6% is increased to 20%, as from January 1, 2014
- The intermediate rate of 7% is increased to 10% as from January 1, 2014
- The reduced and the special rates remain unchanged at 5.5% and 2.1%, respectively

Transfer tax on the sale of French real estate assets (applicable between March 1, 2014 and February 29, 2016):

- The maximum transfer tax rate on the direct transfer of French real estate assets is increased from 5.09% to 5.81%

3.2. Other Relevant Information (2/2)

Increase of the statute of limitations periods:

- The statute of limitation for the recovery of taxes due by non French residents established outside the EU in a country with which France has not concluded an agreement providing for assistance in the recovery of taxes is increased from 4 years to 6 years
- Where the FTA has issued an exchange of information request to a foreign tax authority, the statute of limitations period for the reassessment of tax (i) may be extended up to the end of the calendar year following the one in which an answer from the foreign tax authority was received, but (ii) shall in no case be extended beyond the end of the 3rd year following the end of the initial statute of limitations period for the relevant tax
 - The request for information must be submitted by the FTA within the initial statute of limitations period
 - The extension of the statute of limitations period is subject to the taxpayer being informed, within 60 days, that a request for an exchange of information was sent to the foreign tax authorities, or that an answer from the foreign tax authorities was received
 - In respect of undisclosed business activities, the statute of limitation, whose initial period is 10 years, may be extended to 13 years

Increase of the FTA power in case of undisclosed activity (applicable as from to tax audit notification issued as from December 6, 2013)

- In case of an undisclosed business activity conducted by a taxpayer, the FTA is now entitled to adjust the taxpayer's taxes unilaterally without issuing any formal notice

4. Main Measures Invalidated by the French Constitutional Court

4.1. Transfer Pricing requirements Regarding Business Restructuring Transactions

Background:

- In order to challenge the transfer pricing of a transaction realized between a French company and a foreign entity, the FTA must demonstrate that (i) the French company is legally or economically related to that foreign entity and (ii) the compensation received for the transaction does not reflect its fair market value, and therefore constitutes a transfer of income from the French company for the benefit of the foreign related entity

New transfer pricing rules invalidated by the French Constitutional Court:

- Pursuant to the draft Finance Act for 2014, French companies involved in “business restructuring transactions” (as defined below) were required to provide evidence that they have received a fair market value compensation in consideration for those transactions (i.e. the burden of the proof of the fair market value of the compensation received was shifted from the FTA to the French company)
- This new transfer pricing rule only applied to business restructuring transactions as a result of which (i) one or several companies transfer one or several functions or risks to a related entity and correlatively cease to carry out such functions or bear such risks (a “**Business Transfer**”), and (ii) the operating income (EBIT) generated by the relevant companies in respect of any of the two FYs following the Business Transfer has decreased by more than 20% compared to the average EBIT generated in respect of the three FYs closed prior to the Business Transfer
- This new transfer pricing rule was invalidated by the French Constitutional Court on the grounds that certain important conditions of the new rule, regarding in particular the transfer of functions or risks, were not sufficiently defined and thus created uncertainty for taxpayers

Comments:

- Transfer of risks and functions that do not give rise to a fair market value compensation are still likely to be challenged by the FTA under the current transfer pricing rules or in application of the abnormal act of management theory; however, in this case the burden of the proof lies on the FTA
- The FTA may propose in the future a more accurate definition of business restructuring transactions with a view to reverse the burden of the proof on the taxpayers

4.2. New Definition of the Abuse of Law

Background:

- Under the current definition of the abuse of law, the FTA are entitled to disregard or disqualify any legal transaction(s) in either of the following cases:
 - The transaction(s) is/are fictitious (abuse of law by simulation)
 - The transaction(s) result(s) from a literal application of regulations that contradicts the objectives of such regulations, and the sole purpose of that/those transaction(s) is to avoid or reduce taxes (abuse of law by fraud)
- Taxpayers involved in such transactions are subject to penalties up to 80% of the avoided tax

New definition of the abuse of law by fraud invalidated by the French Constitutional Court:

- The draft Finance Act for 2014 provided for a new definition of the abuse of law by fraud, pursuant to which the FTA were entitled to disregard any transaction(s) that result(s) from a literal application of regulations that contradicts the objectives of such regulations, and the main purpose of which is to avoid or reduce taxes
- The French Constitutional Court invalidated the new definition of the abuse of law by fraud, considering that it would have left the FTA too much discretion for its characterization, all the more considering the very significant level of penalties the taxpayer may face

Comments:

- In practice, even under the current definition, abuse of law by fraud may be characterized if the transaction or the structure cannot be justified by valuable business reasons

4.3. Disclosure of Tax Optimization Schemes to the FTA

Background:

- A report on the tax optimization of multinational companies was published by the French parliament's finance committee on July 10, 2013, suggesting, in particular, that the "tax optimization schemes" implemented by taxpayers should be filed with the FTA

New declaration requirement invalidated by the French Constitutional Court:

- Pursuant to the draft Finance Act for 2014, any person (either companies or individuals) who (i) markets a tax optimization scheme for the benefit of a client or (ii) develops and implements a "tax optimization scheme" for his own benefit, was required to declare it to the FTA before its marketing or implementation
- Tax optimization schemes were defined as any combination of legal, tax, accounting and financial procedures and instruments, (i) whose main purpose is to reduce the tax liability of a taxpayer, to defer a tax payment or to obtain its reimbursement and (ii) which would meet conditions to be determined by decree
- Failure to comply with the new declaration requirements would be punished by a 5% fine based on (i) the amount of the remuneration received in consideration for the marketing of a tax optimization scheme or (ii) the amount of the tax benefits obtained by persons developing and implementing tax optimization schemes for their own benefit
- This new declaration requirement was invalidated by the French Constitutional Court on the grounds that (i) the definition of tax authorization schemes was not precise and relied on conditions to be determined by decree, which was viewed as a negation of the parliament's authority, and (ii) it represented an infringement on the constitutional principle of freedom of entrepreneurship

Comments:

- It is uncertain whether such a declaration requirement could be implemented in the future, even with a more accurate definition of tax optimization schemes, since the French Constitutional Court ruled that this requirement was contrary to the freedom of entrepreneurship

Taxation of French Resident Business Entities	<ul style="list-style-type: none"> ▪ The effective CIT rate for companies whose turnover exceeds 250 million is increased to approximately 40% (including the 3% tax on distributions) ▪ The tax deduction of interest paid by French companies to related party creditors is subject to the demonstration that the creditor is subject to a taxation equal to at least 25% of the French CIT rate in respect of the relevant interest income ▪ French entities (businesses, companies, partnerships and French permanent establishments of foreign companies) are subject to a temporary 50% tax assessed on compensation paid exceeding €1 million booked during calendar years 2013 and 2014 ▪ French REITs are subject to new mandatory distributions requirements, and such distributions are exempt from the 3% tax on distributions on a permanent basis ▪ Large French companies are subject to new transfer pricing documentation requirements ▪ In the course of a tax audit, French companies are required to provide the FTA with their cost accounting, if such a cost accounting is maintained, and with their consolidated accounts, if the establishment of such accounts is required by French commercial law
Taxation of French Individuals and non French Residents	<ul style="list-style-type: none"> ▪ New rebates for holding periods apply to capital gains realized on the sale of shares and real estate assets ▪ Capital gains realized by non French residents on the sale of interests in French investment funds and on the distribution of French assets by French investment funds are, subject to specific conditions, subject to a 45% withholding tax ▪ The scope of the exit tax applicable to French tax residents who transfer their tax residence outside of France is amended
Miscellaneous	<ul style="list-style-type: none"> ▪ The law creates a public register for trusts and increases the penalties applicable to trustees who fail to fulfill their reporting obligations
Main Measures Invalidated by the French Constitutional Court	<ul style="list-style-type: none"> ▪ New transfer pricing rules governing business restructuring transactions, applicable in the case of transfer of functions and risks, were invalidated on the ground that those conditions were not defined by the law ▪ A new definition of the abuse of law, which targets transactions whose main purposes (instead of the sole purpose) is to avoid tax, was invalidated on the ground that it would have left too much discretionary power to the FTA ▪ The obligation to declare tax optimization schemes to the FTA was invalidated on the grounds that (i) tax optimization schemes was not sufficiently defined by the law and (ii) this obligation was contrary to the constitutional principle of freedom of entrepreneurship



Antoine Vergnat | Partner, Paris | avergnat@mwe.com

T: +33 1 81 69 15 09 - F : +33 1 81 69 15 15

Antoine Vergnat is a partner in the law firm of McDermott Will & Emery AARPI, and is based in the Paris office. He is a partner in the U.S. and International Tax Practice Group.

Antoine assists French and foreign investment funds, corporate groups and entrepreneurs operating in the industrial, service and real estate sectors on a broad range of domestic and international tax matters.

His practice focuses on transactional matters, relating in particular to the acquisition and sale of assets, the financing and the restructuring of groups, as well as on the management of tax affairs and controversies.

Antoine has also developed a strong background in the structuring of equity compensation schemes as well as in the tax advice to high-net-worth individuals. In addition, he has gained extensive experience in all matters relating to private equity and real estate investment funds.



Emilie Renaud | Associate, Paris | erenaud@mwe.com

T: +33 1 81 69 15 29 - F : +33 1 81 69 15 15

Emilie Renaud is a senior associate in the law firm of McDermott Will & Emery AARPI and is based in the Paris office.

Emilie focuses her practice on transactional tax law, in particular on matters relating to the acquisition and sale of assets, the financing and the restructuring of groups, on the management of tax disputes and on tax advice to high-net-worth individuals. Emilie has experience of domestic as well as cross-border transactions.

Before joining McDermott Will & Emery, Emilie spent 5 years as a tax associate in the Paris office of other leading international law firms.



Jules Bourboulon | Associate, Paris | jbouboulon@mwe.com

T: +33 1 81 69 15 34 - F : +33 1 81 69 15 15

Jules Bourboulon is an associate in the law firm of McDermott Will & Emery AARPI and is based in the Paris office.

Jules focuses his practice on transactional tax law, in particular on matters relating to the acquisition and sale of assets, the financing and the restructuring of groups, and on the tax advice to entrepreneurs and individuals.

Before joining McDermott, Jules was a trainee within a leading international law firm and within the tax departments of several major French companies.