

## French Amended Finance Bill for 2009 — Significant Changes in Corporate Taxation

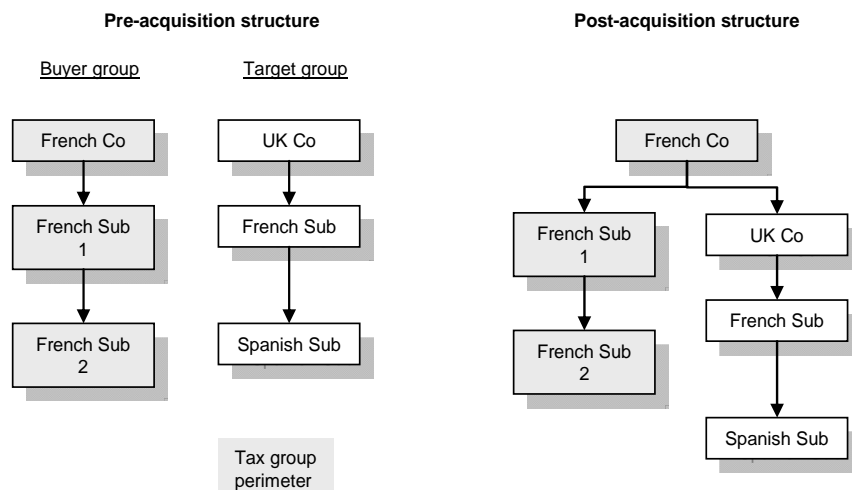
February 11, 2010

The Amended Finance Bill for 2009, which was passed on 30 December 2009, has brought about significant tax changes which will have a major impact on many French and international groups. The French government is blowing hot and cold: some of the new measures should definitely be regarded as an improvement, whereas others have created new obstacles to the global tax planning of French and international groups.

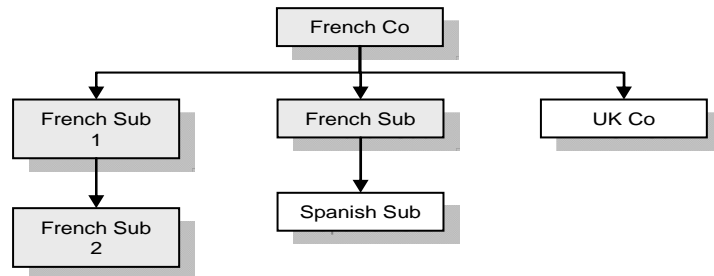
### Group Relief – The *Butterfly Effect*

- 1) Under the French group relief system (also referred to as "tax consolidation regime"), the profits and losses of group member companies may be consolidated for corporate tax purposes. To that effect, a "group parent" must elect to become liable for the corporate tax assessed on a consolidated basis formed by the sum of individual profits and losses derived by those affiliates which agreed to become members of the tax group.
- 2) Unlike many other jurisdictions, France's corporate taxation system is based on the principle that sole profits derived from businesses operated in France may be subject to French corporate tax. In consequence of this territorial principle, group relief mechanisms were designed in such a way that the tax consolidation benefits of group relief were generally not permitted in group structures involving a non-French parent company or the interposition of a non-French company between French affiliates.
- 3) More precisely, a French parent company and its French affiliates could be entitled to group relief provided that, amongst other conditions, the parent company owned at least 95% of the affiliates, directly or indirectly, and, in situations where the affiliate was owned indirectly through an intermediary company, it could be entitled to group relief only if (a) the chain of participation only included companies subject to French corporate tax, and (b) all companies composing such chain of participation elected to enjoy group relief.
- 4) In order to mitigate some of the adverse effects of those rules, the regime was amended several times to allow group relief benefits to be granted in certain situations involving non-French companies, but only if those non-French companies were liable for French corporate tax:

- a) A non-French company could be the "head" of the French tax group, i.e., consolidate the profits attributable to its French permanent establishment with the profits of its eligible French affiliates, provided that the shares of those affiliates were recorded on the fiscal balance sheet of the French permanent establishment of the foreign intermediary company.
  - b) If a French subsidiary was owned through a foreign company, such subsidiary could be entitled to group relief provided that (i) the foreign company had a permanent establishment in France, (ii) such foreign company also elected to enjoy group relief (in respect of the profits attributable to its French permanent establishment), and (iii) the shares of the French subsidiary were recorded on the fiscal balance sheet of the French permanent establishment of the foreign intermediary company.
- 5) Following a decision of the European Court of Justice (ECJ 27 November 2008, 418/07, *Société Papillon*) which ruled that the permanent establishment condition imposed on foreign companies was not in compliance with the principle of freedom of establishment, the French government had no other choice but to amend the regime.
  - 6) The new regime no longer requires the foreign intermediary company to be established in France and liable for French corporate tax. However, it contains a number of specific adjustments which are meant to offset the tax effects of certain transactions and operations involving the French subsidiary and other members of the tax group, if they are carried out through the foreign intermediary company.
  - 7) In practice the new regime will avoid certain reorganizations which were required following the acquisition of a multinational group of companies in order for the buyer to achieve tax consolidation of its French subsidiaries and the French affiliates of the target group.  
Example:



Under the prior rules, the newly acquired French Sub could not be consolidated for tax purposes because it was not directly owned by an existing member of the French tax group. In order to achieve such tax consolidation, a post-acquisition reorganization was required:

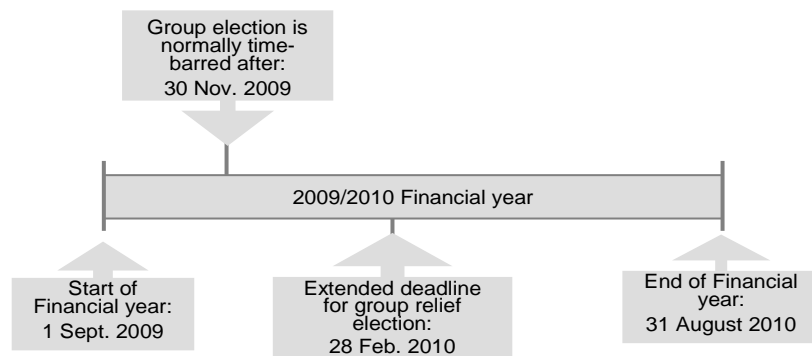


Under the new rules, the post acquisition structure may remain unchanged. The French parent company will be able to fiscally consolidate its newly acquired French affiliate without having to carry out a transfer which could in certain cases generate a tax cost (capital gains tax, transfer tax, registration duty, etc.) for the buyer.

8) The new regime is applicable to financial years ended as from 31 December 2009, and group relief election rules have been adapted to entail, to a certain extent, retroactive benefits when the election in respect of financial years opened during 2009 is time-barred:

a) The election for the group relief regime is normally required to be filed no later than 3 months after the beginning of the financial year for which group relief is claimed. Therefore, if the fiscal year started, say, on 1<sup>st</sup> October 2009 the election was due to be filed no later than 31 December 2009, i.e., before the amended Finance bill for 2009 came into force. To avoid penalizing companies which would be time-barred for group relief election with respect to their 2009/2010 financial year, the new rules provide for a special extended deadline for financial years ending as from 31 December 2009 which started before 1<sup>st</sup> December 2009. The election must then be filed no later than 28 February 2010.

Example:



- b) With respect to financial years ended from 1<sup>st</sup> September 2004 to 30 December 2009, companies may claim the benefit of the new regime in relation to their French affiliates which had not been included in the tax group. Presumably, the claims will be admitted if they are filed no later than 31 December 2010.

### **Anti Tax Avoidance and Fraud Measures**

The Amended Finance Bill for 2009 also contains a series of measures which aim at preventing and penalizing transactions and operations which the French tax authorities deem to entail or facilitate tax avoidance or fraud.

Those measures are focused on transactions, income flows and operations involving territories and states which are qualified as "Non-Cooperative Territories or States" ("NCTS"). Whether or not a territory or state will be considered an NCTS will depend on a series of tests contained in the law. A territory or state will be considered an NCTS if it meets all of the following conditions:

- It is not a member state of the European Union;
- Its position in terms of transparency and exchange of information in terms of tax has been reviewed by the OECD;
- It has not signed a treaty with France containing a clause of administrative assistance entailing the exchange of information necessary to the application of tax legislation; and
- It has not signed a similar treaty with 12 other states or territories.

It is expected that a list of those NCTSs will be published shortly by ministerial Decree. The list will be updated every 1<sup>st</sup> January. The anti-avoidance and fraud measures will apply to territories and states newly added to the list only as from 1<sup>st</sup> January of the following year. For those territories and states that are removed from the list, the measures will cease to apply immediately.

The following charts highlight the impact of the anti-tax avoidance and fraud measures in situations where residents of NCTSs are concerned compared with situations involving residents of territories and states which do not qualify as NCTSs (subject to tax treaty provisions if applicable).

### 1. Dividends Paid Outside France (Article 119 bis of the French Tax Code)

<b>Recipient is an ordinary non-resident</b>	
Dividends paid to an individual	Dividends are subject to a withholding tax at a maximum rate of 25%
Dividends paid to a company	<ul style="list-style-type: none"> <li>• Withholding tax of 25%</li> <li>• Exemption if recipient is an EU qualified parent company</li> </ul>

<b>Dividends are paid in an NCTS</b>	
Dividends paid to an individual	As from 1 <sup>st</sup> March 2010: Withholding tax of 50% applies if dividends are paid in an NCTS (regardless of the country of residence of the recipient)
Dividends paid to a company	As from 1 <sup>st</sup> March 2010: Withholding tax of 50% applies if dividends are paid in an NCTS (regardless of the country of residence of the recipient)

### 2. Dividends Received from a Non-French Distributing Company (Article 145 FTC)

<b>Dividends received by a French company</b>	
<b>Payor is an ordinary non-resident</b>	<b>Payor is a resident of an NCTS</b>
<ul style="list-style-type: none"> <li>• Taxable at ordinary rate of 33.33%; or</li> <li>• Exemption of 95% of the dividend if the French company qualifies as a parent company, i.e., it has owned at least 5% of the capital of the company paying the dividends for at least 2 years</li> </ul>	As from 1 <sup>st</sup> March 2010: Dividends received from an NCTS will be excluded from the 95% exemption, and are therefore fully taxable at the ordinary rate of 33.33%

### 3. Interest Paid Outside France (Article 125 A III FTC)

<b>Interest paid to an individual or company</b>	
<b>Recipient is an ordinary non-resident</b>	<b>Recipient is a resident of an NCTS</b>
As from 1 <sup>st</sup> March 2010, interest paid to a non-resident will no longer be subject to any withholding tax	<p>As from 1<sup>st</sup> March 2010: Withholding tax of 50% applies if interest paid in an NCTS (regardless of the country of residence of the recipient) unless the payor of the interest demonstrates that the purpose of the transactions in respect of which the interest is paid was not the localization of the interest in an NCTS</p> <p>Exceptions have been provided for certain loans executed prior to 1<sup>st</sup> March 2010</p>

#### 4. Capital Gains Realized by Non-Residents (Article 244 bis A and 244 bis B FTC)

	Capital gain realized by an ordinary non-resident	Capital gain realized by a resident of an NCTS
Gains derived from French real property (including real property companies)	Gains are subject to a withholding tax at the rate: <ul style="list-style-type: none"> <li>• 16% if the gain is derived by an individual resident of the EU, Norway or Iceland</li> <li>• 19% if the gain is derived from a French SIIC or other French listed real property company</li> <li>• 33.33% in other cases</li> </ul>	As from 1 <sup>st</sup> March 2010: The gain derived by a person or entity which is domiciled, established or formed in an NCTS is subject to a 50% withholding tax
Gains on shares issued by French companies (other than real property companies)	A withholding tax of 18% applies if, at any time during the 5-year period prior to the sale, the seller has owned more than 25% of the French company. The gain is otherwise exempt	As from 1 <sup>st</sup> March 2010: The gain derived by a person or entity that is domiciled, established or formed in an NCTS is subject to a 50% withholding tax, regardless of the percentage held in the French company

#### 5. Capital Gains Derived by French Companies from Non-French Participations (Article 219 I (a) quinquies FTC)

Participation in a non-resident company	
Ordinary non-resident company	Company which is a resident of an NCTS
<ul style="list-style-type: none"> <li>• The gain is taxable at 33.33%;</li> <li>• Exemption of 95% of the gain if the French company has owned at least 5% of the capital of the foreign company for at least 2 years</li> </ul>	As from 1 <sup>st</sup> January 2011: The gain is taxable at the ordinary rate of 33.33%

#### 6. Deduction of Certain Expenses (Article 238A FTC)

Interest, royalties, and service remunerations paid by a French enterprise	
Recipient who is a resident of an ordinary low-tax jurisdiction	Recipient is a resident of an NCTS
Payments are deductible for tax purposes only to the extent that the French payor is able to demonstrate that the expenses (i) relate to actual transactions, and (ii) the amount is not abnormal or exaggerated	As of 1 <sup>st</sup> January 2011: A further condition is imposed: The payor must evidence that the main purpose or main effect of the transactions to which the expenses relate is not to permit a transfer of profits to an NCTS

## 7. CFC Rules (Article 209B FTC)

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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Ordinary CFC rules	CFC is located in an NCTS
<p>Under CFC rules, the profits which a French enterprise derives from a low-tax jurisdiction, through an establishment or an entity which it controls, are subject to French corporate tax in the hands of the French enterprise.</p> <p>Exceptions to CFC taxation:</p> <p><u>Geographical exception:</u> The foreign establishment or entity is situated in another state of the European Union, and the establishment's operations or the ownership of the foreign entity cannot be regarded as an artificial structure; or</p> <p><u>Local business exception:</u> The profits of the foreign establishment or entity (i) are derived from an effective industrial or commercial activity carried out within the relevant foreign jurisdiction, (ii) no more than 20% of those profits derive from the management of its investment assets or the investments assets of other companies of the group, and (iii) no more than 50% of the profits derive from intra-group supply of services.</p> <p>If the ratios provided for under 2(ii) and 2(iii) above cannot be met, CFC rules will not apply provided that the French enterprise is able to demonstrate that the main purpose of the operations carried out by the foreign establishment or entity is not the localization of profits in a low-tax jurisdiction.</p>	<p>As from 1<sup>st</sup> January 2010:</p> <p>The burden of proof is reversed: in order to benefit from the geographical or local business exceptions, the French enterprise is required to prove that it satisfies the conditions of the exceptions.</p> <p>Furthermore, the French enterprise is required to provide all relevant information which will enable the tax authorities to control the enterprise's entitlement to the CFC exception.</p>

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