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Global Tax Alert

French court rules taxes levied on capital gains on sale of French shares by non-EU companies is contrary to free movement of capital

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Executive summary

On 20 October 2020, a French administrative court of appeals held that a legal entity resident in a non-European Union (EU) country is entitled to a refund of the tax paid on capital gains resulting from the sale of shares in a French company (Article 244 bis B of the French Tax Code (FTC)) on the ground that such tax is contrary to the free movement of capital since the grandfathering clause of Article 64 of the Treaty on the Functioning of the European Union (TFEU) is not applicable.[1]

Detailed discussion

The grandfathering clause of Article 64 of the TFEU allows EU Member States to maintain restrictions on the movement of capital to or from third countries provided that such restrictions existed on 31 December 1993 (the temporal condition) and relate to direct investments (the material condition).

In the case at hand, an entity headquartered in the Cayman Islands claimed the refund of the tax paid on capital gains resulting from the sale of shares in a French company in which the foreign entity held 27% of the share capital of the French company by application of Article 244 bis B of the FTC on the ground that such a tax constituted a difference in treatment contrary to the free movement of capital.

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The lower administrative court held that the tax constituted a restriction to the free movement of capital since a French entity would have benefited from the French participation exemption and would have thus been subject to corporate income tax on a portion of the capital gains.[2] However, the court considered that this restriction fell within the scope of the grandfathering clause of Article 64 of the TFEU since both the material condition and the temporal condition were met.

In its decision rendered on 20 October, the administrative court of appeals held on the contrary that the temporal condition of the grandfathering clause was not met.

First, as previously decided by the French administrative supreme court (*Conseil d'Etat*), the provisions of Article 244 bis B prior to their amendments by the *French Finance Act for 1993* were not applicable to capital gains realized by legal entities not subject to French income tax.[3]

Second, the *French Finance Act for 1993* of 30 December 1993 was published in the *French Official Journal* on 31 December 1993 and, in the absence of an overriding clause, the amendments to Article 244 bis B of the FTC only came into force on 2 January 1994.

As a consequence, the administrative court of appeals held that the taxation of capital gains realized by legal entities not subject to French income tax did not exist on 31 December 1993. Thus, the grandfathering clause did not apply, and the disputed taxation was contrary to the free movement of capital.

Implications

It is likely that the French tax authorities will file an appeal against this decision. However, as a protective measure and without prejudging the position of the French *Conseil d'Etat*, foreign companies resident in non-EU country that have paid the tax on capital gains on the sale of shares in accordance with Article 244 bis B of the FTC should consider the opportunity to claim the refund of such tax.

As recently decided by the French *Conseil d'Etat*, companies are entitled to claim for the refund of the whole amount of the tax paid and not only the difference between the tax and the amount of French corporate income tax that would have been due if the company would have been resident in France.[4]

In accordance with the time-limits set out by Article R.196-1 of the French Tax Procedure Code, companies must claim the tax paid in 2018 before 31 December 2020.

Endnotes

1. Administrative court of appeal of Versailles, 20 October 2020, nr 18VE03012, *Sté Runa Capital Fund I LP*.
2. Pursuant to Artice 219, I, a quinquies of the FTC, capital gains derived by a French resident entity from the sale of qualifying participations that have been held for at least two years before their sale are subject to French corporate income tax on 12% of the gross capital gains. Qualifying participations are: (i) "titres de participation" (specific class of shares for accounting purposes that enables the shareholder to have a controlling interest); and (ii) participations eligible for the dividend participation exemption regime if the shareholder holds at least 5% voting rights.
3. Conseil d'Etat, 25 April 2003, nr 241210, *Eurofind Holding Ltd*.
4. Conseil d'Etat, 14 October 2020, nr 421524, *AVM International Holding*.

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