22 December 2017

Global Tax Alert

# French Parliament approves Finance Bill for 2018 and second Amending Finance Bill for 2017

EY Global Tax Alert Library

Access both online and pdf versions of all EY Global Tax Alerts.

Copy into your web browser:

www.ey.com/taxalerts

## Executive summary

On 21 December 2017, the French Parliament approved the Finance Bill for 2018 and the second Amending Finance Bill for 2017.

Except for the constitutionality review by the *Conseil constitutionnel* (French Constitutional Council), these two Bills are final and expected to be published before 31 December 2017.

This Alert summarizes the main corporate tax provisions relating to companies.

## Detailed discussion

### Decrease of the French corporate income tax rate

The Finance Bill for 2018 provides for a progressive decrease of the French standard corporate income tax (CIT) rate from 33.1/3% to 25% by 2022, as follows:

- For fiscal years (FYs) starting on or after 1 January 2018, a 28% CIT rate will apply on the first €500,000 of taxable income of all entities. Taxable income in excess of €500,000 will still be subject to a 33.1/3% CIT rate.
- For FYs starting on or after 1 January 2019, a 28% CIT rate will apply on the first €500,000 of taxable income of all entities. Taxable income in excess of €500,000 will be subject to a 31% CIT rate.

EY

Building a better working world

- For FYs starting on or after 1 January 2020, a 28% CIT rate will apply for all entities.
- For FYs starting on or after 1 January 2021, a 26.5% CIT rate will apply for all entities.
- For FYs starting on or after 1 January 2022, the 25% CIT rate will apply for all entities.

Moreover, the reduced tax rate of 15% applicable to Small and Medium Enterprises (SMEs) will be maintained for the first €38,120 of taxable income, provided that: (i) the revenue of the entity does not exceed €7.63 million; (ii) the share capital of the entity is fully paid up; and (iii) the entity is held at least up to 75% by individuals or other entities which meet the above conditions.

Finally, for FYs starting on or after 1 January 2018, the tax rates applicable to certain profits realized in France by nonresidents (in particular, royalties and capital gains on the transfer of substantial participations) will be aligned to the standard CIT rate (i.e., 33.1/3% in 2018, 31% in 2019, 28% in 2020, 26.5% in 2021 and 25% as from 2022). Furthermore, for FYs starting on or after 1 January 2020, the French domestic withholding tax on dividends paid to nonresident companies will be aligned to the standard CIT rate (i.e., 28% in 2020, 26.5% in 2021 and 25% as from 2022).

## Repeal of the 3% distribution tax

The 3% distribution tax will be repealed for distributions paid by French companies as from 1 January 2018.

A recent decision rendered by the Court of Justice of the European Union (CJEU) held that the 3% distribution tax was contrary to the European Union (EU) Parent-Subsidiary Directive where it applies to profits redistributed by a parent company that originated from a subsidiary established in the EU falling within the scope of the Directive.[1] The French Minister of Finance had announced this repeal on 20 July 2017.[2]

## Adjustment of the so-called Carrez interest deductibility limitation rule

For FYs beginning on or after 1 January 2012, the "Carrez rule" has been limiting the deductibility of interest expenses on debt subscribed for the acquisition of qualifying participations by a French company that is not able to demonstrate: (i) that the decisions concerning these investments are effectively made by the French acquiring company itself, or by a company established in France that controls or is directly controlled by the French acquiring company; and (ii) that the French acquiring company itself, or a company established in France that controls or is directly controlled by the French acquiring company, has effective control or influence over the acquired entities.

Since its compatibility with the EU freedom of establishment was debatable, the Carrez rule has been modified under the Finance Bill for 2018. As a result of this amendment, the Carrez rule will not apply if the French acquiring company is in a position to demonstrate that the decisions related to the acquired shares are made and that the effective control or influence is exercised over the acquired entities either: (i) by the French acquiring company itself; or (ii) by a company established in France, or having its headquarters in the EU, or in a country of the European Economic Area (EEA) having concluded with France a treaty aimed at combating tax fraud and evasion, that controls or is directly controlled by the French acquiring company.

Such amendment of the Carrez rule will apply to CIT due for FYs closed on or after 31 December 2017.

## Replacement of the Tax Credit for Competitiveness and Employment (CICE) by a decrease of employer's social contributions

As from 1 January 2019, the CICE will be repealed and replaced by a decrease in employer's social contributions, as follows:

- A 6% decrease would apply on wages below 2.5 times the French regulated minimum wage.
- An additional decrease of 3.9% would apply on French regulated minimum wages (resulting in a global decrease in the employer's social contributions of 9.9%).

As a transitional measure, the CICE will be maintained in 2018, but its rate will be reduced from 7% to 6% for wages paid as from 1 January 2018.

## Adjustment of transfer pricing documentation requirements to comply with BEPS Action 13

The Finance Bill for 2018 introduces the transfer pricing documentation requirements relating to the Organisation for Economic Co-operation and Development Base Erosion and Profit Shifting (BEPS) Action 13 (Master File and Local File) in the French legislation by amending Article 13 AA of the French tax procedures code (*Livre des procédures fiscales*).

## Repeal of the advance tax ruling required under Article 210 C of the French Tax Code (FTC) and related amendments

Further to the *Euro Park Service* case, whereby the CJEU ruled that the tax ruling required under Article 210 C of the FTC prior to any restructuring operations involving foreign companies was contrary to EU law,[3] the second Amending Finance Bill for 2017 modifies the provisions of French domestic tax law relating to mergers and other reorganization operations (and in particular, repeals this advance tax ruling requirement).

### New anti-abuse provision

A new general anti-abuse provision is introduced, whereby any "merger, demerger or contribution of assets operation having as a main purpose, or as one of its main purposes, tax fraud and avoidance" will not benefit from the French favorable merger tax regime, meaning that the transaction will have to have a valid business purpose, such as the reorganization or the rationalization of the activities carried out by the companies involved in the operations. This new anti-abuse provision applies to both domestic and cross-border mergers and related transactions.

Moreover, this second Amending Finance Bill provides for the introduction of a new ruling process whereby the taxpayer could ask the French tax authorities (FTA) to confirm, prior to the transaction, that the contemplated operations do not fall within the scope of the anti-abuse rule. In the absence of a formal answer from the FTA within six months, the transaction will be considered as valid and the application of the French favorable merger tax regime can no longer be challenged on the ground of the anti-abuse provision.

### Amendment of the requirements to be met in order for demergers and contributions of assets operations to benefit from the French favorable merger tax regime

As per the second Amending Finance Bill, the requirements to be met in order to benefit from the French favorable merger tax regime will differ depending on whether the transaction (i.e., either a demerger or a contribution of assets) aims at transferring one or several "complete line(s) of business."

Provided that the assets contributed constitute a qualifying "complete line of business," the benefit of the favorable merger tax regime will no longer be subject to the three-year holding requirement.[4] However, in the context of a demerger, the condition whereby each beneficiary company must receive at least one complete line of business is maintained.

In the case where the contributed assets do not constitute a qualifying "complete line of business," the transaction can still benefit from the favorable merger tax regime, provided that an advance tax ruling is granted by the FTA. Such tax ruling could be obtained under the main following conditions:

- The transaction is economically justified by a business purpose and, in particular, would allow: (i) the beneficiary company to operate a business activity on an autonomous basis; (ii) to improve the structures; or (iii) to set up an association between various parties, through a commitment to keep the shares received in exchange for the contribution for at least three years.
- The conditions provided under Article 210-0A of the FTC are met (in particular the transaction does not fall within the scope of the new general anti-abuse provision and the new filing requirement introduced for cross-border transactions is fulfilled).
- The modalities of the transaction allow the future taxation in France of the deferred capital gains.

### Cross-border transactions

The second Amending Finance Bill repeals the advance tax ruling currently required prior to any merger, demerger or contribution of assets implemented to the benefit of a foreign beneficiary company.[5] Thus, a tax ruling will only be required in the context of a transaction that does not involve a qualifying "complete line of business."

However, in order for the transaction to benefit from the favorable merger tax regime, the contributed assets have to be allocated to a French permanent establishment of the foreign beneficiary company.

Finally, provided that the transaction will benefit from the favorable merger regime, the French contributing company will have to file a specific return in order for the FTA to understand the purpose of the transaction as well as its consequences.[6]

### Amendments with respect to "apport-attribution" (French spin-off) operations

From a French tax perspective, a spin-off can be defined as a two-step transaction whereby a company: (i) contributes part of its assets and liabilities characterizing a complete line of business to another company, in exchange for shares in this beneficiary company; and then (ii) distributes the shares received in exchange for the contribution to its shareholders. Pursuant to Article 115-2 of the FTC currently in force, the distribution of the shares in the beneficiary company received

in exchange for the contribution to the shareholders of the contributing company can be disregarded for tax purposes, provided that, among other conditions, a specific tax ruling is granted by the FTA.

The second Amending Finance Bill for 2017 provides for the application of this specific tax regime to all distributions of shares received in exchange for a contribution to the shareholders of the French contributing company, provided that the following cumulative conditions are met:

- The shares that are distributed have been received in exchange for a contribution of assets constituting a "complete line of business."
- The initial contribution benefitted from the favorable merger tax regime.
- At least one complete line of business remains at the level of the contributing company further to the contribution.
- The shares in the beneficiary company are distributed to the shareholders of the contributing company pro rata their shareholding in the latter, within a one-year period as from the contribution.

Furthermore, if the assets contributed do not constitute a "complete line of business" or the contributing company does not keep at least one "complete line of business" further to the transaction, the distribution could still benefit from the specific spin-off tax regime, provided that an advance tax ruling is granted by the FTA. Such tax ruling could be obtained under the following main conditions:

- The contribution is economically justified by a business purpose and, in particular, would allow: (i) the beneficiary company to operate a business activity on an autonomous basis; (ii) to improve the structures; or (iii) to set up an association between various parties, through a commitment to keep the shares received in exchange for the contribution for at least three years.
- The conditions provided under Article 210-0A of the FTC are met (in particular the transaction does not fall within the scope of the new general anti-abuse provision and the new filing requirement introduced for cross-border transactions is fulfilled).
- The modalities of the transaction allow the future taxation in France of the deferred capital gains.
- The distribution of the shares in the beneficiary company to the shareholders of the contributing company is economically justified by a business purpose and, in particular would allow: (i) the contributing company to operate a business activity on an autonomous basis; (ii) to improve the structures; or (iii) to set up an association between various parties, through a commitment to keep the shares of the contributing company for at least three years.

### Entry into force

The above described measures will apply to mergers, demergers, contribution of assets and spin-off operations realized as from 1 January 2018.

## Non-deductibility of foreign withholding taxes (WHT) for French tax purposes

Based on recent decisions from the *Conseil d'Etat* (French Administrative Supreme Court), a French company receiving foreign source income, and that cannot offset the foreign tax credit provided under the applicable double treaty (e.g., because of its loss-making position) can deduct the corresponding WHT levied in the source country for French tax purposes, provided that the double tax treaty does not expressly prevent the parties from doing so.[7]

The second Amending Finance Bill provides for an amendment of Article 39-1-4[0] of the FTC, in order to forbid the tax deductibility of "taxes levied by a State or territory in accordance with the provisions of a double tax treaty aiming at avoiding double taxations concluded between France and this State or territory," irrespective of the wording used in the applicable double tax treaty.

However, WHTs levied in the absence of a double tax treaty or outside the framework of a treaty could still be deducted from the taxable result of the French companies.

This measure will apply to fiscal years ending as from 31 December 2017.

## Adjustment of the tax deferral regime applicable to certain intermediary operations realized by companies

The purpose of this measure is to include into French tax law[8] the administrative guidelines providing for the tax neutral treatment of reverse stock splits (*regroupements d'actions*)[9] and stock splits (*divisions d'actions*).[10]

The above-mentioned operations will benefit from a mandatory tax deferral regime, except for the potential boot received by the company, which would be subject to immediate taxation. Moreover, French tax law is amended in order to mention that the holding period required to benefit from the participation exemption regime is not interrupted as a result of these operations.

These measures will apply to fiscal years ending as from 31 December 2017 for companies, and to income tax due by individuals for 2017 onwards.

## Adjustment of tax law regarding the loan of personnel on a non-profit basis

The ordinance related to the "foreseeability and security of working relationships" dated 22 September 2017 provides for the possibility for large companies[11] to loan employees on a non-profit basis to start-up enterprises[12] and SMEs[13] that are not members of their group. The loan is performed on a "non-profit basis" when the amount invoiced by the lending company is lower than the sum of: (i) the wages paid to the employee; (ii) the corresponding social contributions; and (iii) the expenses reimbursed to the employee during the loan.

From a French tax perspective, the second Amending Finance Bill for 2017 amends Article 39 of the FTC to allow the tax deduction of the personnel costs relating to the loaned employees at the level of the lending company, within the limit of €200,000 over three fiscal years.

This measure will be applicable as from 1 January 2018.

## Regulations related to the obligations of financial institutions with respect to the Automatic Exchange of Information (AEOI) and *Foreign Account Tax Compliance Act* (FATCA)

The second Amending Finance Bill includes provisions related to the obligations of financial institutions in relation to the AEOI and FATCA provisions related to financial accounts, notably regarding carrying and archiving the audit trail of their client due diligences, as well as their supervision by the French financial regulator (in addition to the tax authority). The second Amending Finance Bill mentions also new penalties for financial institutions and clients in case of failure to meet certain requirements.

## Decrease of the interest for late filing or late payment and of the interest on arrears

Considering the decrease of the interest rates as well as the costs resulting from the payment of interest on arrears related to tax refunds, the second Amending Finance Bill provides for a decrease in the interest rate for tax and customs purposes from 0.40% to 0.20% per month (i.e., 2.40% per year).

This reduced rate will apply to interest due from 1 January 2018 to 31 December 2020.

## Endnotes

1. See EY Global Tax Alert, *CJEU finds French 3% contribution on distributed profits incompatible with article 4-1 of the EU Parent-Subsidiary Directive*, dated 1 June 2017.
2. See EY Global Tax Alert, *French Minister of Finance announces repeal of 3% distribution tax*, dated 28 July 2017.
3. CJEU, 8 March 2017, C-14/16, Euro Park Service.
4. Under the current French domestic tax rules (Article 210 B of the FTC), in order for a demerger or a contribution of assets transaction to benefit from the favorable merger tax regime, the contributing company or the shareholders of the demerged company must take the commitment to hold the shares received in exchange for the contribution for at least three years.
5. However, in practice, the favorable merger tax regime would not apply should the beneficiary company be a resident of a non-EU Member State with which France has not concluded a tax treaty including an administrative assistance clause for the prevention of fraud and tax evasion.
6. Failure to file such specific return would trigger a €10,000 fine per transaction.
7. CE, 12 March 2014, n 362528, Celine SA; CE, 7 June 2017, n 386579, min. c/ Société LVMH Moët Henessy Louis Vuitton.
8. Article 38-7 ter of the FTC.
9. Operation consisting in reducing the number of issued shares without decreasing the share capital of the company.
10. Operation whereby the number of shares is increased in proportion to the decrease of the nominal.
11. Companies or group of companies hiring at least 5,000 employees.
12. Enterprises established for less than eight years at the moment of the loan of personnel.
13. Enterprises hiring a maximum of 250 employees.

For additional information with respect to this Alert, please contact the following:

**Ernst & Young Société d'Avocats, Paris**

- Eric Verron eric.verron@ey-avocats.com

**Ernst & Young LLP, French Tax Desk, New York**

- Frédéric Vallat frederic.vallat@ey.com
- Mathieu Pinon mathieu.pinon1@ey.com
- Audrey Teurlings audrey.teurlings1@ey.com

**Ernst & Young LLP, Financial Services Desk, New York**

- Sarah Belin-Zerbib sarah.belinzerbib@ey.com

EY | Assurance | Tax | Transactions | Advisory

**About EY**
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2017 EYGM Limited.
All Rights Reserved.

EYG no. 07287-171Gbl

1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

**ey.com**