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# THE INWARD INVESTMENT AND INTERNATIONAL TAXATION REVIEW

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THIRD EDITION

EDITOR  
TIM SANDERS

LAW BUSINESS RESEARCH

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For further information please email  
[Adam.Sargent@lbresearch.com](mailto:Adam.Sargent@lbresearch.com)

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Editor  
TIM SANDERS

LAW BUSINESS RESEARCH LTD

# THE LAW REVIEWS

THE MERGERS AND ACQUISITIONS REVIEW  
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# EDITOR'S PREFACE

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The downturn in economic activity has led to increased competition in the global market as jurisdictions compete to encourage inward investment. Businesses are increasingly receptive to moving to more business-friendly jurisdictions, and are more mobile than ever. One significant factor for any business considering where to locate its headquarters, offices and production facilities is the impact that choosing a particular location has on its effective tax rate. This requires not only a detailed evaluation and comparison of the tax benefits and incentives available in competing jurisdictions, but also consideration of the tax consequences of moving capital and income flows across international borders, and increasingly widespread and complex rules intended to penalise domestic businesses for moving jobs and economic activity elsewhere. Consideration of such cross-border tax opportunities, issues and conflicts between tax systems requires business tax advisers to be more aware than ever before of tax laws beyond the geographical boundaries of the country where they practice.

The aim of this book is to provide a starting point for readers, and to assist businesses and advisers by providing topical and current insights from leading experts on the tax issues and opportunities in their respective jurisdictions (or, in one case, in the European Union). While specific tax advice is always essential, it is also necessary to have a broad understanding of the nature of the potential issues and advantages that lie ahead; this book provides a guide to these.

I would like to thank the contributors to this book for their time and effort, and above all for their expertise. I would also like to thank the publisher and the team for their support and patience. I hope that you find the work useful, and any comments or suggestions for improvement that can be incorporated into any future editions will be gratefully received.

The views expressed in this book are those of the authors and not those of their firms, the editor or publishers. Every endeavour has been made to ensure that what you read is the latest intelligence.

**Tim Sanders**

Skadden, Arps, Slate, Meagher & Flom LLP

London

January 2013

## Chapter 11

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# FRANCE

*Philippe Derouin*<sup>1</sup>

### I INTRODUCTION

France is generally favourable to inward investment, especially where it creates or maintains jobs on French territory. A government agency, the Invest in France Agency, has been created to promote and facilitate international investment. It publishes a brochure that provides most of the relevant legal, regulatory and tax information.<sup>2</sup> Another government publication, the ‘France attractiveness scoreboard’, examines the indicators that position France among several western countries in order to enable foreign investors to compare and make judgments between European countries competing to attract job-creating investment projects.

The French legal and tax environment has considerably evolved over the last couple of years, and shall be modified further as a result of the Finance Bill for 2013 to be enacted before 31 December 2012; the financial crisis and the need to reduce budget deficits have prompted several substantial tax changes, some of which affect inward investment. As the IMF recently stated, ‘With rates of taxation (and government spending) already among the highest in Europe, the ratcheting up of the tax burden in 2012-13 further undermines incentives to work and invest, and places France at an additional competitive disadvantage relative to its peers’.<sup>3</sup>

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1 Philippe Derouin is a partner at Skadden, Arps, Slate, Meagher & Flom LLP, Paris office.

2 ‘Doing business in France’, available at [investinfrance.org](http://investinfrance.org).

3 France: 2012 Article IV Consultation – Concluding Statement; Paris, 29 October 2012.

## II COMMON FORMS OF BUSINESS ORGANISATION AND THEIR TAX TREATMENT

### i Corporate

French law provides for several forms of corporate entities for business activities:

- a* the *société anonyme* ('SA'), a joint-stock corporation, the shares of which may be offered to the public;
- b* the *société à responsabilité limitée* ('SARL'), a limited liability private company;
- c* the *société par actions simplifiée* ('SAS') which is examined further below;
- d* the *société en commandite par actions* ('SCA'), a limited partnership with stock; and
- e* the *société européenne* ('SE' or European Company).

For French tax purposes, all these entities are subject to French corporation tax (except where an SARL or SAS is closely held by individuals and has elected to be treated as a partnership). An SA must have at least seven shareholders and three directors, and an SCA must have at least a general partner and three shareholders, who may be the three members of the supervisory board. SARLs and SASs may have one single shareholder. For US tax purposes, only the SA is deemed a *per se* corporation; other French corporate vehicles may be regarded as partnerships or, if held by a single shareholder – which may be the case for an SARL or an SAS – as disregarded entities.

### SAS

The SAS is a limited liability company that is often used as a corporate vehicle for wholly owned subsidiaries, intermediary holding companies and joint ventures, regardless of the nationality of the parties. One of the major advantages of the SAS is its flexibility and the wide latitude it offers to its shareholders with respect to corporate governance. The only major downside to this corporate form is that since the SAS is in essence a closely held company, it is prohibited from making public offerings of its shares. Should the investors contemplate an IPO of their French corporate vehicle at a later stage, the SAS would need to be converted into a public limited company (SA) in order to be floated on the stock market.

Subject to a limited number of legal requirements, the SAS is primarily governed by the terms and conditions of its articles of association. The articles govern matters such as the organisation of the management, and the amount and type of equity. Where an SAS is used as a joint-venture company, the articles may determine the allocation of the voting rights among the shareholders. A unanimous vote of the shareholders is also required with respect to certain matters.

Great flexibility is granted to the form that shareholders' decisions may take and the conditions applicable to the making of such decisions. In particular, the articles determine the manner in which decisions that require shareholder approval are to be taken.

While the articles can determine the persons competent to make decisions (e.g., they may provide that veto power may be given to certain persons within or outside the company, such as a banker or important customer), decisions relating to certain essential matters may only be made by the shareholders.

## ii Non-corporate

### *French law partnerships*

Most French law partnerships are legal entities that are registered as such with the Business and Companies Registrar. Generally, the partners have unlimited liability, and are personally liable for income or corporation tax on their share of the income or profits of the partnership as if they had generated this themselves. Unless they have elected to be subject to French corporation tax, French partnerships are not subject to any income or corporation tax on their profits, but they are required to maintain separate accounts and file tax returns, and may be subject to tax audit procedures. As a result of such audit procedures, some taxes may be assessed on the partnership (VAT, local taxes including the local economic contribution, payroll taxes, etc.) while other taxes may be assessed upon the partners only (income or corporation tax). Some withholding taxes are assessed on both, and may be challenged both by the partnership (viewed as a paying agent) and by the partners.

For international tax purposes, where a French partnership is liable to or has elected to be subject to corporation tax, it may be regarded as a hybrid entity. In other situations, a French partnership can become a reverse hybrid where it is deemed to be a corporation in the country of (some of) its partners. Accordingly, French partnerships may cover the full spectrum from transparent to opaque via hybrid or reverse hybrid.

The most common forms of French partnership are:

- a* *société en nom collectif* ('SNC'), or general partnership, in which all partners must qualify to carry out a trade in France and are jointly liable for the SNC's debts;
- b* *société civile*, or non-trading partnership, which may not engage in commercial activities and which is mainly used for real estate investment and leasing, certain asset management activities such as portfolio holding and certain (regulated) professional activities;
- c* *société en commandite simple* ('SCS'), or limited partnership, where the share of the profits accruing to limited partners is subject to corporation tax and deemed as dividends as and when distributed to them; and
- d* economic interest groupings (either French 'GIE' or European 'GEIE').

The *société en participation* is an unregistered partnership that does not enjoy separate legal personality. Generally, it is subject to the same tax treatment as a partnership provided the names and addresses of its members are disclosed to the French tax authorities. *Sociétés en participation* are commonly used as joint venture vehicles in the construction industry, the performing arts and the publishing sector, and also to a certain extent in the financial sector.

## iii Other French entities

Assets may be held and activities may be carried out through the French equivalent of common trusts (*fiducie*), which are tax-transparent.

Certain investment trusts are tax-exempt, such as funds for collective investment in transferable securities or securitisation vehicles. Foreign trusts also may hold assets in France – either directly or indirectly through French or foreign entities – and accordingly be subject to certain disclosure obligations.



***Liaison offices: a presence without commercial activity***

Liaison offices may conduct only a very limited range of non-commercial operations, such as prospecting, advertising, providing information, storing merchandise, or other operations of a preparatory or auxiliary nature. Such offices are not separate legal entities. Invoices must be issued by the head office, where any contracts must be signed.

Liaison offices are not permanent establishments for tax purposes. They are not subject to corporate tax or VAT, but must pay certain local taxes and social security contributions on the payroll. However, where commercial activities are conducted in France, in particular where any employee signs contracts on behalf of the foreign company and employer, or where a full manufacturing cycle is completed in France, or where a fixed place of business is maintained in France through which the company conducts all or part of its trade, the foreign company may be deemed to have a branch or permanent establishment in France. Companies wishing to ascertain their tax position may ask the tax authorities to rule in advance whether or not their establishment qualifies as a permanent establishment in France (the tax authorities are deemed to have given tacit consent if no reply is received within three months).

***Distribution through sales intermediaries***

A foreign company may also develop commercial activities in France through a variety of sales intermediaries without being deemed to be established in France, notably through individual sales representatives, independent sales agents (i.e., a self-employed individual, or a company, that acts on its behalf) and independent distributors.

A *commissionaire* (i.e., an undisclosed agent acting on behalf of the principal but in its own name) may have more important functions, risks and costs. In a recent judgment the Conseil d'État<sup>4</sup> noted that, as a rule, a *commissionaire* cannot constitute a permanent establishment of its principal, unless the contractual provisions or the circumstances differ from a true *commissionaire* agreement.

***French branch or permanent establishment***

Branches of foreign companies may generally carry out all the operations of an industrial or commercial company in France, subject to certain professional regulations. They must be registered with the French registrar of businesses and companies ('the RCS'), and must be headed by a legal representative entitled to do business in France and whose identity and particulars must also be published with the RCS. In certain situations, the French tax authorities are inquisitive upon undisclosed permanent establishments, including where a French subsidiary performs certain duties of a related foreign company.

Branches are permanent establishments with regard to tax laws and must pay corporate tax, VAT, local taxes (including the local economic contribution) and social security contributions. The subsequent conversion of a branch into a separately incorporated subsidiary is possible, and must comply with the rules governing the sale or transfer of a business or going concern. Such transfer is generally subject to taxation except where rollover relief applies.

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4 The French Supreme Administrative Court.

### III DIRECT TAXATION OF BUSINESSES

#### i Tax on profits

##### *Determination of taxable profit*

##### *French corporation tax*

French corporation tax is assessed on the earnings determined by commercial accounts established under French generally accepted accounting principles ('GAAP'), subject to specific tax adjustments. Income and expenses are recognised on an accruals basis. Some financial instruments, and any outstanding foreign currency debts and receivables, are taxed on a mark-to-market basis.

Favourable tax adjustments include:

- a* accelerated depreciation of equipment, and certain immovable fixtures, full and immediate depreciation of some IP acquisition costs; and
- b* participation exemption on dividends received (95 per cent exempt) and capital gains realised (90 per cent exempt) upon a substantial (i.e., at least 5 per cent) participation in French and foreign companies or partnerships (unless established in a non-cooperative state or territory ('NCST')).

Unfavourable tax adjustments include:

- a* no deduction for amortisation of goodwill, trademarks and land;
- b* no deduction for most penalties;
- c* limited deduction (85 per cent in fiscal years 2012 and 2013, 75 per cent in fiscal year 2014 and thereafter) of net financial expenses;
- d* restricted or deferred deduction of financial expenses towards related companies ('thin capitalisation'), possibly resulting in reduced or forfeited deduction;
- e* restricted deduction of payments for services, including interest and royalties, to any entity domiciled or established in a low tax country or in an NCST; and
- f* limited deduction for company cars and certain other expenses.

##### *Territorial scope of corporation tax*

Generally, French corporation tax applies to earnings from business enterprises carried out in France or the taxation of which is attributed to France under a double taxation treaty. French corporation tax also applies to any profits generated by controlled foreign corporations established in a low tax country unless a *bona fide* commercial purpose test is satisfied. Different tests apply depending upon whether the controlled foreign corporation ('CFC') is located inside or outside the EU and, if outside, in an NCST.

##### *Capital and income*

Income and capital gains are taxed at the same rates and can be aggregated, except for capital gains and losses realised upon the disposal of substantial participations, which are exempt or subject to special tax rates. A special rate also applies to royalties and proceeds from the licensing or sale of patents and similar industrial property rights. Expenses directly related to such exempt or low-tax gains may only be deducted from such gains.

### *Losses*

Losses may be carried forward indefinitely and survive a change of ownership, but not a cessation or substantial alteration of business. Each fiscal year, carried forward losses may shelter the sum of €1 million plus 60 per cent (to be reduced to 50 per cent by the Finance Bill for 2013) of the current year's profits. They may be carried back for one year and up to €1 million.

### *Rates*

The standard rate of corporation tax is 33 and one-third per cent. In addition, a 3.3 per cent surcharge applies where the annual revenue (turnover) of the company exceeds €7.63 million, thus resulting in an effective rate of 34.43 per cent. Where the corporate sales or revenue – or the total sales or revenue of the companies that are members of a tax consolidated group – exceed €250 million, a further 5 per cent surcharge applies, resulting in an effective tax rate of 36.1 per cent.

Qualifying dividends received and profits made on the sale of substantial participations are exempt, except for a recapture of costs equal to respectively 5 or 10 per cent of the profit or dividend, thus resulting in an effective tax charge of 1.67 or 1.72 per cent on dividends and 3.14 or 3.42 per cent on capital gains.

Special tax rates apply to:

- a* profits generated by the sale of shares in listed real estate companies (19 per cent);
- b* the royalties and proceeds from the license and sale of patents, patentable innovations and manufacturing processes (15 per cent); and
- c* the gain on certain venture capital funds where they do not qualify for the participation exemption.

An overall 3 per cent surcharge further applies to any distributed amounts irrespective of whether they are paid out of taxable profits (thus resulting in an effective tax charge of 36.34 per cent or 38 per cent) or out of exempt profits (thus resulting in a minimum corporate taxation of such profits).

### *Tax credits*

Under French domestic law, many incentives take the form of tax credits, the most important of which is the R&D tax credit, which amounts to 30 per cent of the qualifying expenditure not exceeding €100 million per year and 5 per cent for expenses in excess of such amount.

Except where CFC income is taxable in France, there is no unilateral relief for foreign tax. To the extent foreign-source income is taxed in France, and only where a double taxation treaty applies, foreign withholding taxes may be credited against French corporation tax (except for dividend withholding tax, where the participation exemption applies) pursuant to the relevant double taxation treaty.

### *Administration*

Tax returns are due annually and must be filed electronically. Tax is payable in quarterly instalments, the balance being payable upon filing of the tax return prior to the 15th day of the fourth month following the fiscal year end (i.e., 15 April for corporations whose fiscal year coincides with the calendar year).

Generally, tax returns may be audited and taxes reassessed by the tax authorities up until the end of the third calendar year following the year when a tax was payable. Longer periods of limitation apply in certain cases. In certain situations, where the tax authorities are time-barred from reassessing an element of income or disallowing an expense, the tax may be reassessed on the first non-barred taxable year.

The tax authorities may challenge and set aside any tax avoidance scheme that is either a sham or exclusively tax-driven and seeks to benefit from an advantage contrary to the purpose of the law (GAAR). Substantial penalties apply in such cases (80 per cent or 40 per cent).

Guidance and comfort may be sought from the tax authorities both on points of legal interpretation and how particular facts will be treated. Where formally given, such guidance or clearance is binding upon the tax authorities and the tax courts. Apart from a judicial review of administrative regulations, there is no effective way to challenge a tax position announced by the tax authorities that a taxpayer finds unsatisfactory.

### *Tax grouping*

French tax laws enable corporate taxpayers belonging to the same group to elect for group taxation, resulting in the top French parent company becoming the sole corporate taxpayer for all members of the group and in the exemption of intra-group dividends.

### *Definition of a French tax group*

The group can include only companies that are taxable in France and are at least 95 per cent owned by the parent company, either directly or indirectly through intermediate companies that either are members of the group or are established in an EU jurisdiction. The 95 per cent plus ownership condition must be satisfied for the full 12-month taxation period. Parent companies and qualifying subsidiaries may elect to be included or not in the integrated tax group, which may be modified each year.

### *Group taxable income*

Under the French tax integration or consolidation, the group's taxable income is not the consolidated income of the group (where intra-group profits and losses would have been eliminated), but rather an adjusted combined or amalgamated income of the companies composing the group. Basically it consists of the algebraic sum of the taxable income or losses of all the group members determined as if each of them were independent taxpayers, subject to certain adjustments. Intra-group distributions of dividends are exempt from the 3 per cent corporation tax surcharge on distributed amounts.

As such, there are no transfers or surrenders of losses from one company of the group to another on terms to be mutually agreed. By operation of the law, all the tax losses shown by the members of the group are escalated – together with other tax attributes such as tax credits, either domestic or foreign – to the parent company of the group and sole taxpayer. The parent company may enter into a tax contribution agreement with each of its tax integrated subsidiaries in order to determine the contribution of each subsidiary, and whether the subsidiary is compensated or not for the losses and other tax attributes transferred to the parent company.

### *Exit charges*

Some adjustments to the group income tend to temporarily neutralise the tax effect of certain intra-group transactions or situations, but following the exit of a subsidiary or the termination of the group (including following the acquisition of the parent company, or a merger or demerger where the parent company does not survive), all relevant neutralised items are deneutralised and become taxable or deductible, as the case may be. They must be added to or deducted from the group taxable income for which the parent company is liable to corporation tax. Generally, exits from and termination of the tax group have a retrospective effect on the beginning of the current fiscal year. Where the group terminates as a result of a merger or acquisition of the parent company, the surviving companies of the group may be included in the tax group of the acquirer. Tax losses of the terminated group may be carried forward under certain conditions and restrictions. It is not uncommon for the target company and its ex-parent company to enter into an exit agreement to set certain consequences of the exit of the subsidiary from the tax group, especially with respect to tax losses and credits or other tax attributes.

### ii Other relevant taxes

#### *Business contribution on value added tax*

As a partial substitute for the ill-famed and now removed *taxe professionnelle* (or local business tax), this business contribution on value added ('CVAE') tax of 1.5 per cent is part of the local economic contribution ('CET') and applies annually to the value added by any business established in France. This tax is deductible for corporation tax purposes.

#### *Local taxes*

Businesses established in France must also pay the business contribution on property ('CFE'), which forms the other part of the CET and is calculated, at local authority rates, on the rental value of all properties used for the business.

French or foreign owners of a property located in France are also subject to the real estate tax, based upon the rental value of the property.

#### *Wealth taxes*

Natural persons only are subject to an annual French net wealth tax either on their worldwide assets, if resident in France, or on their French assets, if non-resident. The rate escalates from 0.5 per cent to 1.5 per cent where the total net assets exceed €10 million, but there are many exceptions. Assets held through a foreign trust are included in the taxable base and must be specially reported annually by the trustee.

Legal entities are not subject to a general net wealth tax in France; however, a 3 per cent annual tax is levied on the fair market value of properties directly or indirectly owned by certain foreign entities. Where applicable, the tax is not deductible for corporation tax purposes. Most investors benefit from one or more of the many exceptions applicable, as the tax rule's aim is to discourage anonymous investment in France by presumed tax evaders.

#### *Miscellaneous taxes*

Many other taxes are applicable in France. Some have a very wide scope, such as the apprenticeship tax, based upon payroll in any industry or business sector, the tax on corporate cars, etc.

Other taxes are specific to certain industries (e.g., the payroll tax imposed at rates escalating from 4.25 per cent to 13.6 per cent on businesses that are wholly or partially exempt from VAT such as insurance, banks, etc.) or certain forms of investment.

### *Value added tax*

French VAT applies substantially in line with EU rules on VAT. The standard rate is 19.6 per cent. Reduced rates are 7 per cent, 5.5 per cent and 2.1 per cent. The amended Finance Bill shall increase the standard rate to 20 per cent, and split the 7 per cent reduced rate into a 10 per cent rate on certain items and a 5 per cent rate on certain consumption goods.

There are currently no grouping rules in France for VAT purposes except for consolidated payments.

### *Stamp duties, capital duties and registration taxes*

Generally, French stamp duty applies at fixed flat rates on most corporate documents. There is no capital duty on the issuance of shares or other corporate instruments either for cash or for valuable property.

Registration taxes apply at proportional rates on most transfers of certain assets for a consideration or for the assumption of liabilities:

- a* real property – 5.09 per cent;
- b* goodwill and equipment of a going concern, trademarks – 5 per cent;
- c* shares in unlisted real estate companies – 5 per cent; where made outside of France, the transfer of such shares must be reported by a notarial deed made in France;
- d* interest in an SNC, SARL – 3 per cent;
- e* shares in an unlisted SA, SAS – 0.1 per cent; and
- f* no tax is due on listed shares when no deed is established or executed in France.

A financial transaction tax applies at the rate of 0.2 per cent on the acquisition of shares and other equity instruments of listed French companies where the market capitalisation exceeds €1 billion (a list is published and updated annually: it currently contains 109 names). The tax does not apply to operations that do not result in an acquisition of shares (such as derivatives, CFD, etc.).

Where a deed is made to record a partition of assets among multiple owners who jointly owned them, a partition duty applies at the rate of 2.5 per cent uncapped.

### *Gift and inheritance taxes*

France operates a very wide-reaching gift and inheritance tax system. Subject to the provisions of few double taxation treaties, French gift and inheritance taxes apply on assets worldwide where the donor or deceased is or was a resident of France, or where the heir or beneficiary is a resident of France. Where neither the donor, deceased, heir or beneficiary is a resident of France, French gift and inheritance taxes apply on assets located in France only, including French real property indirectly held through companies, trusts and partnerships, and also including shares in unlisted real estate companies.

There is no tax on transfers to a surviving spouse, but transfers to children and other descendants may be taxed at escalating rates of up to 45 per cent. Transfers to third parties are taxed at 60 per cent. Both formal and informal transfers are taxable.

#### IV TAX RESIDENCE AND FISCAL DOMICILE

Since French corporation tax is assessed on a territorial basis (i.e., on the net income generated by businesses carried out in France), and since there is no French net wealth tax on corporate bodies, corporate residence as such is of little relevance for French tax purposes, and there is little guidance and limited case law on the point.

Corporate residence was – and to some extent, still is – relevant for certain stamp duties, distribution taxes (including the corporation tax surcharge of 3 per cent on amounts distributed) or miscellaneous discriminatory tax provisions. These are fairly limited, since the tax judges tend to interpret legislative provisions targeting the head office of an entity as concerning not the actual corporate head office but instead any permanent establishment in France. As a result, the French tax authorities seldom try to demonstrate that a corporation is resident in France as it is sufficient to demonstrate that it has a permanent establishment in France. Corporate residence is relevant mainly for double taxation treaty purposes. Corporate residence is essential for determining the law applicable to a corporate entity as French law applies to entities with a corporate head office in France. The migration of corporate entities out of or into France may be organised under certain conditions (see Section IV, *infra*).

Despite a mid-nineteenth century statute apparently still in force but now of no practical effect, foreign corporate entities and certain foreign partnerships are entitled to enter into contracts and acquire assets in France, and also to appear and act before French courts. Subject to certain direct investment restrictions, they may also open and maintain branches or other forms of permanent establishment in France (see Section IV, *infra*).

##### i Corporate residence

French corporate laws apply to corporate bodies with a head office in France.<sup>5</sup> The corporate seat is presumed to be located at the place indicated in the articles of association or, if different, at the place where the senior person or group of persons (shareholders' meeting, board of directors) effectively make strategic and other major decisions for the company, including wherever the operation of the company and its current management are carried out in any other location or jurisdiction.<sup>6</sup>

In substance, the test is similar to the place of effective management referred to in the OECD model for double taxation treaties and the commentaries thereof (at least before the 2008 revision),<sup>7</sup> and to the centre of main interests under the EU regulation on insolvency proceedings.

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5 Articles 1837 of the Civil Code and L. 210-3 of the Commercial Code.

6 Cass. Civ. 7 July 1947 and other similar precedents.

7 Cass. Ass. plén. 21 December 1990 Roval; and Conseil d'État 5 July 2010 No. 309 693 Pinacothèque d'Athènes.

Although there is no law, court precedent or administrative guidance on the point, a single (or few) board meetings in France should not characterise a corporate head office in France, provided most other meetings are held and decisions made outside France. Similarly, a few board meetings held outside France should not be sufficient to characterise a corporate head office outside of France when most meetings are held and decisions made in France.

Inbound transfers of the corporate head office of a foreign entity into France are recognised under French civil, corporate and tax laws, and do not amount to the formation of a new entity, provided the continuation of the migrating entity is also recognised under the corporate law of the jurisdiction of origin. Outbound transfers of corporate head offices are less common and, except for companies organised as European companies, require the unanimous consent of all shareholders. As a domestic tax rule, the transfer of the corporate seat outside France generally triggers the consequences of a cessation of business, including the immediate taxation of profits and potential gains, and the deemed distribution of all profits;<sup>8</sup> however, a transfer to another Member State of the European Union does not trigger such consequences, some of which are to be defined by the third Amending Finance Bill for 2012 to be enacted before 31 December 2012.

## ii Branch or permanent establishment

### *What is deemed a branch or permanent establishment?*

Under French domestic tax laws, French corporation tax is assessed on the earnings from any enterprises operated in France, and on the income and gains arising from properties located in France or from investment in real estate companies or entities.<sup>9</sup>

There is no statutory definition of an enterprise operated in France, and the tax courts hold that this implies a business activity:

- a* either conducted by an establishment, which includes the equivalent of a permanent establishment under the OECD model double taxation treaty and could extend to some fixed business installations that are excluded under the OECD model (see Section II, *supra*, for the exclusion of liaison offices);
- b* carried out by a dependent agent, also in terms similar to those of the OECD model (see Section II, *supra*, for the situation of independent intermediaries); or
- c* which consists of a full commercial cycle of operations, such as the purchase and sale in France of merchandise, even in the absence of any physical presence in France. The reverse could not be verified where the decisions are made and the financial movements originate in France. In such cases, the tax authorities and courts consider the decision centre in France to be the place of management in France and, accordingly, a permanent establishment to which the operations of the company must be allocated.<sup>10</sup>

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8 Article 221-2 of the French Tax Code and CE 30 December 2002.

9 Article 209-1 of the French Tax Code.

10 CE 7 September 2009 Sté Stamping international.



Where a foreign entity (including an entity effectively managed from an EU Member State) realises earnings in France, these are deemed distributed abroad at the end of each fiscal year, and trigger the 3 per cent corporation tax surcharge and also (but only where the foreign entity is outside the EU) a further 30 per cent withholding tax,<sup>11</sup> unless excluded or reduced by a double taxation treaty.

Where corporation tax does not apply under the above terms, withholding taxes apply in France to payments for services by French debtors to foreign residents (see Section VI, *infra*).

If a double taxation treaty applies, protection from French taxation may be obtained where the presence in France either does not fall within the definition of, or benefits from an exception to, the relevant treaty provisions on permanent establishment and branch profits tax.

### *Taxable base*

Both under domestic law and the relevant treaty provisions, the profits taxable in France are limited to the earnings attributable to the French operations or permanent establishment, but there are few precedents and little administrative guidance on the allocation of income between the French and the foreign establishment.

## **V TAX INCENTIVES, SPECIAL REGIMES AND RELIEF THAT MAY ENCOURAGE INWARD INVESTMENT**

There is no French tax incentive especially designed to encourage inward investment, and only a few French tax measures of a rather limited impact – such as the temporary deduction of losses made abroad by medium-sized enterprises or the now-terminated global consolidated tax regime – tend to favour operations outside the home jurisdiction. However, certain features of the French tax system – which apply to both domestic and inward investors – compare reasonably well with similar measures in other jurisdictions.

### **i Holding company regimes**

There is no special tax regime for holding companies; however, as mentioned above, there is no capital duty and, for corporation tax purposes, both the participation exemption and the tax consolidation provide substantial benefits to companies – including the French permanent establishment of foreign companies – holding substantial participation in French and (as far as participation exemption is concerned) foreign entities.

### *Participation exemption*

Qualifying participations include shares in French and foreign corporations, and interest in French and foreign partnerships. However, shares in entities established in an NCST are excluded from the exemption.

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11 Article 115 quinquies of the French Tax Code.

Dividend received 95 per cent exemption is subject to a minimum 5 per cent fully paid shareholding with voting rights and is conditional on a two-year holding period (potentially extending either side of the dividend date).

Capital gains 90 per cent exemption applies under similar but not identical circumstances. The decisive criterion is the accounting treatment as *titres de participation* or 'investment in subsidiaries' under French GAAP.

The participation exemption does not prevent an acquiring company from deducting both acquisition costs for the shares (which may also be amortised over a period of no more than five years) and financial expenses related to acquisition financing. However, any deduction of financial expenses related to acquisition finance is conditioned upon demonstration that the decision-making and control of the acquired company was carried on in France.<sup>12</sup>

The participation exemption also does not prevent the 3 per cent corporation tax surcharge to apply upon distribution of dividends by the parent company, even if made out of exempt dividends or gains from subsidiaries (a situation that is not beyond criticism).

### *Tax grouping*

Where the acquiring company is a member of a consolidated tax group, then dividends received from other consolidated companies within the group are fully exempt, even when the conditions for the dividend received exemption are not satisfied. Tax deficits resulting from the deduction of acquisition costs and interest on acquisition financing may shelter the taxable profits of any consolidated operating company, including the target, an essential feature for leveraged acquisitions by financial investors such as private equity funds. Thin capitalisation rules would apply as previously indicated where (part of) the acquisition finance is provided by the shareholders or related entities.

Further care should be taken to avoid the '*amendement Charasse*' when the acquisition is made from investors who control the consolidated group. This special anti-abuse provision disallows group financial charges in proportion to the purchase price of shares in subsidiaries that were acquired from persons who control the group, subject to certain exceptions. Since control can result from a concert, it could also apply in circumstances where the vendors of the target receive an interest in the parent company giving them rights in the management of the group. A minority interest with clauses preserving their financial interests only should not result in such concert and accordingly should not trigger an application of the '*amendement Charasse*'.

### ii IP regimes

Again, there is no special tax regime, such as 'patent box' companies, in France, but the standard provisions of French tax laws contain several incentives for R&D and IP.

R&D costs are deductible expenses. Acquisition costs of patents are not deductible but may be amortised over five years, even where the protection extends over a longer period.

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12 See administrative comments on BOI 1S-BASE-30-50-20121130.

R&D equipment is exempt from CET. There is also an R&D tax credit, which generally equals 30 per cent of the qualifying expenses up to €100 million, and 5 per cent for the portion of expenses that exceeds the limits.

There is a reduced corporation tax rate (15 per cent) on gains and royalties resulting from the transfer or licensing of patents, patentable inventions and related industrial know-how.

### iii State aids

There are a variety of state aids available in France.<sup>13</sup> Generally, the French authorities support investment projects that entail:

- a* investment and job creation by large companies in economically disadvantaged regions and regions undergoing industrial redevelopment, as are indicated on a map approved by the European Commission (the Regional Aid Zones map);
- b* business R&D projects;
- c* professional training programmes for employees;
- d* job creation for defined populations;
- e* investment and job creation by small and medium-sized enterprises in all parts of the country; and
- f* protection of the environment.

### iv Temporary tax credit on lower wages

As part of a plan to boost ‘competitiveness’, the Amending Finance Bill introduces a tax credit on lower wages (below 2.5 times the legal minimum salary – currently of €1,426 per month). Although this measure is aimed at boosting the manufacturing industry, the credit applies to any economic sector and would benefit mainly retail and banking services.

## VI WITHHOLDING AND TAXATION OF NON-LOCAL SOURCE INCOME STREAMS

### i Withholding outward-bound payments (domestic law)

There are no withholding taxes on interest, except where it is paid either in an NCST or to an entity established or domiciled in an NCST. An NCST is ‘blacklisted’ when it is outside the EU and does not meet international standards of exchange of information on tax matters. The ‘blacklist’ is updated from time to time, and currently includes eight territories.<sup>14</sup> New territories could be included again, as the French tax administration is currently testing the effectiveness of information exchange with former NCSTs. Where applicable, withholding applies at 55 per cent of the gross amount, except where the payer demonstrates *bona fide* commercial reasons for the transaction. An administrative

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13 See the IFA document ‘Doing business in France’.

14 BOI 14 A-5-11 of 27 April 2012.

regulation has created a safe harbour for notes and other negotiable debt securities.<sup>15</sup> At present, there is no safe-harbour rule for interest payments on any other debt instrument. Other withholdings include:

- a* 33 and one-third per cent withholding on royalties paid and other payments for services made to any non-resident with no establishment in France, 55 per cent withholding where paid in or to an entity established in an NCST;
  - b* 30 per cent withholding on dividends and other distributed income, including deemed dividends (at the grossed-up effective rate of 30/70) paid to any non-resident unless the payment is attributable to a permanent establishment, 55 per cent withholding on payments in an NCST;
  - c* 30 per cent withholding on profits made in France by a foreign corporation and deemed to be distributed outside France;
  - d* 19 per cent withholding on gains from the sale of any part of a substantial participation in a French company, 55 per cent withholding if paid to an NCST; and
  - e* 33 and one-third per cent (or occasionally 50 per cent) withholding on gain from the sale of property in France, or from the sale of shares in companies whose principal assets consist directly or indirectly of property located in France.
- ii Domestic law exclusions or exemptions from withholding on outward-bound payments**

*Interest exemption*

Safe harbour regulations are applicable to notes and other negotiable debt securities.<sup>16</sup> An EU parent company exemption applies to interest, dividends and royalties paid to a direct EU parent company owning at least 10 per cent of the French payer company. As regards dividends, the exemption also applies under the participation exemption where the EU parent company owns at least 5 per cent of the French distributing company and is conditional upon a two-year holding period; 21 per cent (instead of 30 per cent) withholding applies on dividends paid to individuals domiciled in the EU or in an EEA country; and 15 per cent (instead of 30 per cent) withholding applies on dividends paid to not-for-profit institutions in the EU or the EEA.

No 'branch tax' applies on profits made in France by corporations having their place of effective management in an EU country, but the 3 per cent corporation tax surcharge does apply where such profits are not reinvested in France.

19 per cent (instead of 33 and one-third per cent) withholding applies on capital gains made by EU residents on real estate located in France.

Foreign governments, central banks and foreign public financial institutions are exempt from withholding taxes on interest, dividends and capital gains.

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15 Revenue Ruling 2010/11 of 22 February 2010, now available on the Bofip.impots database: BOL.INT.DG.20.50 2012 09 12 No. 990.

16 Id.

### iii Double taxation treaties

France has an extensive double taxation treaty network.<sup>17</sup> Most follow the OECD model; however, there are a few notable exceptions, such as Belgium, Monaco and some Gulf states.

Although the solution may vary from treaty to treaty and should be checked accordingly, qualifying residents of a treaty country receiving income from French sources generally enjoy an exemption from or the reduction of withholding tax charged on such income.

## VII TAXATION OF FUNDING STRUCTURES

French entities are commonly funded with an appropriate combination of equity (i.e., share capital, including preference shares) and debt (including convertible or exchangeable notes) from third parties and related parties. As a result of French common tax rules, debt financing remains tax-favoured to the extent interest expense is largely (85 per cent in fiscal years 2012 and 2013, 75 per cent in fiscal year 2014 and thereafter) deductible on an accrued basis and there is no withholding tax on interest (unless at the 50 per cent dissuasive rate when paid in an NCST, or to a person domiciled or established in an NCST, in situations where the safe harbour on notes and other negotiable debt instruments does not apply).

### i Thin capitalisation

There is no general thin capitalisation principle. Subject to dealings between connected parties, French tax law does not impose any general debt-to-equity ratio on enterprises taxable in France. This is expressly recognised by the Conseil d'État, which has ruled that enterprises can freely determine the manner in which they obtain their financing.<sup>18</sup> In certain cases, the French tax authorities attempted to deny the tax deductibility of one part of the financial interest incurred on the grounds of the *acte anormal de gestion*, as they considered the gearing to be excessive and thought it was likely that the borrower would not be in a position to reimburse all its debts, and they argued that a more prudent debt-to-equity ratio should be retained. This argument has been rejected by the Conseil d'État. As a result, a reassessment on the sole basis of an unbalanced debt-to-equity ratio is unlikely to succeed before the French courts.

#### *Related-party loans limitation rules; scope of thin cap rules*

French thin capitalisation rules apply to all loans granted to any enterprise taxable in France either by another 'related-party' enterprise or by a third party where they are guaranteed by a related enterprise.

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17 The list of treaties existing as at 12 September 2012 between France and more than 120 countries or territories is available on the Bofip.impots database: BOI-ANX.000306.20121126.

18 'CE Section 30 décembre 2003 n°233894'; SA Andritz.

Enterprises are deemed related where:

- a* either one enterprise directly or through any interposed entity holds the majority of the share capital of the other, or in practice exercises decision-making power;
- b* or both enterprises are under the control of a single other enterprise.

According to the administrative regulations, the rules apply to any enterprise carrying out a business in France, including permanent establishments of foreign corporations, and French or foreign partnerships to the extent that they or their partners are subject to corporation tax in France on their share of profits.

#### *Impact of the thin capitalisation rules*

Interest accrued on amounts loaned to an enterprise by a related enterprise would be denied where it exceeds any of the following limitations.

Within these limits, interest deduction would apply subject to other limitations, including the above-mentioned 85 per cent or 75 per cent deduction limits.

#### *Interest rate limitation*

As far as loans granted directly by a related party are concerned, the rate of deductible interest is capped at the rate provided for in the French Tax Code<sup>19</sup> (i.e., 3.99 per cent for the fiscal year closed on 31 December 2011), unless it can be demonstrated that the borrowing could not have been obtained from independent financial establishments at a lower interest rate (documentary, benchmarking evidence is required).

#### *Leverage limitation*

The amount of deductible interest is capped at the highest of the following three limits:

- a* the average rate for loans entered into by the enterprise from related enterprises or guaranteed by any of them multiplied by 1.5 times the amount of the company's net equity;
- b* 25 per cent of pre-tax current profits, increased by interest paid on related-party debt and other disqualifying guaranteed loans, depreciation allowances and rents paid pursuant to financial leases that are allocated to the acquisition cost of assets purchased under such financial leases; or
- c* the amount of interest received from related enterprises.

Few exceptions are provided to the application of these three limits (e.g., financing operations within cash-pooling arrangements).

These limits also do not apply if the borrower company can demonstrate that the consolidated leverage ratio of the group of companies to which it belongs is equal to or higher than its own leverage ratio for the relevant fiscal year.

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19 Article 39-1-3° of the French Tax Code.

### *Worldwide group debt ratio*

The worldwide group debt ratio is determined, for a group of companies ('the group'), through the comparison of the total amount of the debts of the enterprises within the group with the net equity of the group. Where applicable, IFRS may be relied upon.

## **ii Deduction of finance costs**

### *Capitalised interest deduction*

The French Tax Code<sup>20</sup> provides for specific deductibility rules in respect of loans comprising capitalised interest. These rules apply to redemption premiums, and the French tax authorities consider that redemption premium includes capitalised interest. As a general principle, capitalised interest is tax-deductible on a yearly basis as and when it accrues; however, under these specific rules, when the aggregate of capitalised interest over the duration of the loan exceeds 10 per cent of the nominal amount of the loan, the capitalised interest must be apportioned and deducted on a yield-to-maturity basis.

Convertible bonds are explicitly excluded from such specific rules and deduction is allowed on a cash basis only.

### *Tax treatment of other financing costs*

#### *Corporation tax*

To the extent that they are incurred in the interest of the French enterprise, fees relating to the financing of the entity or any of its transactions are deductible for corporate income tax purposes during the fiscal year in which they are incurred. However, further to a global decision, bank fees may be activated and then amortised over the duration of the loans (either in proportion to the interest accrued or on a straight-line basis).<sup>21</sup>

#### *VAT treatment*

Most acquisition and financing costs (e.g., auditors' fees, lawyers' fees, certain banks' commissions such as arrangement fees, depending on the global election of the invoicing banks) are subject to VAT. Other fees, however – in particular the majority of bank commissions – are VAT-exempt (e.g., underwriting and commitment fees).

## **iii Restrictions on payments**

### *Dividends*

Under French corporate law, dividends are decided by shareholders at general meetings and cannot exceed the total of all distributable profits and unrestricted reserves:<sup>22</sup>

- a distributable profits consist of the profits for the year, less prior-year losses and sums that the law or the articles request be reserved, plus the unallocated retained earnings; and

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20 Article 39-1-1° ter of the French Tax Code.

21 Article 39-1-1° quater of the French Tax Code.

22 Article L.232-11 of the Commercial Code.

- b* the unrestricted reserves include capital surpluses such as issuance premiums and accumulated profits, except for the legal reserve (in SA, SAS, SCA, SE and SARL), the revaluation reserve and, where applicable, any reserves whose distribution is prohibited by the articles.

A second restriction is that no distribution may be made to shareholders when the net equity is or would become lower than the sum of the share capital and restricted reserves.<sup>23</sup>

Any dividend paid in excess of the limits described above would be deemed fictitious, and would trigger both criminal sanctions against the corporate officers<sup>24</sup> and the civil liability of the shareholders to repay dividends where they knew or could not ignore the irregular nature of the operation.

Dividends are generally paid in cash, but may be paid *in specie* where the articles of the company so provide.

#### **iv Return of capital**

##### *Common rules*

##### *Corporate law*

In order to return capital to some or all of the shareholders, a corporation may decide on a reduction in the share capital. Such a decision must be made by an extraordinary general shareholders' meeting on the basis of a qualified majority and pursuant to a special report from the statutory auditors. It may be enforced only after creditors have been given 20 days in which to object to the reduction of capital following the filing of the decision's minute with the commercial court.

A return of capital commonly results from a share buy-back followed by the cancellation of the acquired shares.

##### *Taxation*

A fixed stamp duty applies to the reduction in share capital; where shares are bought back, no transfer tax applies.

Any sums paid to the shareholders are deemed a distribution of dividends up to the total amount of the tax reserves and retained earnings, and a return of original capital only if and to the extent all reserves have been depleted. Where shares are bought back, the taxable amount is limited to the excess of the share price over the tax basis (cost) of the shares. Such amount triggers first the 3 per cent corporation tax surcharge payable by the company, and also distribution taxes to be borne by the shareholders. Rollover relief is available to individual shareholders where shares are bought back in exchange for other shares under a public offer; 95 per cent participation exemption applies to qualifying corporate shareholders.

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23 Article L.232-11 al.3 of the Commercial Code.

24 Article L.242-6-1° of the Commercial Code.



### *Share buy-back programmes*

#### *Corporate law*

A share buy-back programme may be carried out by the board of directors or the management board within the limit of 10 per cent of the share capital.<sup>25</sup>

#### *Taxation*

For tax purposes, shares bought back under such schemes are not deemed a distribution of dividend, but a sale of shares that accordingly generates capital gains or losses and does not trigger the 3 per cent corporation tax surcharge.

## **VIII ACQUISITION STRUCTURES, RESTRUCTURING AND EXIT CHARGES**

### **i Acquisition**

#### *Asset or share deal*

Generally, the acquisition of a local business in France is organised as a sale of shares in the operating business (or any holding company owning it) rather than a sale of assets both for corporate, civil and administrative law reasons and for tax reasons.

On the tax side, a sale of assets triggers a substantial proportional transfer tax on the value of equipment and intangible assets, and also, where applicable, on property. In contrast, a share deal triggers reduced transfer taxes (see Section III.ii, *supra*). For corporation tax purposes, an asset deal generally triggers the recognition of taxable gains and deductible losses, the cost of which may be acceptable to the vendor only where taxable gains may be sheltered with deductible losses from prior years or from other retained businesses. A share deal generates no corporate taxation in France for the acquired company and reduced capital gains tax for the vendor. Most tax attributes of the acquired company (including any losses carried over) survive the change of ownership. The major downside of a share deal for the acquirers is that this does not result in a stepped-up value for the corporate assets, and accordingly does not uplift the basis for depreciation or amortisation and future capital gains. Certain corporate reorganisations may overcome all or part of this encumbrance.

#### *Acquisition vehicle*

Generally, a foreign investor acquiring a French business by the means of a share (or an asset) deal would use a French entity in order to take advantage of the tax deduction in France of the acquisition costs and the financial expenses related to the acquisition.

Even where the French business is only one part of a global transaction, the consideration for which consists of shares or other financial instruments issued by a foreign company, it is tax-effective in France to use a local entity to carry out a leveraged acquisition and become the top entity of a consolidated tax group. The decision must be made prior to the original acquisition in order to avoid the ‘*amendment Charasse*’ mentioned above, and the acquired company must be controlled from France.

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25 EU Regulation 2273/2003 of 22 December 2003 and L 225-209 of the Commercial Code.

### *Consideration for sellers*

When contemplating the acquisition of a business in France, an investor should also consider the tax impact of the transaction upon certain individuals and especially the vendors, and upon the personnel and especially the management, in order to offer tax-attractive terms for the transaction. Where the vendor is a corporate shareholder, it is to be expected that the capital gains would be 90 per cent exempt under the participation exemption irrespective of whether the acquisition price is paid in cash, shares or assumption of liabilities. Certain share-for share – or assets-for-share – reorganisations qualify for rollover relief. Where the vendors are natural persons, two major issues need to be considered by any domestic or foreign investor: capital gains taxation (generally at the escalating income tax rate cumulating at 62.2 per cent – occasionally reduced to 34.5 per cent – for individual French residents) and wealth tax.

One also needs to consider the personal taxation of the personnel, especially on employee shareholding and stock-option schemes, which are considerably less tax-favoured in France than they used to be.

## **ii Reorganisation**

### *Tax-favoured reorganisations*

French tax law provides for rollover relief and stamp duty exemption on a series of corporate reorganisations substantially reflecting the provisions of EU Directive 2009/133 of 19 October 2009, as amended. As a result, the amalgamation of an acquired business with an existing French business can be achieved without adverse French tax consequences. The major restriction is that any existing losses within the disappearing companies cannot be transferred unless approved by a tax ruling to that effect.

The tax-free reorganisations are the following:

- a* Statutory mergers, including an upstream merger between a parent company and its wholly owned subsidiary, which may be carried out either under the merger laws (and accordingly may have a retroactive effect up to first day of the current fiscal year) or under a Civil Code provision named ‘dissolution without liquidation’, the effect of which is delayed until the end of an objection period open to creditors and may not have a retroactive effect.
- b* Split-up or ‘scission’, where the tax-favoured treatment is conditional upon administrative approval, unless the divided company had at least two business activities, with each of the surviving companies receiving at least one complete branch of activity and the shareholders of the divided company receiving a pro rata share of the surviving companies’ stock. Where the divided company is closely held or controlled, its major shareholders must undertake to hold such stocks for three years.
- c* Spin-off or partial division, where assets representing a complete branch of activity may be transferred in exchange for new shares on a rollover basis. Such shares may be distributed to the shareholders of the transferring company without triggering distribution taxes, but rather on a rollover basis. This exemption is subject to an administrative ruling.

Certain exchanges of shares may not be immediately subject to capital gains tax but may rather be taxed upon the subsequent sale of the shares received in exchange (on a rollover basis).

### *Cross-border reorganisations*

The favourable tax regime applies in France where foreign companies are involved in the reorganisation, provided that all of them are established in countries that have entered into a treaty with full exchange of information with France.<sup>26</sup>

Where, as a result of the transaction, assets are transferred by a French company to a foreign company, the rollover relief is subject to prior administrative authorisation.<sup>27</sup> No such authorisation is required for either 'inbound' or foreign-to-foreign reorganisations, even when certain assets are located, or certain shareholders are resident, in France.

French companies may participate in triangular mergers on a tax-free basis in France. There are several examples where French companies have taken part in reverse triangular mergers with the French acquiring company being the surviving entity in the transaction. Participation by French companies in forward triangular mergers is less common but not unknown. There are only very few precedents for triangular mergers in which a French public company is either the target or the disappearing company: the formation of EADS in 2000 was a notable exception. Despite the implementation of EU Merger Directive 2005/56/EC, there is no example of any French public company completing an outbound cross-border merger.

More commonly, French public companies may be acquired on a rollover basis in a cross-border transaction by the means of a public exchange offer.

### iii Exit

See Section IV.i, *supra*, regarding the conditions for and consequences of a transfer of the company's head office.

## IX ANTI-AVOIDANCE AND OTHER RELEVANT LEGISLATION

### i General anti-avoidance

The French tax system contains both a very general anti-avoidance rule, commonly referred to as *abus de droit* or abuse of the law, and a series of specific anti-avoidance rules, some of which cover certain cross-border situations or transactions.

#### *General anti-avoidance rule or abus de droit*

A statutory provision enables the tax authorities to set aside any legal instrument or scheme where it is either fictitious (a 'sham' transaction or corporate entity), or exclusively tax-driven and seeking to benefit from a literal construction of any applicable rule contrary to the objectives of the rule's authors.<sup>28</sup>

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26 Article 210-0 A French Tax Code.

27 Article 210 C-2 French Tax Code.

28 Article L.64 of the Code of Fiscal Procedure.

This provision applies to any French tax, and covers any set of rules such as French laws and regulations or double taxation treaties. In the past, French tax courts held that this does not extend to administrative guidance that is binding upon the administration and the judge.

When abuse of law is declared, the avoided taxes may be reassessed with interest, and a proportional penalty of 80 per cent, or 40 per cent where the taxpayer was neither the main initiator nor the principal beneficiary of the scheme.<sup>29</sup> All of the parties to the contract or the scheme are jointly liable with the taxpayer for the payment of the interest and penalties.<sup>30</sup>

### *Specific anti-avoidance provisions*

Among the many specific anti-avoidance provisions contained in French tax law, some specially cover outward situations such as transactions with low-tax jurisdictions that have not entered into an extensive exchange of information agreement with France.

Favourable tax provisions, such as the rollover relief of mergers and other corporate reorganisations, do not apply in the absence of an extensive exchange of information agreement.

Dissuasive or punitive measures apply in relation to transactions involving NCSTs. For example, payment for services made, or to a person established, in a low-tax jurisdiction (i.e., a jurisdiction where there is no income tax or where the tax is lower than one-half of French corporation tax). In such cases, the deduction is not allowed for corporation tax purposes (and a 30 per cent withholding tax grossed up to 30/70 applies on the related deemed dividend) unless the taxpayer demonstrates a *bona fide* commercial reason.<sup>31</sup>

### *Special disclosure requirement*

Although the French tax authorities have considered introducing disclosure legislation in France in the recent past, there is currently no general obligation for any type of transaction (other than asset holding by a foreign trust and certain tax-favoured overseas schemes) or uncertain tax position.

French legal privilege rules prevent the authorities from accessing any correspondence between any individual or entity and its attorney. Other privileges could have the same effect, and no precedent indicates that the French tax authorities have tried to examine statutory auditors' working papers.

## **ii Controlled foreign corporations**

France has extensive controlled foreign enterprise ('CFC') rules that may apply to any type of income generated by any branch or entity, including a trust, established or organised in a low-tax jurisdiction (as defined above).

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29 Article 1729 (b) of the French Tax Code.

30 Article 1754 V.1 of the French Tax Code.

31 Article 238 A of the French Tax Code.

The positive income generated by such branch or entity is taxable for the French corporate taxpayer that owns the branch or a controlling interest in the entity unless there is a *bona fide* commercial purpose.<sup>32</sup>

'Control' generally means directly or indirectly holding more than 50 per cent of the share capital, financial rights or voting rights of the entity. A 5 per cent stake, however, would be deemed part of joint control where more than 50 per cent of the low-tax entity is held by other French enterprises or by related enterprises.

A safe-harbour provision applies for enterprises or entities established or organised in an EU Member State provided this is not part of an artificial scheme aimed at circumventing French tax legislation.

Where the entity is established outside the EU, the CFC legislation would not apply only where the profits are generated by an industrial or commercial activity carried out locally.<sup>33</sup> Further tests apply if the CFC is an intermediate holding company within a group or renders intra-group services.

Where CFC rules apply, the positive income of the entity is subject to French corporation tax in proportion to the direct and indirect interest of the French corporate taxpayer in the entity. Foreign tax credit is allowed for corporation tax in the jurisdiction where the entity is established, and for withholding taxes on interest, dividends and royalties from treaty countries.

### iii Transfer pricing

France applies transfer pricing rules, largely in line with the practices adopted in other major industrial countries and EU Member States.

The legal basis for this is a very short and general statutory provision,<sup>34</sup> and there are no detailed regulations or administrative guidelines and very few case law precedents.

Documentary obligations have been increased over the years,<sup>35</sup> with penalties that may reach 5 per cent of the profits transferred abroad.<sup>36</sup>

The French tax authorities may enter into advance pricing agreements with French corporate taxpayers either unilaterally, bilaterally or multilaterally with other jurisdictions.

In the event of reassessments of transfer pricing with treaty countries, the mutual agreement procedure may be enforced under the terms of the relevant treaty and may result in corresponding adjustments being made. An arbitration procedure applies within the EU<sup>37</sup> and also under certain double taxation treaties, especially with the US.

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32 Article 209 B of the French Tax Code.

33 The French tax courts strictly construe this condition and require a detailed factual analysis – CE 28 November 2012 BNP Paribas.

34 Article 57 of the French Tax Code.

35 Articles L.13AA, L.13AB and L.13B of the Code of Fiscal Procedure.

36 Article 1735 ter of the French Tax Code.

37 Arbitration Convention of 23 July 1990.

**iv Tax clearances and rulings**

Several provisions of French law enable the tax authorities to deliver clearances and rulings that are binding both upon them and the tax courts.<sup>38</sup> Some have a very general scope, but do not create an obligation for the authorities to take a position. Others are more specific and fix a deadline, after the end of which the administrative decision is deemed favourable. This applies, *inter alia*, to requests from foreign enterprises upon the existence or not of a permanent establishment in France.

Specific rulings are also available on the taxable basis of international headquarters or logistics centres based in France.

No specific procedure exists in relation to the acquisition of a local business by a foreign investor, and it is not common practice to seek any.

**X YEAR IN REVIEW**

Several series of tax measures were introduced in 2011 and 2012 with the view to raising government revenue and reducing the budget deficit. Most of them affected individual taxation and substantially increased the tax burden on high-income residents of France, such as impressive income tax surcharges (especially on earned income realised in fiscal years 2012 and 2013, where the aggregate marginal rate of taxation reaches and occasionally exceeds 80 per cent); dividend and capital gain taxation (now subject to escalating income tax rates reaching 62.2 per cent); wealth tax amendments; inheritance duties, etc.

The tax environment of business investment was also affected albeit to a lesser extent: restricted use of net operating losses, new corporation tax surcharges, general limitation of deductible net financial expenses and conditional deduction of acquisition financial expenses.

**XI OUTLOOK AND CONCLUSIONS**

The French tax environment has become extremely unattractive for high-income taxpayers, and especially corporate managers and top executives. Corporate taxation also increased but does not reach such punitive levels, and leaves France as an attractive place to invest. Hopefully a reduction in public spending should enable the French government to relax this tax grip in the medium term.

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38 Articles L.80A and L.80B of the Code of Fiscal Procedure.

## Appendix 1

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# ABOUT THE AUTHORS

### **PHILIPPE DEROUIN**

*Skadden, Arps, Slate, Meagher & Flom LLP*

Philippe Derouin is a partner with Skadden, Arps, Slate, Meagher & Flom LLP. He has vast experience in business, civil, corporate, administrative and international law. He focuses on taxation, particularly in relation to mergers and acquisitions, corporate reorganisations, financial instruments, structured finance and project and asset financing, both domestic and international.

Mr Derouin is also active in litigation, including assisting in tax audits and litigation before courts in France, Monaco, the Court of Justice of the European Union and the European Court of Human Rights, especially in important tax cases relating to domestic and international tax issues (transfer pricing, double taxation treaties, European law), and he handles contract and civil liability cases relating to taxation.

He is consistently ranked among the leading professionals in his field.

### **SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP**

68 rue du Faubourg Saint-Honoré

75008 Paris

France

Tel: +33 1 55 27 11 00

Fax: +33 1 55 27 21 50

[philippe.derouin@skadden.com](mailto:philippe.derouin@skadden.com)

[www.skadden.com](http://www.skadden.com)