NEWS ON THE FRENCH FRONT: TAX LAW CHANGES FOR CORPORATIONS AND INDIVIDUALS

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INTRODUCTION

In France, main tax law changes are passed pursuant to an end-of-year legislative process. These yearly changes are either part of the upcoming year's finance law (the "Initial Finance Law") or the amended current year's finance law (the "Amended Finance Laws"). The Initial and Amended Finance Laws govern the country's budget allocations regarding government revenue and expenses, and thus contain tax measures. The Initial Finance Law is voted on at the end of the year prior to its year of application. Throughout the applicable year, amendments to that finance law are passed. In addition, further tax laws are also passed independently of the yearly finance laws and generally focus on one main tax provision.

The Initial Finance Law is passed in various steps. First, the government drafts a proposed Initial Finance Law, which is then submitted to the French Parliament (composed of the *Assemblée Nationale* and the *Sénat*). All proposed Initial Finance Laws are examined by the National Assembly (*Assemblée Nationale*) and are then transmitted to specialized committees in charge of advising and making changes to the draft. After this review, both houses of the French Parliament consider the new version of the proposed law over the course of several weeks and amend it until agreement is reached on the final version. After a constitutionality review by the French Constitutional Court (*Conseil Constitutionnel*), the finance law is final and expected to be published before year end. This legislative process cannot exceed seventy days.

As mentioned previously, the government is also entitled to propose Amended Finance Laws, which mainly amend the Initial Finance Law. Approved tax provisions are retroactively applicable to income and gains generated in the year in which the Initial Finance law was enacted as if the taxable event did not yet occur ("*petite rétroactivité*"). Stated differently, all income is considered to be recognized at the close of the year, not before. For corporate taxpayers, the "taxable event" is the close of their tax year. For individual taxpayers, the "taxable event" is generally the end of the calendar year.

This article seeks to summarize some of the key tax measures contained in the 2017 Initial Finance Law and the 2016 Amended Finance Law, as validated by the French Constitutional Court on December 29, 2016, and published on December 30, 2016. Among the invalidated measures were the public access to country-by-country reports and the introduction of a French diverted profits tax. The latter is briefly discussed below. Although not adopted, these measures are emblematic of the general tax environment in France and Europe.

Certain measures have been long awaited, such as the withholding tax on salaries, whereas others are emblematic of the current fight against tax evasion or the will to make France a go-to place for start-ups. However, the future of the measures is uncertain, as 2017 is an election year in France. The current government is winding down and certain presidential candidates are already claiming the need to make changes to the new provisions.

INDIVIDUAL INCOME TAX

Withholding Tax as of 2018 with 2017 Tax-Free for Certain Types of Income

Currently, French residents generally file an annual income tax return between May and June of the following year, depending on whether the filing is done on paper or online, and depending on their place of residence. They also generally pay their income tax in three yearly estimated payments. In September, they generally receive an assessment of the outstanding balance of their tax liability and have one month to effect payment.

The new law provides for monthly payment of the income tax liability. The payment will be effected through withholding by the payor or monthly payments by the taxpayer, depending on the nature of the income. Certain exceptions exist for employee-based compensation items and income from certain hedge funds, French-source income paid to nonresidents, and foreign-source income entitled to a foreign tax credit pursuant to an income tax treaty.

"The new law provides for monthly payment of the income tax liability."

These new provisions will take effect as of January 2018. Income tax due on certain items of income that have a non-exceptional nature, or that do not constitute income that is excluded from the new provisions, will be cancelled if the income is earned in 2017.

Corporations will become the withholding agents for withholding taxes to be levied on its employees' salaries. Employees will have the choice among (i) a default standard withholding tax rate, (ii) a personalized withholding tax rate, and (iii) a neutral withholding tax rate. Corporations will have to incur significant costs and spend a substantial amount of time and effort in implementing these new changes.

However, in light of the upcoming elections, it is not clear whether these provisions will remain in effect or be repealed by the new government.

Free Shares – Yet Another Regime Change

The tax regime of free shares has been reformed several times over the last years. The current favorable regime is based on a 2015 law[1] enacted to reverse the cutback of tax benefits through multiple successive reforms. The 2017 Finance Law again reverses course by depriving the free share regime of several of the beneficial aspects implemented by the 2015 legislation.

The new regime applies to free shares granted by board decisions voted after the publication of the 2017 Finance Law, which occurred on December 30, 2016. From that date forward, the portion of the acquisition gain benefitting from the favorable capital gain computation and abatement regime is capped at €300,000. Acquisition gain in excess of this amount is treated as salary for French tax purposes.

[1] Law 2015-990, August 6, 2015. For more on the regime applicable to French shares, see Fanny Karaman and Stanley Ruchelman, "French v. U.S. Share-based Compensation Plans: A Comparative Analysis," *Insights* 10 (2016).

The excess is subject to higher employment-related social charges and no longer benefits from abatements, which can be as high as 65% in most cases and 85% in certain circumstances. Thus, although still a favorable tool for small start-ups, free shares are again minimally attractive for highly compensated individuals of larger corporations.

CORPORATE INCOME TAX

Decrease in Tax Rate

Throughout the 2016 tax year, French corporate income tax was generally imposed at the rate of 33.33%. Corporations that owed more than €763,000 in corporate income tax were subject to an additional 3.3% social charge on the amount of corporate income tax in excess of €763,000. Corporations that had gross receipts below €7.63 million were subject to a reduced corporate income tax rate of 15% on taxable income up to €38,120.[2]

From January 1, 2017 until January 1, 2020, the rate of corporate income tax will be decreased in annual increments until the rate is reduced to 28%, which will be applicable to all corporations. The 3.3% additional social charge will remain in effect.[3] This will result in an effective 28.9% corporate income tax rate for large corporations. The following table summarizes the gradual decrease in corporate tax rates:

Taxable Income Brackets and Rates*								
	Gross Receipts							
	< €7.36 Million		> €7.36 Million < €50 Million		> €50 Million < €1 Billion		> €1 Billion	
2017	€0-€38,120	15%	€0-€38,120	15%	€0-€38,120	15%	€0-€38,120	15%
	€38,120-€75,000	28%	€38,120-€500,000	28%	> €38,120	28%	> €38,120	28%
	> €75,000	33.33%	> €500,000	33.33%				
2018	€0-€75,000	28%	€0-€500,000	28%	€0-€38,120	15%	€0-€38,120	15%
	> €75,000	33.33%	> €500,000	33.33%	> €38,120	28%	> €38,120	28%
2019	33.33%		€0-€500,000	28%	28%		28%	
			> €500,000	33.33%				
2020	33.33%		€0-€500,000	28%	€0-€500,000	28%	28%	
			> €500,000	33.33%	> €500,000	33.33%		

*The 3.3% additional surcharge was not factored in and may apply.

2 Article 219 of the French Tax Code, as applicable for 2016.

3 New Article 219 of the French Tax Code.

Here again, with the upcoming elections, it is unclear whether these changes will be maintained. Certain presidential candidates favor a further decrease in rates.

3% Tax on Dividend Distributions – Exemption Extended

Currently, corporations must pay an additional 3% tax on certain distributions, including dividends.[4] Exemptions exist for dividends distributed to members of a consolidated group. However, when the distribution is made to a non-French entity, that distribution is subject to the 3% additional tax.

As of 2017, the exemption is extended to distributions made to European corporations or corporations based in countries with which France has a mutual assistance agreement in place, provided that these non-French corporations would otherwise qualify for the consolidated regime requirements had they been resident in France.[5]

Changes to the French Parent-Subsidiary Regime

Prior to the 2017 Finance Law, parent and subsidiary corporations could benefit from the participation exemption for dividends and gains pursuant to the parent-subsidiary regime where the parent corporation (i) was subject to the French corporate tax, (ii) held at least a 5% interest in a corporation making a dividend distribution, and (iii) held that interest for at least two years. If the above requirements were met, 95% of the dividends received by the parent would be deductible.[6] Shares without voting rights did not qualify their holder for the beneficial regime.[7]

From January 1, 2017 forward, the mere holding of shares without voting rights, such as preferred shares, does not disqualify the recipient corporate shareholder from the benefits of the parent-subsidiary regime.[8]

Increase of Tax on Financial Transactions

France imposes a transaction tax on certain transfers of title in publicly-traded equity securities. The tax is applicable when the issuing corporation is a French corporation that has a market capitalization in excess of €1 billion on December 1 of the year preceding the transfer of title. The tax rate has increased to 0.3% in 2017.[9] Previously, the tax rate was 0.2%.

FIGHT AGAINST TAX EVASION

French Diverted Profits Tax – Not Adopted

Article 78 of the 2017 Initial Finance Law provided for a corporate income tax on foreign entities having

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4 Article 235 *ter* ZCA of the French Tax Code.

5 New Article 235 *ter* ZCA, I, 1 of the French Tax Code.

6 2016 versions of Articles 145 and 216 of the French Tax Code.

7 Article 145, 6, c) of the French Tax Code, as applicable in 2016.

8 New Articles 145 and 216 of the French Tax Code, as resulting from Article 91 of the Amended Finance Law for 2016.

9 Article 25 of the Proposed 2017 Finance Law, amending Article 235 *ter* ZD of the French Tax Code.

- a controlled subsidiary in France;
- goods or services sold in France by a French or non-French entity, with the aim to escape or decrease the corporate income tax otherwise due; or
- a computer server in France or elsewhere, through which they sold or provided goods or services to French residents.

Only taxpayers undergoing an examination by the French tax administration could be subject to this new provision.

The French Constitutional Court deemed this proposed legislation unconstitutional. The Court recognized that Parliament can extend the scope of the corporate income tax to nonresident taxpayers. However, Parliament could not allow the French tax administration to choose the corporations that are subject to this tax by choosing the corporations that will be subject to examination.

Change in Failure to Disclose Penalties

Under prior law, the failure to disclose foreign bank accounts, foreign cash surrender value of foreign life insurance policies, and foreign trusts is subject to penalties based on the amounts that are undisclosed. The rate of penalty differed among the investment vehicles:

- The penalty for failing to disclose foreign bank accounts is up to 5% of the undisclosed balance in the account.
- The penalty for failing to disclose cash surrender values of foreign life insurance policies is 5% of the undisclosed cash surrender value.
- The penalty for failing to disclose funds held by a foreign trust is 12.5% of the undisclosed amounts held by the foreign trust.[10]

Now, the penalties based on unreported accounts will be replaced by an 80% penalty applicable to the late taxes due, if any, on these undisclosed assets.[11] As with the other provisions discussed above, the new penalties may be withdrawn depending on the outcome of the presidential elections that will be held later this year.

10 Former Articles 1736 and 1766 of the French Tax Code.

11 Article 110 of the amended 2016 Finance Law; new Article 1729-0 A of the French Tax Code.