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Changes in French Tax Law: Second Amending Finance Act for 2012 | Nouvelles mesures fiscales : Deuxième Loi de Finances Rectificative pour 2012

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The act provides a series of tax measures affecting corporate, individual, and international taxation to redress public finances.

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France's second Amending Finance Act for 2012 (the Law), approved by Parliament on 31 July 2012 and published in the national legal paper *Journal Officiel* on 17 August, provides a series of tax measures that goes beyond the electoral promises President François Hollande made while running for office. These provisions, announced by the new French government in order to redress public finances, relate to corporate taxation, individual taxation, and international taxation.

Corporate Taxation

Abolition of Social VAT

The Law repeals the increase of the standard value-added tax (VAT) rate introduced in the first Amending Finance Act for 2012, which was to take effect on 1 October 2012. The increase (from 19.6% to 21.2%) was aimed at financing, in part, a decrease in employers' contributions to Social Security. The standard VAT rate will remain at 19.6%.

New 3% Levy on Dividends

A 3% levy assessed on dividends is due from distributing companies with distributions made on or after 17 August 2012—the date of the Law's publication.

This levy is borne by companies or entities subject to corporate income tax, but does not apply to *petites et moyennes entreprises* (PMEs), also known as small- and medium-sized enterprises (SMEs), within the meaning of European Union (EU) law and collective investment funds listed in Article L. 214-1 of France's Monetary and Financial Code.

However, the 3% levy is not due on the following types of dividends:

- Dividends distributed among (i) member companies of the same tax group within the meaning of Article 223 A of the French Tax Code, (ii) member companies of mutual financial institutions under certain conditions, and (iii) listed real estate investment companies that have elected for the specific tax regime (*les societes d'investissements immobilier cotées* or SIIC).
- Dividends paid in shares pursuant to Article L. 232-18 of the French Commercial Code, provided no redemption of shares is implemented within one year of such distribution.

This levy applies to distributions mentioned in Articles 109 to 117 of the French Tax Code. This broad scope includes dividends and all distributions (e.g., sums paid to shareholders in the case of capital decrease, redemption of stocks, and liquidation proceeds) as well as other payments qualified as distributions for tax purposes (e.g., occult remunerations and distributions and excessive expenses).

In addition, it should be noted that the 3% levy is not deductible for corporate income tax purposes and that tax credits or carryback claims and annual flat-rate tax (*imposition forfaitaire annuelle* or IFA) are not deductible therefrom.

Increase in Social Security Contribution Rates on Equity Granted to Employees

Tax rates for Social Security contributions payable by employers and employees on grants of stock options and free shares have been increased. The Law increases the employer Social Security contribution on stock options and free shares from 14% to 30% and the employee Social Security contribution on stock options and free shares from 8% to 10%.

The increase in the employer Social Security contribution applies to stock options and free shares granted on or after 11 July 2012. The increase in the employee Social Security contribution applies to all sales of stock options and free shares on or after 11 July 2012.

Limitation in Use of Carryforward Tax Losses

The Law provides for a limitation of the use of carryforward tax losses in case of change of activity or reorganization.

In the event of a change of business

A "profound change" in the activity performed by a company requires the forfeiture of its carryforward tax losses; however, the current regulations do not define this concept which, to date, has been determined through case law.

The Law introduces a legal definition of "profound change of activity" that includes the following:

- The disappearance of the production resources needed for the pursuit of the activity (i) for more than 12 months, except in the case of a *force majeure* event, or (ii) followed by the disposal of the majority of the company's shares.
- The addition of new activities triggering, during the fiscal year of the addition or the following fiscal year, an increase of more than 50% of either (i) the company's turnover or (ii) the average number of employees and the value of the company's fixed assets.
- The complete or partial termination or transfer of one or more activities triggering, during the fiscal year of the event or the following fiscal year, a decrease of more than 50% of either (i) the company's turnover or (ii) the average number of employees and the value of the company's fixed assets.

However, provided a ruling is granted from the French tax authorities, the following circumstances are not regarded as a profound change of activity:

- The temporary disappearance of the production resources needed for the pursuit of the activity for more than 12 months, provided that the interruption and the resumption of the activity are mainly nontax driven.
- The adjunction, cessation, or transfer of the activity when such action is essential for the continuing of the prior business activity that generated the tax losses and for maintaining employees in their job.

These provisions apply to tax years closed on or after 4 July 2012.

It should be noted that, unlike in Germany and certain Anglo-Saxon States, change in control of a company does not require the forfeiture of carryforward losses when it is not subsequent to a disappearance of production resources.

Transfer of carryforward tax losses in case of reorganization

The Law strengthens the conditions necessary to obtain a ruling from the French tax authorities for the transfer of carryforward tax losses in the case of corporate reorganization. Such a ruling will be granted provided the following conditions are met:

- The business that gave rise to the tax losses must not have undergone any significant change over the course of the fiscal years that generated the tax losses.
- The business that gave rise to the tax losses must be continued for a period of at least three years from the date the reorganization took place and should not, during this three-year period, undergo any profound

change of activity as defined above.

In addition, carryforward losses stemming from either a securities management activity performed by a company whose assets are mainly financial interests or the management of real estate assets are not transferrable. Corporate reorganizations carried out in a consolidated tax group are also affected by these provisions.

These provisions apply to tax years closed on or after 4 July 2012.

Anti-Abuse Provisions in Connection with Participation-Exemption Regime

The Law provides the following anti-abuse provisions in connection with participation-exemption regime:

- Dividends received by real estate dealers in respect of shares of real estate companies booked as inventories are excluded from the participation-exemption regime.
- Capital loss and provision booked in respect of shares held by a securities portfolio company are not deductible from the taxable result of the company up to the amount of dividend received which has benefited from the participation exemption regime. This new provision concerns all income benefiting from the participation-exemption regime generated during the year of the sale of shares and the five precedent financial years for the provision booked.
- In case of a merger achieved less than two years from the date of acquisition of the shares of the merged company, only that amount of short-term capital loss in excess of the amount of dividends distributed by the merged company that benefited from the participation-exemption regime is deductible.

These provisions apply to tax years closed on or after 4 July 2012.

Non deductibility of Financial Waivers of Debt or Subsidies

In order to avoid tax optimization that consists of granting a waiver of debts deductible for tax purposes, rather than recapitalizing a company in loss position, the Law provides that financial waivers of debt or subsidies provided by a French company are disallowed for corporate income tax purposes.

Only waivers of debts or subsidies made for commercial reasons remain deductible, provided they cannot be regarded as an abnormal act of management. A new exception allows a tax deduction for waivers of debt granted for financial reasons specifically in the context of bankruptcy proceedings or in case of receivership court proceedings and mediations.

These provisions apply to tax years closed on or after 4 July 2012.

Elimination of Distortions Between Tax Treatment of Subsidies and Contributions

The Law introduces a new provision that denies the tax deductibility of tax losses realized upon disposal of shares issued in consideration for a capital contribution when the shares have been issued in consideration for a contribution to a company with a negative net equity.

The nondeductible part of the capital loss is equal to the difference between the value for which the shares are recorded and their fair market value at the issuance date.

Disposals of shares also include sales, contributions, and exchanges. Disposals of shares that occurred more than two years after their issuance are not concerned by this provision.

This provision applies to the disposal of shares received as consideration for a capital contribution realized on or after 19 July 2012.

Doubling of Financial Transaction Tax Rate

The Law provides for an increase from 0.1% to 0.2% of the rate applicable to acquisition of stocks in listed French companies.

This financial transaction tax is applicable to transactions carried out on or after 1 August 2012.

Individual Taxation

Introduction of Wealth Tax Surcharge

A temporary wealth tax surcharge is due from those taxpayers subject to the wealth tax in 2012. The purpose of this provision is to achieve the same result as the former wealth tax scale, which was applicable before the enactment of the so-termed Loi TEPA dated 21 August 2007. However, the wealth tax surcharge only affects taxpayers whose taxable assets for 2012 are in excess of €1.3 million.

Taxpayers whose taxable assets total between €1.3 million and €3 million will be assessed the surcharge in their wealth tax notice of assessment; all sums must be paid prior to 15 November 2012.

Taxpayers whose taxable assets are in excess of €3 million, as well as non-French taxpayers subject to the wealth tax on their French assets, will receive a specific tax return that must be filed with the French Tax Authorities prior to 15 November 2012. The payment must be remitted by the same date.

Strengthening of Gift and Inheritance Duties

The Law introduces the following measures that increase applicable gift or inheritance taxes:

- The fixed deduction of €159,325 for the calculation of taxes has been decreased to €100,000.
- The recall period (*délai de rappel*) is extended from 10 years to 15 years. Similarly, the exoneration period for family gifts in cash is extended from 10 years to 15 years.
- The annual update of deductions, rates, and scales applicable to gift or inheritance taxes is abolished.

These provisions apply for estates that go into probate and gifts that are made on or after 17 August 2012.

International Taxation

Controlled Foreign Companies

Under Article 209 B of the French Tax Code, profits of entities controlled by French companies and located in jurisdictions where they benefit from a tax-privileged regime are subject to corporate income tax in France, even if these profits are not distributed to the French controlling company.

A tax regime is deemed to be privileged if the effective tax charge is less than 50% of the tax charge that would have incurred under the standard French rules if the taxpayer had been resident in France. However, safe-harbor provisions may apply, depending on the place of establishment of foreign entities.

Until now, a safe-harbor provision has applied to non-EU-controlled entities if, among other conditions, their profits were derived from an industrial or commercial activity actually carried on from their state of establishment. This safe-harbor provision has also applied to controlled entities located in a non-cooperative state or territory (NCST), with the specification that the burden of proof was upon the taxpayer.

The Law simplifies the conditions for the safe-harbor provision to apply to non-EU-controlled entities. Now, in order to benefit from this provision, a taxpayer must demonstrate that the activity of its controlled entity established in a non-EU country is not driven by the purpose of benefiting from a tax-privileged regime therein, regardless of whether such non-EU country is an NCST or not.

This provision applies for the financial year ending on 31 December 2012 and for subsequent financial years.

Abolition of French Withholding Tax on Dividends Paid to Foreign Collective Investment Funds

In order to comply with European principles settled in the *Santander*case law rendered by the European Court of Justice (10 May 2012, case C-338/11), the Law abolishes the withholding tax, levied at a 30% rate as of 1 January 2012, on dividend payments made to Undertakings for Collective Investment in Transferable Securities (UCITS) (o*rganismes de placement collectif en valeurs mobilières* or OPCVM), real estate collective investment schemes (*organismes de placement collectif en immobilier* or OPCI), and close-ended investment companies (*société d'investissement à capital fixe* or SICAF) established in a foreign country that comply with the two following conditions:

- Raise capital from a number of investors in order to invest in the interests of these investors.
- Present characteristics similar to those of the French collective funds listed above.

This last condition will be analyzed on a case-by-case basis.

However, dividends paid in an NCST remain subject to the French withholding tax, due at a 55% increased rate.

Accordingly, withholding tax unduly paid as of 1 January 2009 can be subject to a tax refund. The global amount of these refunds is estimated at approximately €4.5 billion.

This provision applies the date of the Law's publication.

Extension of Territorial Scope of Social Levies

The Law introduces, as an exception to the current principle, a provision that extends social levies (i.e., *contribution sociale généralisée* or CSG, the *contribution au remboursement de la dette sociale* or CRDS, the contribution and the additional contribution) to French-source real property income and capital gain realized by non-French, nonresident individuals.

As a reminder, the global rate of social levies currently applicable amounts to 15.5%.

This provision applies to rental income received on or after 1 January 2012 and to gains on real property realized on the date of the Law's publication.

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