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France: Non-Cooperative States as of 1 January 2014

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Article of Interest

Tax
France

France's list of non-cooperative states and territories published in 2013 includes Botswana, Brunei, Guatemala, Marshall Islands, Montserrat, Nauru and, effective from 1 January 2014, Jersey, Bermuda and the British Virgin Islands. It is likely, however, that Jersey and Bermuda will be removed from the list to be published in 2014, with retroactive effect as of 1 January 2014.

On 21 August 2013, the French government published a new list of "non-cooperative states and territories" (NCSTs) for French tax purposes.

The French NCST List

An NCST is a jurisdiction that is not an EU Member State and has not concluded with France, or with at least 12 other states as of 1 January 2010, a treaty that includes an administrative assistance provision regarding tax matters. A jurisdiction with which France has signed such a treaty may also become an NCST if the treaty is not ratified, or if the administrative assistance provision is not effectively applied by the other contracting jurisdiction.

The French government publishes the list of NCSTs on an annual basis. Jurisdictions that are included in the NCST list for the first time will be treated as NCSTs from 1 January of the year following the first listing, while jurisdictions that are removed from the NCST list cease to be treated as NCSTs as of 1 January of the year of the delisting.

The NCST list published in 2013 includes Botswana, Brunei, Guatemala, Marshall Islands, Montserrat, Nauru and, effective from 1 January 2014, Jersey, Bermuda and the British Virgin Islands.

As regards Jersey and Bermuda, the French government addressed a letter to the French Parliament's finance committees at the end of 2013 in which it indicated that these two states should be removed from the NCST list to be published in 2014, with effect as of 1 January 2014, considering the fact that since August 2013 they had significantly improved their cooperation with the French tax authorities.

The Adverse French Tax Consequences Resulting from Inclusion in the NCST List

The French tax rules regarding NCSTs are designed to discourage taxpayers from doing transactions with those jurisdictions, by, inter alia, drastically increasing taxation on payments made directly in an NCST (i.e., to a bank account opened in an NCST or, if the payment is not made through a wire transfer, to a person or entity whose domicile or main office is located in an NCST) and on investments made, directly or indirectly, in an NCST.

Payments to NCSTs or to NCST Residents

Higher Withholding Tax Rates. Pursuant to French domestic tax rules, portfolio income derived by a non-French-resident person or entity, from a French-resident person or entity, is subject to a withholding tax of 30 per cent for dividends; 0 per cent for interest; 33.33 per cent for service fees, including royalties; and 45 per cent for capital gains where the seller held more than 25 per cent of the financial rights in the French target at any point in time during the five years preceding the sale (except if the French target is a real estate entity for French tax purposes, in which case the withholding tax is imposed at a rate of 33.33 per cent, irrespective of the stake held in the French target).

However, where the payment is made directly to an NCST, or, with respect to capital gains, where the seller is a person or entity that is domiciled or formed in an NCST, the withholding tax is increased to 75 per cent.

As regards interest payments and service fees, the 75 per cent withholding tax rate does not apply in specific circumstances (e.g., to listed debt instruments), or if the French-resident debtor is in a position to demonstrate that the main purpose and effect of the transaction is not to locate income in the relevant NCST, which in practice may prove difficult.

Non-Deductibility of Payments. In addition to the above, interest payments and service fees paid, or due, by a French-resident person or entity to a person or entity domiciled or formed in an NCST are not deductible for French tax purposes, unless the French-resident debtor demonstrates that the main purpose and effect of the transaction is not to locate income in the relevant NCST.

Investments in an NCST

Non-Application of the Participation Exemption Regime. Pursuant to French domestic tax rules, dividends and capital gains derived by a French-resident company in respect of a qualifying participation held for more than two years are partially exempt from corporate income tax (up to 95 per cent, as regards dividends, and 88 per cent, as regards capital gains), but this participation exemption regime does not apply where the relevant participation is held in a company that is domiciled in an NCST.

Strengthening of Controlled Foreign Corporation (CFC) Rules. Pursuant to French domestic tax rules, CFC rules do not apply if, inter alia, the CFC entity can demonstrate that it carries out a commercial or industrial activity in the jurisdiction where it is either domiciled or has its main office, which in practice may prove difficult if the relevant CFC entity is domiciled in an NCST.

More Burdensome Transfer Pricing Documentation. Pursuant to French domestic tax, French-resident companies which (i) are required to prepare transfer pricing documentation and (ii) have entered into transactions with entities located or formed in an NCST must provide to the French tax authorities the full accounting data that would be required from the relevant NCST entities if they were domiciled in France.

NCSTs and the 3 Per Cent Tax

French and foreign entities that own, directly or indirectly, real estate properties located in France are liable for an annual tax that is equal to 3 per cent of the fair market value of their direct or indirect share in the French properties, unless they benefit from a specific exemption. In particular, entities that (i) are domiciled in France, in an EU Member State or in another state with which France has signed an agreement including a non-discrimination or an exchange of information provision (a treaty-protected state), and (ii) disclose, or commit to do so, the identity of their shareholders, are exempt from this 3 per cent tax.

Those entities that are domiciled in a treaty-protected state are eligible for the above 3 per cent tax exemption even if the relevant treaty-protected state is, or has become, an NCST, unless the relevant agreement is terminated either by France or by the treaty-protected state.

Conclusions

Considering the above adverse tax measures applicable to NCSTs, international corporate groups and private equity funds with a presence both in France and in any of the listed NCSTs should examine their structure to determine whether they are affected by these measures.

As regards Jersey and Bermuda, these states became NCSTs as of 1 January 2014 and technically will remain so until the new NCST list is published later this year. If they are effectively removed from that list, they will be treated as if they had never been NCSTs. As a result, should the local French tax authorities ignore the position of the French government and regard Jersey and Bermuda as NCSTs for French tax purposes at any time prior to the publication of the 2014 NCST list, taxpayers involved in transactions with Jersey and Bermuda should be entitled to claim a refund of any additional tax incurred pursuant to the NCST rules between 1 January 2014 and the date of publication of the 2014 NCST list.

Finally, it should be noted that NCSTs are likely to become a greater area of focus by the French tax authorities in the future. The initial draft of the act on tax fraud and financial crime provided for a new definition of NCSTs, effective from 1 January 2016, which would include any jurisdiction outside the European Union that did not implement, or commit to doing so, an automatic system of exchange of information with France, prior to that date.

Considering the fact that, to date, there is no international consensus regarding information exchange procedures, this provision was considered disproportionate by the French Constitutional Court and was therefore deleted from the final act voted on by the French Parliament. The French tax authorities could, however, make new proposals on the subject in the next few years.