THE NATIONAL LAW REVIEW

French Finance Act for 2017 and Amending Finance Act for 2016: Most Important Changes Affecting Businesses

Friday, January 20, 2017

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Global
Tax
France

The ***French Finance Act for 2017 and Amending Finance Act for 2016*** were enacted on December 30, 2016 (the "**Acts**"). The Acts introduce a progressive reduction of the corporate income tax rate (28% instead of 33.1/3%). The Acts also made changes to the participation exemption regime applicable to dividends.

The key tax measures of the Acts are as follows:

- The corporate income tax rate will be progressively reduced to 28%. The new rate will apply to financial years commencing on or after:
    1. January 1, 2017, for all Small and Medium-sized Enterprises ("**SME**"), for profits up to €75,000;
    2. January 1, 2018 for all companies, for profits up to €500,000;
    3. January 1, 2019 for companies with a turnover lower than €1 billion, on all profits; and
    4. January 1, 2020 for all companies, on all profits.

In addition, the reduced corporate income tax rate of 15% will apply to companies with a turnover lower than € 50 mio (previously €7,630,000)[1].

- The rate of the competitiveness and employment tax credit *(crédit d'impôt pour la compétitivité et l'emploi)* is increased from 6 to 7%[2]. This tax credit was created in 2013 and now amounts to 7% of payroll, excluding salaries above 2.5 times the minimum wage of €1,480 (gross).The rate of the financial transaction tax is increased from 0.2% to 0.3%[3]. The scope of the tax is extended to intraday operations (i.e. acquisition and disposal of the same shares during the same single day).
- The specific 3% contribution on distributed income is no longer due on distributions paid to (French or foreign) companies owning, directly or indirectly, at least 95% of the distributing company's share capital. In other words, the beneficiary company is no longer required to be part of the same tax consolidated group as the distributing company to benefit from the 3% tax exemption. A provision is introduced to allow the 3% exemption to also apply where the beneficiary company is located in a so-called Non-Cooperative State and Territory ("**NCST**"). The French distributing company must demonstrate that (i) the company located in the NCST carries on real activities and that (ii) the aim of the entity's location is not to benefit from a favorable tax regime in the NCST[4].Under French tax law, dividends eligible for the participation exemption regime are exempt from corporate income tax, except for a 5% proportion of costs and expenses that is added back to the taxable result (95% exemption). The beneficiary company is no longer required to hold at least 5% of the voting rights of the subsidiary to benefit from the participation exemption regime as the holding of 5% of the share capital is now sufficient[5].
- Under French tax law, dividends paid by a French company subject to corporation tax to a company

located in a NCST are subject to a 75% withholding tax (instead of - generally - a 30% withholding tax, unless a tax treaty provides for a lower rate). A provision is introduced to prevent the application of the 75% withholding tax. The French company must demonstrate that the dividend distribution has neither the object nor the effect of allowing, for the purpose of tax evasion, the location of the sums in question in such an NCST[6].

Several changes have been made to the quasi-exemption regime applicable to long term capital gains:

Under French tax law, long term capital gains realized by a corporation upon the disposal of shares - held for at least 2 years - qualifying as *equity securities (titres de participations)* can benefit from an exemption of corporate income tax except for a 12% proportion of costs and expenses that is added back to the taxable result (88% exemption).

- The qualification of *equity securities* is now denied when the transferor company does not hold at least 5% of the subsidiary's voting rights[7].
- A provision is introduced to allow the quasi-exemption regime to apply to long term capital gains realized upon the disposal of shares of a company located in an NCST. The French transferor company must demonstrate that (i) the company located in the NCST carries on real activities and that (ii) the aim of the entity's location is not to benefit from a favorable tax regime in the NCST[8].

Other changes affecting individuals which may be of interest to businesses:

As from January 1, 2018, a withholding taxation system will be implemented on income (e.g. wages, pensions) paid to individuals. From that date, personal income tax on remuneration owed by employees will be directly withheld by the employer.

- The period during which foreign individuals working in France (the "impatriates") can benefit from a favorable tax regime (i.e. a partial exemption, under certain circumstances, from personal income tax) is increased from 5 to 8 years[9].
- The rate of the employer social security contribution owed on the value of free shares at the time of vesting (the "Vesting Gain") is increased from 20% to 30%. In addition, the portion of the Vesting Gain exceeding €300,000 is now taxed as a salary and cannot benefit from the favorable capital gain tax regime anymore[10].

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[1] Applicable to financial years commencing on or after January 1, 2019.

[2] Applicable to compensation paid as from January 1, 2017.

[3] Applicable as of 1 January 2017.

[4] Applicable to distributions paid as from January 1, 2017. The current list of NCSTs includes Botswana, Brunei, Guatemala, Iles Marshall, Nauru Niue and Panama.

[5] Applicable to financial years ending on or after December 31, 2016.

[6] Applicable to distributions paid as from December 31, 2016.

[7] Applicable to financial years commencing on or after January 1, 2017.

[8] In principle applicable as from decision n° 2014-437 of the French Constitutional Council of January 20, 2015.

[9] Applicable to employees arriving in France as from July 6, 2016.

[10] Applicable to free shares granted as from December 31, 2016.