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When is tax planning becoming aggressive in France?

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- **Introduction**

In France, as in many other countries of civil law and common law tradition, the main issue in respect of tax planning is no longer drawing the line between tax avoidance and tax evasion. The latter is a criminal offence which is outside the scope of the conference and will not be dealt with in this report. As a general rule, it is easy to identify whether or not an arrangement is contrary to the black letter of the law and is then obviously illegal. It is much more difficult to identify when the red line between legitimate tax planning and so called abusive or aggressive tax planning (ATP) is crossed.

In France, this is the case when an « abuse of law » is deemed to occur. The doctrine, which was developed by case law before becoming a statutory provision in the tax code, has been applied by the French tax authorities for a long time, although more and more frequently, recently. The abuse of law procedure is a general anti avoidance provision (GAAR) which, as opposed to similar statutes in some other jurisdictions, covers all taxes and may apply both corporate and individual, in respect of domestic as well as international tax planning.

The present report prepared for the 2018 meeting of the Academy in Lisbon specifically covers the application of the catch-all abuse of law legislation in the context of individual tax planning. It does not cover the plethora of targeted anti-avoidance provisions (TAAR) (e.g interest limitation and thin capitalization rules, CFC rules, "anti-rent a star" scheme…) which limit tax planning opportunities for individuals with French connections when the conditions of their application are met.

The French abuse of law procedure is a sword of Damocles that is hanging over the (too) creative tax planners' heads. It is then essential for anybody involved in French tax planning to understand under which circumstances the relevant procedure might be applied successfully by the French tax authorities, what are the consequences when this happens and what are the rules protecting the taxpayer.

- **Historical development**

The doctrine of abuse of law developed by case law is a legal concept that imposes sanctions upon the use of a right when that use exceeds the limits of its reasonable use and enforcement.

This is a judicial creation issued for the first time during the Nineteenth Century by the "*Cour de Cassation*" (the Supreme Civil Court) which was took over later by the "*Conseil d'Etat*" (the Supreme

Administrative Court). The decision of the "*Cour de Cassation*" relating to registration duties in 1867 was based on fundamental principles and, among others, the adage "Fraus omnia corrumpit"[1].

Beginning with the *Clément Bayard* case in 1915, the abuse of law doctrine was developed during the Twentieth Century. In the case at hand, the French Court of Cassation ruled that the right of ownership cannot be used maliciously.

In tax matters, the abuse of law doctrine initially developed by case law was first enacted as a statutory provision in 1925 in relation to transfer taxes, and then in 1941 in relation to income tax. It was subsequently codified in Article L 64 of the LPF (*Livre des procédures fiscales).*

As a general rule, French taxpayers are free to organize their activities and structure their transactions as they wish (the freedom of choice principle). However, such a freedom is subject to limitations (see below) on the ground of "*abus de droit"*. For a long time courts have denied legal effects to transactions on the grounds of abuse of law, only if they were artificial or "fictitious" (i.e. a sham).

However, in 1981 the Supreme Administrative Court (*Conseil d'Etat*) ruled that a transaction is abusive when the arrangement under review is fictitious, but also when it cannot be justified by any reason other than the exclusive and intentional purpose of reducing or avoiding tax (12th June 1981 case)[2].

Following a case in 2006 *("Janfin")*[3], article L 64 of the LPF was redrafted. It now provides that:

« In order to restore their true character, the tax authorities have the right to ignore, as not binding, acts which constitute an abuse of law, either because these acts are ***fictitious*** *or because* ***seeking the benefit of a literal application of the law*** *or decisions contrary to the objectives of their author, they cannot have been inspired by* ***any other motivation than avoiding or reducing the tax burden*** *that the person would have normally borne in view of his / her situation or his / her real activities. ».*

Further to the leading case of 27th September 2006 ("*Janfin*"), article L64 of *the Livre des Procédures Fiscales* (LPF) was redrafted along the line of the wording of the case in order to improve legal certainty.

In other words, France anticipated ten years ago what was going to become the European Commission definition of aggressive tax planning namely « *aggressive tax planning consists in taxpayers reducing their tax liability through arrangements that may be legal but are in contradiction with the intent of the law* »

- **Under what circumstances is French abuse of law applicable?**

Article L64 of the LPF allows the French tax authorities to challenge any legal arrangement and to raise the taxes which would have been due in the absence of such an abuse in two types of situations:

[1] Cass. Civ. 20th August 1867, Legrand: DP 1867, 1, p. 337)
[2] CE, plén. Fisc. 10th June 1981, n°19079 : Dr. Fis, 1981, n°48-49 ; RJF9/1981 n°787
[3] CE 27th September 2006 n°260050 sect., Sté Janfin RJF /2006

(i) The transaction is considered to be « artificial », fictitious or « simulated » i. e. is a sham.

In other words, it consists of dressing up an arrangement so that it appears to be something else (e. g. a gift taxable at 60% is disguised into a sale never to be paid but taxable at 6%) and/or

(ii) Although the transaction is genuine, it is **purely** tax motivated and the taxpayer has obtained an improper tax benefit by a literal application of the relevant tax rules while disregarding the **spirit** of such rules.

It is interesting to note that, as opposed to the situation in some other jurisdictions and to the OECD « Principal Purpose Test » (PTT), the French statutory definition of abuse of law applies a sole purpose test which, on the face of it, should be more protective of the taxpayers' interests.

Although the French tax authorities tried in 2014 to enlarge the scope of the abuse of law procedure by replacing the **sole** tax purpose test by a **principal** purpose test, this attempt was invalidated by the "*Conseil Constitutionnel*" (Constitutional Court) on the grounds that the proposed new test would have provided the FTA with too much discretion, contrary to the constitutional principle of legality of offences[4].

On the other hand, experience shows that in practice the French courts tend not to apply the « sole purpose test » too strictly and tend to accept that a transaction may still be disregarded by the FTA and driven by a tax motive, but only when the non-tax reasons alleged by the taxpayer are negligible (see for example the Garnier-Choiseul Case of 17th July 2013[5]).

- **What are the consequences of a successful application of Art L 64 LPF?**

In addition to the payment of the avoided tax and the interest for late payment (4.8% per year up until December 31, 2017, currently 2.4%) the taxpayer is subject to a special penalty of 80% of the amount of the tax if he was primarily responsible for initiating the abusive transaction or was its main beneficiary. Otherwise the additional penalty is reduced to 40% if the relevant transaction has not been performed on the main initiative of the taxpayer or if the latter has not been the main beneficiary of the transaction. The FTA have the burden of proving that the 80% penalty is due.

It has also become more and more frequent for the FTA to consider that a transaction characterized as an abuse of law also constitutes a criminal offence ("*fraude fiscale*") giving rise to penal sanctions.

- **What are the rules protecting the taxpayer?**

Under article L64 B of LPF, a taxpayer can request that FTA confirms that a contemplated transaction will not be treated as an abuse of law. The taxpayer should provide the FTA with all the relevant information necessary to assess the potentially abusive nature of the transaction. If the FTA does not reply within 6 months, the abuse of law procedure will not apply. This specific procedure is very rarely used.

[4] DC, 29th December 2013, n°2013-685

[5] CE, 17th July 2013, n°352989, SARL Garnier Choiseul Holding

As opposed to the situation in some other jurisdictions, in France, if the FTA considers that there is an abuse of law, the fact that the taxpayer has relied on a legal opinion does not provide protection against the application of the above mentioned penalties.
In case of litigation in relation to an alleged abuse of law the key issue is the burden of proof. As a protective measure for the taxpayer a reassessment on such a ground is subject to a specific procedure. In the absence of agreement between the taxpayer and the FTA, each of them may require the opinion of a special committee dealing only with abuse of law issues.

The « *Comité de l'abus de droit fiscal* » (the Committee) is an independent body the role of which is to issue non-binding advisory opinions in respect of tax reassessments made on the ground of abuse of law. The Committee does not have any FTA representatives, but has, in addition to judges, a tax professor, an avocat, a notary and a CPA.

The opinions issued by the Committee are not binding but are in practice very influential on tax courts (see appendixes 1 and 2). Neither the FTA nor the taxpayers are precluded from continuing litigating their case before the relevant tax court. However, the Committee's opinion shifts the burden of the proof which is very important in practice due to the somewhat subjective nature of what is or is not an abuse of law. If the Committee sides with the FTA it is for the taxpayer to convince the courts that the relevant transaction is not constitutive as an abuse of law and vice versa.

- **Recent key cases of interest**

The FTA challenge transactions on the ground of abuse of law both in respect of domestic tax planning and international tax planning.

- ***Abuses of law in respect of domestic tax planning***

The abuse of law doctrine may be used by the FTA when taxes (all taxes due either by corporations, corporate bodies or individuals) are avoided, partially or in full, and/or postponed.

You will find below the most interesting recent decisions given by the Committee or cases ruled by the French Supreme Courts in relation to taxes due by individuals.

Cases eluding gift and inheritance taxes are very frequently challenged by the FTA followed by those avoiding capital gains tax for individuals as illustrated in Appendixes 1 and 2.

- Abuses of law in respect to gift and or inheritance tax

- Donations disguised as sales

While donations are subject to gift tax at rates amounting to 60% between unrelated persons, transfer duties at the rate of approximately 6.5% are due on sales of real estate. It explains why one may prefer selling than gifting.

The intention of the seller, his/her situation (age, health and wealth), those of the purchaser, as well as the modalities of the sale are taken into consideration by the Committee and the Supreme Civil Court (SCC) to qualify the existence of an abuse of law.

The SCC traditionally qualifies the existence of an abuse of law when the sale price is not paid by the purchaser[6] (generally younger than the seller). The health of the seller, the delay between the sale and the seller's death, as well as the importance of the seller's wealth compared with those of the purchaser are also taken into consideration by the SCC.

- Life insurance policies avoiding inheritance tax

Subscribing to a life insurance policy may allow avoiding inheritance tax under certain circumstances. A decision rendered by Administrative Appeal Court of Douai states that subscribing to life insurance policies representing 77.50% of the wealth the first day of hospitalization a few days before death should be seen as constitutive of an abuse of law[7]

- Donations disguised as loans

A free interest loan granted by a 99 year old lender to his son has been considered as a disguised gift [8] by the SCC. In the present case, the SCC looked at the arrangements between the father and his son and considered the obligation to refund the loan as random.

- Abuses of law in respect capital gains tax

  - Donation of shares before their sale to a third party

In order to avoid capital gains tax, one may expect to gift the shares to the children before selling them to a third party.

If the donation is fictitious because the donor does not intend to gift the shares, the operation may be seen as an abuse of law. It has been qualified by the French supreme administrative court (SAC) as when the sale price has been apprehended by the donor[9].

  - Contribution of shares followed by their sale

In order to avoid capital gains tax, a taxpayer may contribute the shares to an intermediate company benefiting from a capital gains tax exemption, before selling them to a third party.

The SAC ruled that these operations of contributing the shares before their sale should be qualified as an abuse of law when the sale price is not reinvested in another economic activity[10].

The Committee considered that reinvesting within three years following the sale justifies the absence of abuse of law[11] and that the absence of reinvestment during this period may be justified under certain circumstances[12].

Numerous advisory opinions of the Committee and case laws discuss whether or not contributions of shares followed by their sale should be seen as constitutive of an abuse of law.

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[6] Cass Com 8th February 2017, n°15-23.043 F-D
[7] CA Douai, 29th September 2003, n°02-2777
[8] Cass Com 8th February 2017,n°15-21.366 F-D
[9] CE 14 October 2015, n°374440 ; CE 5 February 2018, 409718
[10] CE 27th July 2012 327295, 10ème et 9ème S-s, Berjot
[11] Avis du Comité d'Abus de droit 2015-16
[12] Avis du Comité d'Abus de droit 2015-23 and 2017-06

Finally, the law has been modified. The contribution of shares followed by their sale is a taxable event for the contributor regardless of his/her intention and the circumstances of the operations.

- Abuses of law in respect to wealth tax

There are few decisions regarding the existence of an abuse of law aimed avoiding wealth tax. One of them is a perfect transition to the next section dealing with abuses of law in respect of international planning.

A non-resident of France owning the usufruct of French company's shares was subject to wealth tax. In order to avoid it, these shares were contributed to a Dutch holding company. The Committee considered that due to the lack of substance and the artificiality of the ownership structure, it was constitutive of an abuse of law[13].

- ***Abuses of law in respect of international tax planning***

The FTA are also applying the abuse of law concept in relation to international tax planning, particularly in order to defeat treaty shopping, as the two following examples show:

- *Min c/Sté Bank of Scotland CE, 29th December 2006*[14]

Although this ruling of the SAC does not concern individual tax planning, it is worth mentioning as it is illuminates the circumstances in which the FTA considers a cross border arrangement to be abusive.

In this case, the SAC looked at a financial arrangement between a British bank and a US company. The bank bought the usufruct of shares without voting rights of the French subsidiary of the US parent company. Subsequently, the French company distributed dividends to the bank, which immediately requested a refund of the French withholding tax as well as the transfer of the "*avoir fiscal* "(tax credit). The FTA rejected the bank's claim on the grounds that the beneficial owner of the shares was not the bank but the US parent company. The SAC agreed with the FTA to disregard the arrangement as an abuse of law on the ground that the usufruct arrangement was motivated solely by the aim of benefiting from the transfer of the "*avoir fiscal*" which was available under the France-UK tax treaty but not under the France-US tax treaty.

- *Min c/Mr Verdannet (CE, 25th October 2017)*[15]

This is another good example of when an international tax planning scheme is considered to be aggressive and disregarded by the FTA and the SAC as being constitutive of an abuse of law.

This recent case concerns an individual who signed an agreement in his personal name to buy a real estate property in the French Alps. Shortly after, he incorporated a Luxembourg company which was substituted as the buyer. A couple of years after the purchase, the Luxembourg company sold the property, making a significant profit. Capital gains tax was not due in France under the provisions of the tax treaty between France and Luxembourg, with no tax being due in Luxembourg either. The FTA set aside the substitution of the Luxembourg company on the basis

[13] Avis du Comité de l'abus de droit n°2013-06
[14] CE, 29th December 2006, n°283314, Ste Bank of Scotland
[15] CE plén. fisc. 25th October 2017, n°396954, Cts Verdannet

that its only "*raison d'être"* was for the individual to avoid French capital gains tax. The SAC upheld the tax assessment on the basis that under the circumstances the Luxembourg company had indeed no other reason for being involved in the transaction than to enable the taxpayer to avoid the capital gain to be taxed. Concerning the issue of whether or not the double non-taxation resulting from the literal application of the France-Luxembourg tax treaty then in force was against its spirit, the SAC did not go further than asserting that it was obvious that this could not possibly have been the intent of the treaty's negotiators!

- Interposition of foreign companies in order to avoid capital gains tax

An Italian citizen resident in Monaco was a former French resident exercising her activity as a real estate broker in France. She set up four companies registered respectively in France, Luxembourg, Denmark and the United Kingdom, which purchased four flats located in Cannes. The four flats were sold soon after their acquisition. These sales were not taxable either in France, Luxembourg, Denmark or the United Kingdom by application of the tax treaties respectively signed by France with Luxembourg, Denmark and the United Kingdom. The Committee[16] considered that the abuse of law was qualified in the case at hand, as the use of the four companies was artificial and that the Contracting States in signing the tax treaties have no intention to allow avoiding taxes in all countries.

The FTA does not only challenge the abuse of tax treaty, they are also applying the abuse of law doctrine in relation to the constitution of foreign trusts:

- *DRESG/Eugenie L*[17]

A UK resident gifted the shares of a Luxembourg company holding a French company to his wife. Immediately after the gift she transferred the shares of the Luxembourg company to irrevocable and discretionary trusts. The FTA used the abuse of law doctrine considering the operations as artificial and motivated only to avoid French gift tax which is due when the shares of a French company is gifted between spouses.

The Administrative Court of Paris confirmed among other considerations, that the constitution of a trust which is motivated by estate planning considerations cannot be seen as an abuse of law having for sole motive the avoidance of gift/inheritance taxes despite the favorable tax treatment it implies.

- **Requirements to report aggressive tax planning arrangements**

Such a requirement currently does not apply in France. This is because in 2013, the Constitutional Court[18] struck down a proposal for intermediaries to report tax optimization schemes to the FTA, on the ground that this would have restricted the freedom of enterprise as resulting from Article 4 of the 1789 Declaration of Human and Civil Rights and especially the one of tax advisors.

[16] Avis du Comité de l'Abus de droit 2016-53
[17] CAA Paris 19th March 2018, n°16/09096
[18] DC, 29th December 2013, n°2013-685

- **Conclusion**

Although France recognizes the freedom for the taxpayer to « *choose the less taxed way* » this right is not without limits. Respecting the letter of a statute is not sufficient. A transaction will be disregarded not only if it is artificial but also in the case of lack of substance and/or if it does not comply with the spirit of the relevant rules. As a consequence, tax planning in France should be contemplated and implemented with great care. Any structure, e .g. a French or foreign company, involved in a transaction should have both legal and economic substance. Likewise any arrangement should have other sufficient reasons for its implementation other than achieving a tax benefit.

It should also be noted that no significant changes, if any, will affect the French limits in respect of international individual tax planning as a result of the implementation of the EU « ATAD » Directive and the OECED anti-BEPS package. First, these measures do not apply to individual taxpayers. Moreover, they only concern income tax treaties and no other taxes which are also subject to article L 64 of LPF. Lastly, French case law is already consistent with action 6 of the OECD anti-BEPS package which proposes introducing, in income tax treaties, as a minimum standard, a provision aimed at the elimination of double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance.