TAX NEWS

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LEADER

France evidently plans to strengthen its anti-avoidance measures. The main provisions of the Amended Finance Bill 2009 affecting private clients modify existing tax law regarding taxpayers who deal with so-called Uncooperative States or Territories. The tax shield is being amended to increase the income taken into account in determining the potential reimbursement due.

FINANCE BILL FOR 2010

CARBON TAX

Carbon tax was expected to become effective as of January 1st, 2010 but the Constitutional Council has cancelled the existing bill in its present form. Labelled a "climate-energy contribution", it is to be payable by all consumers of fossil fuels (but not of electricity), whether businesses or individuals, with the exception of companies already covered by the EU's Emission Trading Scheme. CO_2 emissions are priced at EUR 17 per ton. The French Government is expected to present by the end of January 2010 a new bill which will grant fewer specific exemptions, as required by the Constitutional Council in its decision.

BUSINESS TAX REFORM

As from 2010, business tax is to be replaced by a new regional tax known as the *Contribution Economique Territoriale* (CET) which will include the *Cotisation foncière des entreprises* (CFE) and an additional contribution. The CET mechanism, which is fairly similar to that of business tax, will be levied on the rental value of assets liable to property tax. The portion corresponding to equipment and other movable assets will be eliminated. The new tax aims to include within its scope real estate companies, and leases and subleases of buildings (excluding unfurnished residential buildings) will be treated as a business activity subject to the CET. In the context of a leasing activity, the CET will be payable by the lessees of a building. This tax will be equal to the added value generated by the company multiplied by a single rate determined on the basis of the turnover (varying from 0.10% to 1.50%).

TAX SHIELD

The Government has decided to amend the tax shield. As from 2011, dividends will be taken into account in their amount before the abatement (of 40%); and only deficits and capital losses which occur during the same year as the income giving rise to the tax shield will be taken into account in calculating it.

AMENDED FINANCE BILL FOR 2009

ANTI - TAX AVOIDANCE AND ANTI - TAX HAVEN MEASURES

On November 16th, 2009, the French Council of Ministers issued a Finance Amendment which provides for retaliatory measures against so-called uncooperative tax jurisdictions. The measures against tax avoidance and uncooperative jurisdictions were to come into force by January 1st, 2010. Having noted the March 2010 compliance deadline issued by the G20 to uncooperative jurisdictions, the Council instructed the relevant Ministers to prepare retaliatory measures against uncooperative jurisdictions before 2010.

FRANCE 'S LIST OF UNCOOPERATIVE JURISDICTIONS

A new provision in the French tax code will define the French concept of "uncooperative" jurisdiction as one that is not an EU Member State, which has not concluded at least 12 treaties on mutual administrative assistance in tax matters and has not entered into such a treaty with France. This annual review will allow France to add countries which have concluded an administrative assistance convention with France but which, in practice, have not allowed the French tax authorities to access relevant information or which have demonstrated insufficient cooperation on tax matters. French parties will need to take this into account before contracting with an entity located in a country which has recently committed to the internationally agreed tax standard (i.e. jurisdictions which in the past were viewed as tax havens but have been removed from the OECD's grey list because they have recently committed to comply with the requirement for 12 agreements).

LIMITATION ON TAX ADVANTAGES

The Amended Finance Bill 2009 provides that amounts flowing from or to uncooperative countries will either be excluded from favourable tax rules or subjected to higher tax rates. As a result, the following consequences can be triggered. Dividends paid as from January 1st, 2011 by an entity located in an uncooperative country will not benefit from the 95% exemption under the French participation exemption. Interest payments made by a French entity to a company located in an uncooperative country will be disallowed for tax purposes regardless of compliance with the arm's length standard. A specific withholding tax of 50% will be imposed on dividends, interest and royalties paid to beneficiaries located in an uncooperative country. Service fees paid to such countries will remain subject to the standard 33 1/3% withholding tax, provided it is demonstrated to the authorities that the services were genuine. If this is not proved, the rate stays at 50%.

TIGHTENING OF CFC RULES

The CFC rules will be more stringent when a subsidiary is located in an uncooperative country. It will no longer be possible to set off the withholding tax on passive income received by the CFC from such a country. The French company, which can normally benefit from the safeguard clause when the foreign entity located in an uncooperative country carries out effective industrial or commercial activities, will bear the burden of proof that the entity is engaged in industrial or commercial activities.

END OF DISCRIMINATION AGAINST FOREIGN PUBLIC INTEREST ORGANISATIONS

After the *Hein Persche* European Court of Justice decision, the tax deduction regime for gifts to French public interest organisations is extended to similar organisations established in another EU Member State.

REGULARISING TAX SITUATIONS

The Government is increasing pressure on taxpayers who have undeclared assets outside France. On August 27th, 2009 Christine Lagarde and Hans-Rudolf Merz, the French and Swiss Finance Ministers, signed the proposed new Franco- Swiss double taxation treaty. This will enable France, on request, to obtain information relating to banking assets in cases of tax evasion as well as tax avoidance. Such requests, however, must identify the taxpayers concerned and be supported by documentary justification: this procedure will therefore not enable France to go on a fishing expedition. The intention is still that this agreement will enter into force as from January 1st, 2010, subject to ratification and to a possible referendum in Switzerland. Although, as expected, the Regularisation Unit closed on December 31st, 2009, it is likely that it will still be possible for new taxpayers willing to regularise their tax situation spontaneously to reach similar arrangements with the French tax authorities.

RECENT CASE LAW

WEALTH TAX EXEMPTION ON FINANCIAL INVESTMENTS

Non-residents are only liable to wealth tax on their assets located in France, with the exception of financial investments. In a decision of March 3rd, 2009, however, the French Supreme Court highlighted a real risk by strictly analyzing the criteria for French tax residence set out in the French tax code (FTC).

In the case in question, the Supreme Court held that a taxpayer who was a resident of Grenada was liable to wealth tax on his worldwide assets, on the grounds that his centre of economic interests was in France. The Court based its conclusion on the fact that he held financial investments in France generating substantial income, which substantially exceeded the value of his worldwide real estate assets. Moreover, as there is no tax treaty between France and Grenada, only the alternative criteria provided by Article 4 B of the French tax code were applicable. These provisions may trigger a liability to wealth tax in France for taxpayers who do not live in France but who receive most of their income from financial investments located in France.

This decision emphasises the risk of investing heavily in France for non resident individuals if they reside in a country that has not entered into a tax treaty with France.

NEW DEFINITION OF ABUSE OF LAW

In two recent important judgments (Supreme Administrative Court, September 7th, 2009, *SA Axa* and *Sté Goldfarb*) the French Supreme Administrative Court used the *Janfin* judgment definition of “fraud on the law”. This definition was given in a case in which the authorities applied the abuse of law procedure provided for by article L.64 of the French tax procedural code (which has included this new definition since January 1st, 2009). These judgments also clarify the debate on transactions allowing the transfer of tax credits. To avoid losing the advantage of the *avoir fiscal*, some companies that were not in a position to use their tax credits sold their shares before the date of a dividend payment to companies which were liable to corporate income tax and thus in a position to use the tax credits.

Once the dividends had been distributed, the initial seller bought back its shares for a price equal to the original sale price minus the amount of the dividends received and, if applicable, part of the *avoir fiscal*. Using the criterion of the intention of the legislator, the Supreme Administrative Court considered that this kind of transaction was not an abuse of law. A somewhat narrow interpretation of the intention of the legislator led the Court only to take into account the status of the shareholder at the time the *avoir fiscal* is obtained, no matter how long it has lasted.

Penalties: From January 1st, 2009, the 80% penalty for abuse of law is now reduced to 40% if it cannot be demonstrated that the taxpayer was the main initiator of an act constituting an abuse of law or was the main beneficiary of it. However, from now on, the taxpayer must pay the penalty and late payment interest even if he is not a party to the act. In the *Caisse Interfédérale de Crédit Mutuel* case, the Supreme Administrative Court passed over the legislator to apply the new penalties to a case that arose before January 1st, 2009. Indeed, in accordance with Article 6 of the European Convention on Human Rights this new penalty should be applied retroactively where it is more favourable to the taxpayer.

ANNUAL 3% TAX

On September 29th, 2009, the Supreme Court gave an interpretation of the ECJ’s decision relating to the annual 3% tax on real estate owned by foreign companies. Under the former Article 990 E of the FTC, the tax was not payable by (among others) non resident companies based in a country with which France had concluded a convention on administrative assistance or a tax treaty containing a non-discrimination clause based on nationality, and which have filed a declaration containing certain information about the property and the company. In the absence of such a declaration, the tax authorities subjected the company to the annual 3% tax. Sté Témis claimed that, pursuant to the ECJ decision mentioned above, France was no longer allowed to recover the tax in dispute. On October 2007, the ECJ held in its *Elisa* decision that the measure (the condition of the existence of a tax treaty) constituted a prohibited restriction on the free movement of capital. But the claimant company was in a different situation from the one involved in *Elisa*, as Sté Témis could have benefited from the exemption by providing the required information. The court considered that the tax provided for by the former provision (i.e. before the amendments introduced by the Finance Bill on December 25th, 2007) did not in itself infringe the right to free movement of capital, because only the exemption rule based on the residence of the taxpayer was held inconsistent with the internal market according to settled case law of the ECJ. In addition, the Court emphasised that the assessment of real estate tax did not deprive Sté Témis of the possibility to claim the exemption regime. The tax liability of the Belgian company relating to its immovable property in France was therefore upheld.

To be noted

France may shortly put an end to the VAT exemption on the acquisition of building lands by individuals to construct buildings for their residential use. The EU Commission has recently sent to France a reasoned opinion to remind it that the VAT directive does not grant an exemption for such acquisitions.