TAX NEWS

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Amended Finance Bill for 2010 and Finance Bill for 2011

LEADER

The French government has introduced new provisions in the Finance Bill for 2011 whereby it intends to increase the burden of taxpayers in response to the current economic situation and to tackle the level of French public debt. These new measures range from an increase in the rates of income tax and social contributions to a limitation of tax incentives and certain wealth tax reliefs. With regard to corporate tax matters, the Finance Bill has implemented new anti-avoidance provisions concerning the thin capitalisation rules and the parent companies regime. In addition to these measures, the French government continues to extend its network of tax treaties containing exchange of information provisions by signing new agreements with low tax jurisdictions.

INDIVIDUALS

RAISE OF TAX RATES

Income tax. The maximum income tax rate has been increased from 40% to 41% for the taxation of 2010 income and successive years.

Capital gains tax. The flat rate tax on capital gains on shares has risen from 18% to 19% as from 1st January 2011. Furthermore, individuals will no longer benefit from the €25,830 threshold under which gains were exempt.

As from 1st January 2011, the flat rate of capital gains on real estate has also increased from 16% to 19%. Moreover, the capital gains exemption which was applicable to non residents on the second transfer of a real estate asset in France has been abolished. The exemption is now limited to their first transfer of real property in France, provided certain statutory conditions are met.

Dividends. Taxpayers electing for the final levy tax on dividends received in 2011 will be liable to a rate of 19% (instead of 18%). The withholding tax on dividends paid as from 1st January 2011 by French companies to non resident individuals within the EU has also been raised from 18% to 19%. Likewise the tax credit on dividends (50% up to €115 or €230) will be abolished in respect of income tax for 2010.

Social contributions: The social surtaxes applicable to investment income have been increased from 2% to 2.2%. The overall flat rate of the aggregate social contributions on investment income now amounts to 12.3%. This new rate is applicable to income from capital assets received from 1st January 2010 and to savings income accrued from 1st January 2011.

LIMITATION ON TAX INCENTIVES

The Finance Bill for 2011 has tightened the global capping measures introduced in 2008, under which tax incentives granted to taxpayers could not exceed €25,000 plus 10% of their taxable income for 2009 and €20,000 plus 8% of their taxable income for 2010. The capping measure has been again reduced, to €18,000 plus 6% of their 2011 taxable income. Moreover, most of the tax incentives covered by this capping measure have been reduced by 10%, except notably for tax credits available for household employees' expenses, the cost of care for young children and rental investments in some French overseas territories. This limitation applies to the 2011 tax year in respect of any expenses incurred during 2011.

WEALTH TAX

Taxpayers are now subject to wealth tax if the net value of their assets owned on 1st January 2011 exceeds €800,000 (instead of €790,000). As from 13th October 2010, the scope of wealth tax relief available for investments in qualifying small and medium companies ("SMEs") has been tightened. Moreover, the French government has decided to reduce wealth tax relief from 75 % to 50 % of the amount invested by the taxpayer in the SME and to limit the tax incentives applicable to such investments from €50,000 to €45,000. A far reaching reform of wealth tax and of the French "tax shield" is expected to be introduced in the next Finance Bill.

TAX SHIELD

In order to give full effect to the measures described above (in increase in tax rates, the limitation of tax incentives and the removal of certain tax thresholds), their impact on the level of taxation will be disregarded for the purposes of the "tax shield".

UNCOOPERATIVE JURISDICTIONS

Since the adoption on 1st January 2010 of measures against fraud in respect of the so-called "uncooperative" jurisdictions (see our International Tax Newsletter of January 2010), France has entered into a large number of treaties in order to facilitate the exchange of information relating to tax matters. Some of them have already entered into force and are therefore enforceable (including the treaties with Jersey, the Bahamas, the Cayman Islands, Liechtenstein and San Marino). The amended Finance Bill for 2010 also provides that France will enter into an agreement with Taiwan by 1st January 2012 at the latest. This agreement will also include specific provisions to develop the exchange of information for tax purposes between both countries.

PENSIONS DRAWN IN THE FORM OF A LUMP SUM PAYMENT

As from 1st January 2011, all pensions drawn, whether from France or abroad, in the form of a lump sum payment will be subject to income tax under the pensions rules. On the other hand, when the retirement scheme has been subscribed for abroad, only the income generated by the capital is subject to income tax under the investment income rules. To be entitled to this specific regime, the beneficiary must prove that the contributions paid to the plan were not deducted from his taxable income or do not relate to an exempt income.

STOCK OPTIONS

Provided that the beneficiary has not opted for their taxation as a salary, gains from the exercise of stock options will be taxed at 41% (instead of 40%) on the part of the gain which exceeds €152,500 and which relates to stocks held for less than two years after the four year period of "unavailability". These gains will also be subject to social contributions at the rate of 12.3% applicable to investment income.

CORPORATION TAX

AMENDMENT OF THE FRENCH PARENT COMPANY REGIME

Dividends received by a French company from a qualifying subsidiary under the parent company regime are still 95% exempt from corporation tax, whereas the remaining 5% (deemed to correspond to expenses incurred) are taxable. The Finance Bill for 2011 provides that the recipient company will no longer be able to cap the amount of the taxable dividend by reference to the expenses that it has actually incurred. This provision, which applies to tax years ending on or after 31st December 2010, will have tax consequences for groups of companies (especially those which have a large number of holding companies). The structure of groups of companies will need to be reconsidered in order to take account of this amendment to the parent companies regime.

THIN CAPITALIZATION

For tax years ending on or after 31st December 2010, the interest deduction limitations under the French thin capitalization rules are extended to interest paid on third-party loans which are guaranteed either by a party that is related to the borrowing entity or by a non related party that is itself secured by a loan guarantee made by a related party. Nevertheless, these new rules are not applicable (i) to the interest on loans granted before 1st January 2011 for the acquisition of shares or their refinancing, (ii) to bonds issued through a public offering, (iii) to loans refinancing a previous loan, the repayment of which was compulsory owing to a change in control of the debtor or (iv) to loans secured by a pledge of shares or receivables, a pledge of shares of a company that directly or indirectly owns the debtor where the holder and the debtor are members of the same tax consolidated group. This provision will have significant consequences for the restructuring of financing agreements.

DISTRIBUTION FOLLOWED BY THE TRANSFER OR THE MERGER OF THE DISTRIBUTING COMPANY

The French government has enacted new anti-avoidance provisions in order to prevent tax structuring that combines (a) an exemption of dividends derived by a parent company from its subsidiary under the parent company regime and (b) a subsequent tax deduction of the short term capital loss generated by the transfer or exchange of the distributing company's shares and due to the decrease in its value further to the distribution. Thus, from 1st January 2011, the parent company regime is no longer applicable to distributions followed by the exchange of the distributing company's shares if the short term capital loss incurred upon the transaction is deducted from the taxable result of the tax year in which the transaction occurred (i.e. if the company does not elect for a deferred taxation mechanism). The French government has also enacted new rules which apply to tax consolidated groups and under which, when the distributing company's shares have not been held for at least two years, capital gains or losses deriving from the sale or exchange of these shares are increased or decreased by the amount of dividends that have been exempt at the level of the tax consolidated result.

RESEARCH AND DEVELOPMENT CREDIT

The Finance Bill for 2011 renews the immediate refund mechanism for tax claims arising from the R&D tax credit in favour of European SMEs. The assessment of research expenditures qualifying for the R&D tax credit is also modified and will have adverse consequences for the amount that may be claimed. Finally, the special tax credit rate available for the first two years is respectively decreased from 50% to 40 % for the first year and from 40% to 35% for the second year.

INDUSTRIAL PROPERTY INCENTIVES

In order to promote the exploitation of industrial property in France, the 2011 Finance Bill has removed a major restriction which limited the deductibility of royalties paid with reference to the licensing of patent and patentable rights to related companies. Such royalties paid during tax years beginning on or after 1st January 2011 are now totally tax deductible even if the royalties are paid to a related company entitled to the 15% reduced rate. Some anti-avoidance provisions limit the measure's benefit to the effective exploitation of patents.

In addition, the scope of the 15% reduced rate regime has been extended under certain circumstances to income deriving from the sub-licensing of qualifying industrial properties, as well as to improvements made to patents and patentable inventions.

MEASURES AGAINST FRAUD AND UNLAWFUL ACTIVITIES

In 2010 the French government introduced a new judicial procedure of investigation regarding tax matters which has given extensive powers to French tax authorities, particularly where there is a risk of losing evidence of tax evasion offences via uncooperative jurisdictions or forgery. The amended Finance Bill for 2010 has extended the scope of this procedure to ancillary offences connected with fraud.

The mutual agreement procedure which has been initiated from 1st January 2011 in accordance with double tax treaty provisions will no longer suspend French recovery as far as a "low tax jurisdiction" is concerned. This measure is intended to limit the abuse that the French tax authorities have observed.

The tax authorities' right of disclosure has been extended to four new categories of entities and companies: casinos, craftsmen, second-hand retailers (including antique shops) and bullion makers and sellers (including jewellery stores).

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