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Entry into force of the second amended finance bill for 2012

After two weeks of stormy debates, the French parliament finally adopted the second amended finance bill for 2012 on July 31.

This is the first step of the tax reform announced by the French government and further measures are expected in the fall. The objective of this amended finance bill ("AFB") is two-fold: (i) breaking with the policy implemented by the former government, and (ii) pursuing the consolidation of French public finances. To achieve this objective, all economic actors have been asked to contribute. This article provides a snapshot summary of the main tax measures that entered into force on August 17, 2012.

Changes impacting personal income tax and wages

Application of social taxes to income from property and real estate gains earned by non-residents

Starting in 2012 income from property and real estate gains earned on assets located in France by non-resident individuals will be subject to social taxes (before only the income tax was due). Until now, only French residents had to pay social taxes on this income (the proceeds of these taxes were originally used to diversify the financing of social protection). This represents an additional charge of 15.5% of the net income.

Other investment income from French sources – e.g. dividends, interests, etc. – continues to be exempt from social taxes in France when received by non-residents.

a) Increased contributions on the grant of stock options and restricted stock

The new government first envisaged to immediately remove the favorable treatment of options and free shares but eventually decided to increase the contributions levied on such grants through two new measures. On the one hand, the employer contribution rate is increased from 14 % to 30 % and the contribution rate of the beneficiary is increased from 8 % to 10 %. On the other hand, the derogatory rate applicable to free shares, which annual value per employee was less than half of the annual social security ceiling, is suppressed.

b) The rate of the employer flat contribution called "forfait social" is raised from 8% to 20%.

The new 20% rate will apply to gains and remunerations which are both (i) excluded from the social security contribution calculation base and (ii) subject to the so-called "*Contribution Sociale Généralisée*" tax. This increased rate applies to gains and remunerations paid from August 1, 2012.

Changes impacting corporate income tax ("CIT")

a) New tax on dividend distributions

The AFB introduces an additional 3 % tax on dividend distributions payable by French and foreign companies subject to CIT in France. The tax will not be payable by undertakings for collective investment (commonly known as collective investment vehicles ("CIV") and small- and medium businesses within the meaning of EU legislation (i.e. companies with less than 250 employees, with annual turnover of less than €50m or a balance sheet total of less than €43m).

Are equally exempt from the tax charge distributions made within a French tax group, a mutual banking group, or between entities which have "SIIC" status, i.e. listed real estate investment companies, to the extent that they belong to the same French tax group.

The new tax will apply to all distributions, including deemed distributed income, made or payable as from the date of publication of the AFB. This tax will also apply to all sums treated as dividends for tax purposes, e.g. profits realized by French branches of foreign companies, at the time these profits are remitted to the overseas head office.

b) Profits from companies based in a tax favorable country

French parent companies of non-EU direct or indirect subsidiaries that benefit from a tax favorable regime and that are therefore subject to the so-called French CFC rules (art. 209B of the French Tax Code), may henceforth only benefit from the safe harbor clause if they demonstrate that the establishment of the subsidiary in a tax favorable jurisdiction is not mainly tax driven. This condition is considered as satisfied if the foreign non-EU entity effectively carries out an industrial or commercial activity in the tax favorable jurisdiction.

c) Non-deductibility of financial debt waivers

For financial years ended on or after July 4, 2012, the financial aid provided by companies to their subsidiaries will no longer be deductible for tax purposes from the contributor's profits. The only waivers that remain deductible for tax purposes are commercial debt waivers and aids provided to companies subject to insolvency/bankruptcy proceedings. On the other hand the beneficiary company will not, under certain conditions, be taxable on the debt waiver if it increases its share capital by an amount equal to that of the waiver.

d) Restriction of the deduction of short-term capital losses on certain newly-issued shares

If a company makes a contribution in exchange for shares, any short-term capital loss arising on disposal of those shares (i.e. disposal within two years) will not be deductible if the actual value of the shares (on the date of the share issue) was less than their accounting value. This provision applies to sales of shares received in exchange for contributions made on or after July 19, 2012.

e) Restriction of tax losses carry-forward

In France tax losses of companies subject to CIT can be carried forward indefinitely, except if the company ceases its activity or undergoes a real change of business, as defined by French courts, in which case tax losses are lost.

The AFB defines the concept of a "real change of business" which now includes the addition or discontinuance / transfer of an activity that entails an increase or decrease, respectively, of more than 50% (compared to the previous financial year) in either (i) revenue or (ii) the average headcount and gross amount of fixed assets.

In certain specific situations, however, a ruling can still be requested from the tax authorities by demonstrating that the change of business is not primarily tax driven.

In the event of a merger or similar operation, a number of conditions must be met in order to obtain approval for any tax losses to be carried forward. The "absorbing" company or that which receives contributions must now undertake to refrain from making "significant changes" to the activity which gave rise to the tax losses.

f) New provisions against divestment schemes referred to as "*coquillards*" (i.e. through the use of shell companies)

In a nutshell, such divestment schemes mean transactions where a parent company receives from a subsidiary dividends that are tax free under the parent-subsidiary tax regime or under the tax consolidation scheme, while simultaneously deducting a capital loss or a provision for depreciation due to the decrease in value of its subsidiary's shares.

In order to prevent such transactions, four anti-abuse provisions targeting four different specific situations have been adopted:

- Dividends deriving from shares in real estate companies that are booked as inventories in the balance sheet of their (real estate dealer) shareholder will no longer be eligible to the parent-subsidiary 95% dividend CIT exemption;
- The potential short term capital loss resulting from the cancellation of shares of the absorbed subsidiary

will no longer be deductible up to the amount of distributions made by such subsidiary that have benefited from the parent-subsidiary 95% CIT exemption;

- The capital loss or the provision for depreciation on these shares will no longer be tax deductible up to the amount of the 95% CIT exempt dividends distributed during the financial year where such capital loss was recorded as well as for the five previous financial years;
- If the shares in the tax consolidated entities have been held for at least two years, the consolidated capital loss should be computed by reference to the purchase price of these shares decreased by the amount of exempt dividends distributed.

g) Advance payment of the exceptional 5% corporate income tax surcharge

The exceptional 5% corporate income tax surcharge is owed by companies with annual turnover exceeding EUR 250m for financial years ending between December 31, 2012 and December 30, 2013. Pursuant to the AFB the due date for payment of this surcharge has been brought forward (compared to the due date initially planned in the draft version of the AFB) so it is payable at the same time as the fourth installment payment of CIT, i.e. for companies with a financial year ending on 31 December 2012 by 15 December 2012. This exceptional tax surcharge should be levied only in 2012.

Changes impacting financial activities and CIVs

a) Repeal of the withholding tax applicable to dividends paid to foreign collective investment vehicles

Under the AFB, CIVs equivalent to French CIVs established in other EU states or in non-EU states with which France has signed a treaty which contains an administrative assistance clause will no longer be subject to the withholding tax. This is the consequence of the judgment rendered on May 10, 2012 by the European Court of Justice in the Santander case, in which the withholding tax applied to dividends paid to CIVs situated in other EU Member states was ruled to be contrary to EU law. Affected taxpayers can file claims, in accordance with the standard French statute of limitations, to recover tax paid on or after January 1, 2009.

b) Financial transaction tax (“FTT”)

The FTT became effective in France on August 1, 2012 and applies to acquisitions of equity securities issued by French companies whose market capitalization exceeds EUR 1 billion on January 1 of the year of taxation. The text explicitly states that the provider who is closest to the initial issuance of the purchase order is the person liable to tax. The tax rate will be 0.2% instead of 0.1% as originally planned.

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