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The new reform of groups' tax consolidation system

For several years, the judgments of the European Court of Justice have constantly challenged certain provisions of the French General Tax Code relating to groups' tax consolidation system. And for a good reason: The various regimes existing within the European Union restrict the freedom of establishment and none of the reasons given by the Member States to justify such restriction is acceptable to the Advocate General of the Court.

The draft finance bill for 2019 therefore provides for several important measures to bring the French tax consolidation system into line with European Union law on a long-standing basis.

Before addressing the subject, it is useful to briefly explain what is the tax consolidation regime defined in Article 223 A of the French General Tax Code ("FGTC"): Tax consolidation is a mechanism allowing a company at the head of a group it forms with its subsidiaries, known as the "parent company", to be the sole party liable for corporation tax for the entire group. This mechanism then makes it possible to offset the profits and losses made by the various subsidiaries within the group for tax purposes, as well as to neutralize intra-group transactions.

In order to take into account the case law of the European Court of Justice ("ECJ") concerning the scope of tax consolidation, the scheme has already been reformed twice. First, the refusal to integrate French sub-subsidiaries held through a foreign subsidiary for tax purposes was found to be a disproportionate infringement of the freedom of establishment[1], which led to the authorization of forming a tax group in this type of situation ("vertical" integration).

Subsequently, the refusal to authorize the integration of French sister companies held by a parent company established in another Member State led the legislator to allow sister companies that are subsidiaries of a European parent company to form an integrated group ("horizontal" integration)[2].

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Recently, the ECJ ruled that the French legislation reserving advantages to national groups schemes was contrary to European Union (EU) law, and in particular to the freedom of establishment, since these advantages concerned only companies that are resident in France.

Taking advantage of the need to comply with the ECJ rulings, the French legislator therefore proceeded, on the occasion of the draft finance bill for 2019 ("DFB 2019"), to make a new adjustment on groups' scheme in order to bring it into compliance with European Union law on a long-lasting basis while maintaining the tax consolidation rationale underlying the current scheme.

Among the various amendments to the FGTC, Article 12 of the DFB 2019 provides for an amendment of Article 223 Q of the FGTC so that subsidies and write-offs of receivables granted between members be no longer neutralized in the calculation of the overall result.

Explanation. Currently, Article 223 B para. 5 of the FGTC provides that "*the write-off of a receivable or direct or indirect subsidy granted between group companies or by a group company to an intermediate company, a foreign company or the non-resident parent entity […] is not taken into account for the determination of the overall result* [established at the parent company level]".

In order to correct the group's result, the amounts included in the deductible expenses of the company that granted the write-off are then reinstated and the amounts included in the profits of the company that received the benefits are deducted.

Wherever the company granting the benefit is not entitled to the corresponding tax deduction, as in the case of write-offs of financial claims[3], the overall result is only reduced by the profit recorded by the company benefiting from the debt write-off or subsidy. The non-deduction of the write-off from the debt of the individual income of the company that granted it, is then not taken into account to determine the overall taxable income.

The objective of the DFB 2019 is to put an end to this neutralization of financial debt write-offs, which are excluded from deductible expenses under current rules[4], unlike commercial debt write-offs, which are already deductible for tax purposes.

The reform should concern write-offs of receivables and subsidies made as from January 1, 2019. When the parent company submits the declaration of the overall result for the financial year under the conditions provided for in Article 223 of the FGTC, it will attach a statement of subsidies and write-offs of receivables not included in the determination of the overall result for financial years opened before January 1, 2019. In addition, Article 223R, which provides for the reinstatement of neutralized subsidies and write-offs in the event of exit from the group, is amended so that reinstatement is limited to operations granted before January 1, 2019.

In addition to this first measure, the DFB 2019 also provides for:

- The end of the neutralization of the share of capital gains on the sale of equity securities within a group. On the other hand, the rate of the share will be reduced to 5% of the gross amount of the capital gains

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on disposal (for 12% previously)[5],
- The setting of the rate of the share of costs and charges on dividends falling under the parent-subsidiary regime at 1%, whether or not the dividends are received by a company that is a member of a group, provided that the beneficiary companies and the French or EU-based distributing companies have met the conditions for forming a group,

which are additional measures that should put an end to French incompatibilities with EU law.

[1] ECJ*, November 27, 2008, Papillon, case N° 418/07*

[2] ECJ, June 12, 2014, case. N° C-39/13, C-40/13 et C-41/13

[3] The financial nature of the aid results from the reason for which it is granted, which normally falls within the scope of safeguarding the value of the shares of the company granting it and the sustainability of the subsidiary in difficulty, in order to avoid being forced to meet its liabilities.

[4] Article 39.1.3 of the French General Tax Code

[5] The amount of the share of costs and expenses should be taxed at the rate of 5% for all capital gains and not only for capital gains on the sale of long-term securities between consolidated companies.

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