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Global Tax Alert

French Parliament approves Finance Bill for 2020

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Executive summary

On 19 December 2019, the French Parliament approved the Finance Bill for 2020 (the Bill).

Except for the constitutionality review by the *Conseil constitutionnel* (French Constitutional Council), this Bill is final and expected to be published by 31 December 2019.

This Alert summarizes the main corporate tax provisions relating to companies in the Bill.

Detailed discussion

Modification of the initially proposed French corporate income tax rate decrease for large companies

Following the partial freeze of the French corporate income tax (CIT) rate decrease for companies (or tax consolidated groups) with revenue realized in France equal to, or higher than €250 million, for fiscal years (FYs) opened during calendar year 2019,[1] the Bill modifies the initially proposed French CIT rate decrease for these large companies, as follows:

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- For FYs starting on or after 1 January 2020, a 28% CIT rate will apply on the first €500,000 of taxable income. Taxable income in excess of €500,000 will be subject to a 31% CIT rate (instead of a 28% CIT rate).
- For FYs starting on or after 1 January 2021, a 27.5% CIT rate will apply (instead of a 26.5% CIT rate).

The initially proposed French CIT rate decrease for companies with revenue lower than €250 million will remain the same as the rates stated by the Finance Bill for 2018,[2] with a 28% CIT rate for FYs starting on or after 1 January 2020 and a 26.5% CIT rate for FYs starting on or after 1 January 2021. For FYs starting on or after 1 January 2022, a 25% CIT rate will apply for all entities.

Finally, the Bill specifies that only the rate applicable to companies with revenue lower than €250 million will be taken into account for the payment of withholding taxes or levies for which the rate is determined by reference to the CIT rate. This rule applies to withholding taxes or levies with a triggering event occurring on or after 6 March 2019, or on or after 1 January 2020 for withholding taxes on dividends.

Repeal of the subject-to-tax test applicable to interest expenses

Due to the implementation of the anti-hybrid rules of the European Union (EU) Anti-Tax Avoidance Directives (ATAD 1[3] and ATAD 2[4]) as described in the paragraph below, the Bill repeals the existing anti-hybrid rules applicable to interest expenses only. Currently, as per Article 212. I, b of the French Tax Code (FTC), interest accrued by the French borrower must be subject, at the level of the lender, to a minimum taxation of 25% of the French CIT which would have been due, had the lender been established in France.

Such a repeal applies to FYs starting on or after 1 January 2020.

Implementation of the anti-hybrid rules under the EU ATAD

The Bill literally transposes into French domestic law the anti-hybrid provisions provided by ATAD 1 and ATAD 2, designed to tackle hybrid instruments as well as hybrid entities.

These directives provide for the transposition into the domestic law of each Member State of the EU, rules to eliminate mismatches in relation to payments as a result of different legal characterization (between Member States of the EU or with third jurisdictions) of an instrument or an entity between two jurisdictions:

- In the case of a double deduction outcome: the deduction in the investor jurisdiction shall be denied or, if not, the payer jurisdiction shall have the right to deny the deduction.
- In the case of deduction without inclusion outcome: the payer jurisdiction shall deny the deduction or, if not, the investor jurisdiction shall have the right to tax the payment up to the deduction obtained in the payer jurisdiction.

These new rules apply to FYs starting on or after 1 January 2020, except for those related to reverse hybrids which will apply to FYs starting on or after 1 January 2022.

Adjustment of the research and development (R&D) tax credit

The Bill provides for a decrease of the percentage (from 50% to 43%) of staff expenses taken into account as qualifying expenses to assess the lump-sum running costs referred to in Article 244 quarter B, II, c of the FTC.

Also, the Bill introduced specific measures in order to prevent the abuse of subcontracting schemes which allowed some taxpayers to benefit, several times, from the R&D tax credit.

These two measures apply to expenses incurred during FYs starting on or after 1 January 2020.

Refund and deferred payment of withholding taxes and levies borne by foreign entities in a tax loss position

Further to a decision issued by the Court of Justice of the EU,[5] the Bill allows foreign entities in a tax loss position to claim a refund of:

- The withholding taxes on dividends imposed under article 119 *bis* of the FTC
- The withholding taxes imposed under article 182 A *bis* and 182 B of the FTC
- The levies on capital gains upon transfer of shares or real estate shares or assets imposed under articles 244 *bis*, 244 *bis* A and 244 *bis* B of the FTC

Regarding the withholding taxes and levies, other than withholding taxes on dividends imposed under article 119 *bis* of the FTC, the eligible entities are foreign entities located in an EU Member State, or in another State that is part of the European Economic Area (EEA) agreement which complies with the two following conditions:

- Said jurisdiction must have concluded with France an agreement with an administrative assistance clause for the prevention of fraud and tax evasion, as well as an agreement with a mutual assistance clause for tax collection which has a similar scope as the EU directive.
- Said jurisdiction is not considered as non-cooperative within the meaning of article 238-0 A of the FTC.

Regarding the withholding taxes on dividends, the eligible entities are: (i) the above-mentioned ones located in an EU Member State, or in another State that is part of the EEA agreement subject to the above-mentioned conditions, as well as (ii) any other foreign entities not located in an EU Member State, or in another State that is part of the EEA agreement, provided for the latter that:

- The jurisdiction at stake also complies with the two above-mentioned conditions.
- The interest at stake in the distributing company does not allow the beneficiary entity to effectively manage or control the distributing entity.

The foreign entity that may benefit from such a refund, as per these new rules, would have to finally pay the tax when it becomes profitable or if the relevant annual tax compliance requirements are not met.

Finally, the Bill has also extended the scope of the withholding tax exemption provided by article 119 *quinquies* of the FTC, which initially applied to dividend distributions received by a foreign entity under judicial liquidation or an equivalent procedure. As per the Bill, this exemption will also apply to all other withholding taxes and levies mentioned above, and the eligible entities are those previously mentioned, subject to the same conditions.

These measures apply to FYs starting on or after 1 January 2020.

Adjustment of the "branch tax"

Further to a recent decision from the *Conseil d'Etat* (French Administrative Supreme Court),[6] the Bill allows entities located in an EU Member State, or in another State that is part of the EEA agreement, which cannot benefit from the current exemption applicable to certain entities located in said States,[7] to avoid or limit the withholding tax imposed under article 115 *quinquies* of the FTC if they are able to demonstrate that their profits have not been divested out of France. This measure applies to FYs starting on or after 1 January 2020.

Adjustment of the "exit tax" to isolated asset transfers to the EU or the EEA

In accordance with the ATAD, the Bill allows the five year spreading of the taxation of unrealized capital gains, provided by the exit tax, to apply, upon request of the taxpayer, on the transfer of isolated assets (even if there is no transfer of residence) to an EU Member State (and an EEA country under certain conditions). Before this change introduced by the Bill, such five year spreading taxation of unrealized capital gains was only granted to the transfer of residence or permanent establishment in another Member State or the EEA country.

This measure applies to fiscal years beginning on or after 1 January 2020.

Repeal of the ruling requirement to transfer an amount of losses of less than €200K in the context of a merger

The transfer upon a merger of carried-forward losses, of non-deductible financial charges (according to article 212 *bis* – "30% EBITDA rule"[8] – or 223 B *bis* – "Charasse amendment rule" – of the FTC) and of unused deductibility capacities (in relation with the same provisions) together referred to as "losses" of the merged company, may no longer require a ruling.

For a stand-alone company, in order for this transfer to be valid with no ruling, it is required that the cumulated amounts of losses at stake: (i) be lower than €200k; (ii) not be derived from a holding activity (in relation with shares or real estate management); and (iii) that during the time period where the losses were generated, the merged company did not sell/cease to exploit a going concern.

This measure applies to merger transactions only, as opposed to contributions of business or demergers, which would occur during fiscal years beginning on or after 1 January 2020.

Endnotes

1. See EY Global Tax Alerts, *French Parliament approves draft bill on partial freeze of corporate income tax rate decrease*, dated 16 July 2019 and *French President signs bill on Digital Services Tax and partial freeze of corporate income tax rate decrease*, dated 25 July 2019.
2. See EY Global Tax Alert, *French Parliament approves Finance Bill for 2018 and second Amending Finance Bill for 2017*, dated 22 December 2017.
3. EU Directive 2016/1164 dated 12 July 2016.
4. EU Directive 2017/952 dated 29 May 2017.
5. CJUE, 22 November 2018, C-575/17, *Sofina SA, Rebelco SA, Sidro SA*.
6. CE, 10 July 2019, n° 412581, *Sté Cofinimmo*.
7. Article 115 *quinquies*, 3 of the FTC.
8. Earnings before interest, taxes, depreciation and amortization.

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