

THE NEW FRENCH TAX RULES FOR 2017

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In the last Finance Bills passed before the upcoming presidential election, the French Parliament adopted technical, but rather important, tax measures regarding corporate and individual income tax.

Although the longevity of these taxes will depend on the outcome of the presidential elections, the main French tax developments for 2017 are well worth noting.

CORPORATE TAX

Decrease of the standard corporate income tax (CIT) rate

The Finance Bill for 2017 (the “2017 Bill”) progressively reduces the standard CIT rates from 33.1/3% to 28%. This is the first time the CIT has been reduced since 1993 and the new rate will apply to all companies from January 2020 (assuming that no changes are introduced after the presidential election in May 2017).

The timetable is as follows:

- From January 2017, the new 28% rate will apply only to small- and medium-sized companies (“SMEs”) on the first €75,000 of taxable income. These companies are those that: (i) are subject to the CIT; whose annual turnover is less than €7.63m; and whose fully paid up share capital is at least 75% owned by individuals directly or indirectly; and (ii) fulfil the criteria listed in Annex 1 of EU Regulation 651/2014.
- From January 2018, the new 28% rate will apply to all companies on the first €500,000 of taxable income earned over a 12-month period.
- From January 2019, the 28% rate will apply to all taxable income of all companies whose annual turnover is less than €1bn over a 12-month period. For companies whose turnover exceeds €1bn over a 12-month period, the 28% rate will apply only to the first €500,000 of taxable income earned over a 12-month period.
- From January 2020, the 28% rate will apply to all companies subject to French CIT.

The current reduced CIT rate of 15% will still apply to SMEs for their taxable income up to €38,120 per annum.

New lower threshold on transfer pricing documentation

Transfer pricing continues to be an area of focus in France.

Since 2013, all French entities with a turnover or gross assets on the balance sheet exceeding €400m, or with a more than 50% direct or indirect shareholder ownership or a subsidiary that meets this threshold, are required to file a document each year providing specific information on their transfer pricing policy (form 2257).

For fiscal years ending on or after 31 December 2016, the threshold is reduced from €400m to €50m.

Clarification on the 3% distribution tax

The validity of the 3% distribution tax has been challenged before the French courts, primarily on the grounds that some of its aspects contravened EU laws.

The amended Finance Bill for 2016 finally closed the debate on this subject and extended the exemption from this 3% tax to all dividends distributed by French companies to other companies (whether French or foreign), provided that these companies fulfil all the conditions necessary to be considered members of a French tax group within the meaning of Article 223 A of the French tax code ("FTC"), but regardless of whether they had opted to be integrated in such a tax group.

Distributions made by French companies that are at least 95% owned directly or indirectly by another company will therefore be exempt from the 3% distribution tax regardless of whether the tax group was created under Article 223 A and following of the FTC, and irrespective of the country of residence of the beneficiary companies (except if located in a Non-Cooperative Country or Territory ("NCCT") within the meaning of Article 238-0 A of the FTC).

This general exemption will apply to all distributions made as from January 2017.

Increase in CICE

The tax credit for competitiveness and employment ("CICE") is a tax benefit applicable to all companies with employees. This tax credit is equal to a percentage of each company's payroll (excluding wages exceeding two-and-a-half times the French minimum wage – SMIC), and can be directly deducted from the CIT for the year in which the wages taken into account for its calculation were paid.

The 2017 Bill increases the rate of the CICE from 6% to 7%.

The new rate of 7% will apply to wages paid as from January 2017.

INDIVIDUAL INCOME TAX

Introduction of a new pay-as-you-earn tax system for all French tax residents The 2017 Bill introduces a pay-as-you-earn tax system for individual income tax as from January 2018.

Currently, French tax residents pay income tax a year in arrears, i.e. in the year following the year in which the income is received.

The main goal of this new measure is to avoid discrepancies between the year in which the income was earned and the year of its taxation. This new system will also align France with other countries such as the USA, the UK and Germany.

Scope of the pay-as-you-earn tax system

Income subject to this new pay-as-you-earn tax system comprises wages, pension payments and unemployment benefits paid by French entities. By contrast, wages paid by non-French legal employers through a payroll outside France are excluded.

Business revenue, self-employment revenue, rental and employment income paid by a non-French employer will be submitted to monthly or quarterly income tax payments.

The tax payment mechanism for passive income (interest, dividends and capital gains) will remain unchanged.

Determining the pay-as-you-earn tax rate

Two methods are planned to calculate the tax rate:

The tax authorities will calculate the individual's tax rate based on the previous year's annual tax returns. However, the taxpayer can keep a standard tax rate if:

- the tax authorities cannot calculate an employee's individual tax rate; or
- an employee wants to keep its household tax rate confidential.

In this case, the pay-as-you-earn tax rate will vary from 0% to 43%.

Implementation process

This new pay-as-you-earn tax system will be implemented progressively:

- In 2017, taxpayers will pay the individual income tax calculated on their 2016 income.
- In 2018, taxpayers will pay tax on their 2018 income and will declare their 2017. In order to avoid a double tax burden, on filing their 2017 tax returns, each taxpayer will benefit from a special tax credit called "CIMR" (the "Tax Credit for Modernisation of Income Tax Collection").

However, exceptional income and tax credits pertaining to the 2017 tax year will be taken into consideration in the calculation of the tax rate and could remain taxable.

Both resident and non-resident taxpayers will still be required to file individual income tax returns every year. Penalties will apply for failure to comply with this pay-as-you-earn tax system.

Free shares for managers and employees: back to the starting point

Originally very favourable when it was introduced in 2005, the free shares regime provided for full exemption from social security contributions for the employer and a reduced effective tax rate for the employees. A free shares mechanism is frequently implemented not only in start-ups but also in multinational groups as an incentive plan for managers and employees.

The tax benefits for employees has, however, decreased over the years, in particular with the creation of a specific employee contribution.

The “Macron Law”, which was initiated by the former Finance Minister Emmanuel Macron and adopted on 6 August 2015, amended and improved the tax regime applicable to free shares for employees and employers.

The 2017 Bill has limited the benefits of the new Macron Law and increased the tax burden on free shares:

- the acquisition gain (i.e. the value of the shares at the date of their acquisition by the employee) is now taxed as standard salary income, disallowing the benefit of the capital tax gain regime, which is more favourable;
- the favourable capital gain tax regime will, however, still apply to the acquisition gains realised on free shares granted by SMEs that have never distributed dividends;
- employers’ social contribution rate has been increased from 20% to 30%; and
- the 10% employee social contribution has been restored.

Finally the 2017 Bill has limited the above unfavourable tax measures that do not apply to acquisition gains lower than €300,000.

New anti-abuse rule for the wealth tax shield

A new anti-abuse rule has been introduced to reduce the possibility of capping the amount of wealth tax. The current wealth tax shield caps the total of income tax, social contributions and wealth tax at 75% of the taxpayer’s overall income of the previous year.

The 2017 Bill introduces an anti-abuse rule targeting taxpayers who try to artificially reduce their income level by capitalising cash in a financial holding entity (“cash- box” entity), in order to retain a small amount of income for the calculation of wealth tax cap mechanism purposes.

The new rule provides that income distributed to a company (e.g. dividends distributed by subsidiaries to a financial holding entity) subject to CIT and controlled by the taxpayer shall be reinstated in the income to be taken into account in the calculation of the wealth tax cap for the part corresponding to an artificial reduction of the personal income calculated.

In order to carry out a reinstatement, the tax authorities have to demonstrate that the existence of the company and the choice to use a holding company are mainly intended to avoid all or part of the wealth tax. This new anti-abuse rule will likely create discussions with the tax authorities with respect to family holding companies, which are more and more common in France.

Extension of the application period for the inpatriate tax regime

The inpatriate regime currently allows for a reduction of individual taxable income on both employment income (on an expatriation allowance or on 30% of the total net remuneration and remuneration fraction corresponding to work abroad) and passive income (received abroad under conditions). Additionally, the scope of wealth tax is limited to French assets for the first five years.

The length of the period during which inpatriates can benefit from a specific favourable individual income tax regime is extended from five to eight years. The period of partial exemption from wealth tax remains five years.

The new rule applies for inpatriates who started working in France on or after 6 July 2016.

In addition, inpatriates' expatriation bonus paid as from 1 January 2017 will be exempt from payroll tax, which is a tax mainly due by employers that are not fully subject to VAT (e.g. banks or other financial companies).

NEW NCCT LIST FROM JANUARY 2017

Although the two Finance Bills do not amend the list of NCCT within the meaning of Article 238-0 A of the FTC, this list changed on 1 January 2017 and now includes:

1. Nauru;
2. Guatemala;
3. Brunei;
4. The Marshall Islands;
5. Botswana;
6. Niue Island; and
7. Panama

Panama was reintroduced to this list in 2016, with effect from January 2017.

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