2020 French budget introduces ATAD II and corporate tax rate provisions

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In brief

The French Parliament on December 19, 2019 approved the Finance Act for 2020 (the Finance Act). The Finance Act was subject to constitutional review before publication in the French legal gazette on December 29.

The Finance Act includes corporate tax measures designed to transpose into French law Articles 9, 9 bis, and 9 ter of EU anti-tax-avoidance directive 2016/1164 dated July 12, 2016 (ATAD I) as modified by EU directive 2017/952 dated May 29, 2017 (ATAD II). The Finance Act also includes other EU-compliant measures and postpones, for large companies, the scheduled reduction of the corporate income tax rate.

Most of the measures apply for tax years beginning on or after January 1, 2020, and impact multinational enterprises (MNEs) with French operations or subsidiaries. The Finance Act contains other tax provisions that are not covered in this Insight.

In detail

ATAD II, including hybrid mismatches with third countries

ATAD I and II Directives were introduced as part of the 2015 OECD Base Erosion and Profit Shifting (BEPS) report, Action 2, on neutralizing the effects of hybrid mismatch arrangements.

The Finance Act transposes ATAD II into French law under new Articles 205 B, C, and D of the French Tax Code - essentially focusing on double deductions, imported mismatches, and deduction without inclusion situations that would apply not only between EU Member States, but also in situations involving third countries.

Applicability

The new articles provide that hybrid mismatches could result from:

- Payment under a financial instrument giving rise to a deductible expense in the residence country of the payor without inclusion in the taxable income in the residence country of the beneficiary, where the mismatch outcome is attributable to the differences in the tax characterization of the instrument or the underlying payment
- Expense deduction in the residence country of the payor without inclusion in the taxable results in the residence country of the hybrid entity, when such outcome results from differences in the laws in the residency country of the hybrid entity governing the allocation of that payment to the hybrid entity and the laws of the residency country of any person with a participation in such hybrid entity
- Payment made to an entity with one or several permanent establishments with expense deduction in the residence country of the payor without inclusion in the taxable results of such entity as a result of differences in the residence country laws of a head office and its permanent establishment, or between two or more permanent establishments of the same entity pursuant to the laws of the countries in which such entity performs its activities
- Expense deduction in the residency country of the payor of a payment made to a permanent establishment without inclusion in the taxable income in the country of the permanent establishment under the laws of such country as not treated as a permanent establishment (i.e., disregarded permanent establishment)
- Expense deduction in the residence country of a hybrid entity (payor) without inclusion in the taxable results of the beneficiary as a result of the laws of the residence country of the beneficiary treating such payment as not includible (i.e. disregarded payment)
- Expense deduction in the country of a permanent establishment without inclusion in the taxable income of the beneficiary with respect to a deemed payment between a permanent establishment and its head office or between two or more permanent establishments, as a result of the laws of the residence country of beneficiary treating such payment as not includible (i.e., deemed branch payment)
- Double deductions resulting from payments giving rise to a deduction of the same payment, expenses, or losses in the residence country of the payor and in another country. In the case of a payment by a hybrid entity or a permanent establishment, the residence country of the payor is the one where the hybrid entity or the permanent establishment is established or situated.

Associated entities

The Finance Act provides that the rules apply between 'associated entities' as defined under French law with two main direct and indirect thresholds (25% and 50% of voting rights, share capital, or rights to profits) and apply depending on the type of hybrid mismatch at stake (e.g., 50% for reverse hybrids). It also includes a provision covering persons acting jointly with another person in order to be considered an associated entity.

Inclusion

The Finance Act provides that a payment is deemed included in the residency country of the beneficiary if it does not give rise to an exemption, a tax rate reduction, or a credit or a tax refund (other than a withholding tax) and such inclusion occurred during a tax year that began within 24 months following the end of the tax year during which the expense gave rise to deduction.

The Finance Act also provides that when a payment gives rise to a deduction without inclusion, the deduction should be denied at the level of the French payor. As a secondary rule, if a deduction arose at the level of a foreign payor, the payment should be included in the taxable income of the French payee. A similar provision addresses situations resulting in double deductions (with a corresponding safe-harbor covering double inclusion situations).

When a deductible payment offsets another hybrid payment, directly or indirectly, through a transaction or a series of transactions between associated entities of a taxpayer or through a structured transaction, the deduction on such first payment is denied unless the residency country of one of these entities involved in the transaction neutralizes the impact of such hybrid transaction (if partially neutralized, the deduction then would be partially allowed).

Where a hybrid transfer results in withholding tax relief on a payment derived from a financial instrument transferred to several parties involved in the transfer, the relief would be pro-rated based on the net taxable income related to such payment.

Dual residency

Where dual residency in France and another country gives rise to double deduction of a taxpayer's payments, expenses, or losses, the deduction would be denied in France unless (1) the income is dual inclusion income (although the law is unclear in that respect) or (2) the other country is a EU Member State that denies the deduction and the tax treaty between France and the other Member State considers that the taxpayer is tax resident in France.

Reverse hybrids

The Finance Act includes provisions relating to reverse hybrid entities constituted or established in France. Under the new provisions, France would opt for an exception to apply this provision with respect to collective investment vehicles.

Elimination of current anti-hybrid rules on interest payments

As a result of the transposition into French law of ATAD II, the current French 'anti-hybrid/subject-to-tax' rules applicable to interest (under Article 212, I-b of the French Tax Code) are eliminated. The new rules apply not only to interest but to any other types of payments.

These Finance Act provisions would apply to tax years beginning on or after January 1, 2020, apart from the reverse hybrid provisions, which would apply to tax years beginning on or after January 1, 2022.

Postponement of the corporate income tax rate reduction

The Finance Act postpones, with respect to large companies only, the French corporate income tax rate reduction originally enacted as part of the 2018 French budget. For tax years beginning on or after January 1, 2020 and until December 31, 2020, French companies with revenues of EUR 250M or higher will not benefit from the general 28% reduced corporate tax rate but will be subject to a 31% rate for the portion of taxable income exceeding EUR 500,000 (28% below such threshold).

For tax years beginning on or after January 1, 2021 and until December 31, 2021, French companies with revenues of EUR 250M or higher will be subject to a 27.5% rate. No changes apply with respect to the scheduled rate reduction to 25% for tax years beginning on or after January 1, 2022 for all companies. For companies with revenues not exceeding EUR 250M, the scheduled progressive corporate tax rate reductions remain unchanged over these tax years.

Adjustment of certain withholding tax and levy rates to the French corporate tax rate

The Finance Act aligns or clarifies certain withholding tax and levies rate - in particular, the previous 30% withholding tax rate provided for by article 187 of the French Tax Code, article 182B, 244 bis, 244 bis A&B of the French Tax Code - with the French corporate tax rate reductions scheduled over the next few years.

These provisions apply to triggering events occurring on or after March 6, 2019 and December 31, 2021 and, for withholding taxes under article 119 bis of the French Tax Code, to triggering events occurring on or after January 1, 2020 and December 31, 2021.

Effective January 1, 2022, these withholding tax and levies will be fully aligned with the scheduled corporate tax rate of 25%.

Other EU-compliant measures

Branch tax: amendments in compliance with the EU Freedom of Establishment

Following the French Administrative Supreme Court decision dated July 10, 2019 (Societe Cofinimmo #412581), the Finance Act amends article 115 quinquies of the French Tax Code (i.e., withholding tax provision on deemed distributed profits realized in France by foreign companies).

The amendment provides that a company, subject to tax, having its seat in the European Union or the European Economic Area (EEA) is now entitled to a withholding tax refund when the amounts subject to French withholding tax have not been divested out of France. The measure applies to tax years beginning on or after January 1, 2020.

Withholding taxes: amendments in compliance with EU Free Movement of Capital

Following an ECJ decision dated November 22, 2018 (C-575/17 Sofina SA, Rebelco SA and Sidro SA) regarding French dividend withholding tax application to loss-making Belgian companies, the Finance Act includes several changes to French legislation.

Such amendments grant a conditional and temporary refund (combined with a deferral regime) of withholding taxes for loss-making foreign companies applicable not only to dividends but also to withholding taxes and levies on certain interest, payments, services, real estate gains, and non-resident capital gains (articles 119 bis, 182 A bis & B, 244 bis, bis A, and bis B of the French Tax Code).

The new 'refund and deferral' regime applies under the following conditions:

1. The beneficiary is a foreign entity with its seat, or the permanent establishment in the result of which the income and profits are included, is situated in an EU Member states, or EEA states having concluded a mutual assistance convention regarding the tackling of fraud and tax evasion as well as a mutual assistance convention regarding tax collection, with a similar scope to the EU Directive 2010/24 dated March 16, 2010. Such jurisdiction also must not be considered as non-cooperative according to French legislation.

   With respect to withholding taxes on dividends under article 119 bis of the French Tax Code, non-EU or EEA Member state entities also may benefit from such temporary refund provided (1) they are not situated in a jurisdiction considered as non-cooperative according to French legislation; (2) they are situated in a jurisdiction having concluded a mutual assistance convention regarding the tackling of fraud and tax evasion as well as a mutual assistance convention regarding tax collection as mentioned above; and (3) the ownership in the distributing entity does not allow the beneficiary of the dividend to participate effectively in the management or control of such entity.

2. The beneficiary's tax result, calculated pursuant to the legislation of its seat or permanent establishment, is a loss with respect to the tax year of receipt or realization of the considered income and profits.

3. A formal refund (combined with a withholding tax deferral) request must be filed by the foreign entity with the French Tax Authorities within three months following the end of the tax year during which a considered withholding tax triggering event occurred.

The withholding tax deferral is maintained for each of the following tax years where it is loss-making (subject to timely and complete filing compliance).

The deferral will end (and the withholding tax payment will be due immediately):

- where the beneficiary becomes profitable (i.e., deferral ends up to such taxable income and profits);
- where there is a restructuring that impacts the beneficiary (e.g,. dissolution without liquidation, merger and assimilated events, etc.) unless the losses are transferred to the new beneficiary, with a surviving or absorbing entity and filing commitments that are timely made by such new beneficiaries or absorbing entities pursuant to its tax loss results; or
- if there is non-compliance with the required tax deferral filings within 30 days following the receipt of a formal notice from the French Tax Authorities.

The Finance Act also extends the scope of exemptions for the withholding tax on dividends and levies on certain interest, payments, services, real estate gains, and non-resident capital gains (listed above) under the same conditions applicable to the foreign entity and its seat, as described above provided (1) the foreign company's tax result, calculated pursuant to the legislation of its seat or permanent establishment, is a loss; and (2) the foreign company is under a judicial liquidation procedure (or comparable) pursuant to the French Commercial Code or, absent such procedure, in a dire financial situation impossible to recover from.

The provisions apply to tax years beginning on or after January 1, 2020. Situations prior to that date should be reviewed and addressed through refund claim procedures.

Transfer of isolated assets within the European Union

Pursuant to the French Tax Code, a specific election allows for taxation over five years of built-in gains relating to asset transfers upon a transfer of a company seat or of one of its permanent establishments in another EU Member state, or EEA state having concluded a mutual assistance convention regarding the tackling of fraud and tax evasion as well as a mutual assistance convention regarding tax collection.

This provision is now extended to transfers of one or several isolated assets and applies to tax years beginning on or after January 1, 2020.

Other notable measures

Clarifications regarding French interest deductibility rules implemented under ATAD I

Under current legislation prior to the current Finance Act and for entities part of a group that files eligible consolidated financial statements pursuant to French law, a safe-harbor provision allows under certain conditions an additional deduction equal to 75% of the net financial expenses not deducted pursuant to the main interest deductibility limitation (30% of tax EBITDA or EUR 3M).

The Finance Act provides that companies that are not part of a group that files eligible consolidated financial statements pursuant to French law and that do not have any establishment outside of France or any associated enterprise pursuant to EU Directive 2016-1164 dated July 12, 2016, can also benefit from the above safe harbor.

The Finance Act also provides clarifications as to the determination of the tax EBITDA pursuant to French rules.

The new provisions apply to tax years ending on or after December 31, 2019.

Merger, demerger and assimilated regimes

A recent change in French corporate law (Soilihi law 2019-744 dated July 19, 2019) simplified the legal process applicable to mergers and demergers (and assimilated) between sister companies wholly owned by the same parent allowing such restructurings to not require an exchange of shares in the process.

The Finance Act correspondingly amends article 210-0A of the French Tax Code allowing the above restructurings performed in the absence of exchange of shares to benefit from a tax deferral regime.

Such amendments also allow the benefit of several other favorable provisions applicable to mergers and demergers in the context of a tax consolidation, to rulings availability regarding the transfer of carryforward losses by a contributing company to a beneficiary company, to the transfer to an absorbing company (or beneficiary in case of demerger) of a receivable resulting from a loss carry-back election made by the merged or demerged company, etc.

These new provisions apply to the above restructurings realized on or after July 21, 2019.

Elimination of the ruling requirement to transfer loss carryforwards in case of merger

The Finance Act eliminates the requirement for a ruling from the French Tax Authorities allowing the transfer of loss carryforwards (as well as carryforwards of non-deductible financial expenses and unused deductibility capacities) exclusively in the case of a merger provided the following conditions are met:

- the cumulative amount of loss carryforwards (and carryforwards of non-deductible interest and unused interest deductibility capacities) transferred is lower than EUR 200k;
- such transferable carryforwards do not arise from the management of shares or interest by holding companies or from the management of real estate assets; and
- the period during which these transferable losses were realized did not see the absorbed entity transfer or cease its business as a going concern or an establishment.

These provisions apply to mergers realized on or after January 1, 2020.

New 'name and shame' procedure against non-cooperative online platforms

The Finance Act introduces a new sanction consisting in the publication online of the identity of platform operators that repeatedly failed to comply with their French tax obligations.

In order for the sanction to apply, the platform would need to have first defaulted to certain listed obligations followed by another default within 12 months.

The provision notably covers:

- VAT for which the platform is jointly liable for not requiring its professional users to be compliant with their VAT obligations
- a penalty for absence of answer to a request from the French tax authorities under article L.81 al.2 or L.82 AA of the Tax Procedural Code
- a penalty for default filing obligations regarding income realized by its users through the platform
- a taxation resulting from an automatic tax assessment procedure regarding VAT on online distance sales of goods realized through the platform
- a taxation resulting from an automatic tax assessment procedure regarding the French digital tax

The publication could not last more than one year and would be removed from the website as soon as the amounts due (tax liability or penalties) are paid by the platform. The provisions apply effective January 1, 2020.

The takeaway

Multinational companies operating in France should consider the impact of the Finance Act with respect to their international flows, structure, and tax obligations. ATAD II provisions require a thorough understanding of the interactions and conflicts between foreign tax regimes with respect to the same structures or flows.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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