FRANCE

FRANCE

INTERNATIONAL DEVELOPMENTS

1. WHAT ARE RECENT TAX DEVELOPMENTS IN YOUR COUNTRY WHICH ARE RELEVANT FOR M&A DEALS AND PRIVATE EQUITY?

- **Progressive reduction of the Corporate income tax (CIT) rate**

  For FYs ending after 30 December 2016, the exceptional contribution on CIT of 10,7% no longer applies, bringing the maximum effective CIT rate to 34.43% (standard CIT rate of 33.33% + 3.3% of Social security surtax over EUR 763.000).

  Please also note that French CIT rate should decrease progressively from 33,33% to 28% for all entities by the end of year 2020 (Finance Law for 2017, article 11). This measure should apply in priority to small and medium sized companies, and to larger companies within a 4-year period.

- **Extension of the 3% Contribution on dividend distributions exemption**

  Under the French Tax Code (FTC), a 3% contribution generally applies on the amount of dividends distributed by companies subject to corporate income tax in France (article 235 ter ZCA).

  An exemption was however provided for distributions made between companies belonging to the same French tax consolidated group.

  According to the decision issued by the French Constitutional Court on 30 September 2016, this limited scope of exemption entailed a discrimination and a breach of constitutional principles.

  Following this decision, the Legislator decided to extend the exemption of the 3% Contribution on dividend distributions:

  - Made to French consolidated companies and to EU-Companies subject to a corporate tax equivalent to the French CIT in the EU or in another State having concluded with France a tax treaty with an administrative assistance clause fulfilling the criteria for tax consolidation (i.e. holding at least 95% of the share capital of the French distributing entity).
  - Made between French resident entities qualifying for the tax consolidation regime, but which have not elected for it.

  This new regime applies as from 1 January 2017 (Finance Law for 2017, article 12).

  On 29 March 2017, the Administrative Supreme Court extended the reasoning of the French Constitutional Court to distributions made before 1 January 2017 on the basis of the European Convention on Human Rights (decision No. 399506, Layher).

  Refund claims relating to such distributions may therefore be based on this decision.

- **Amendment of the parent-subsidiary regime and participation exemption regime**

  The French Constitutional Court (QPC n°2016-553, July 8, 2016) ruled that French provisions excluding the application of the parent-subsidiary regime to dividends received by parent companies unless they hold at least 5% of the capital and voting rights of the distributing company are unconstitutional.

  Based on the EU-Directive, it is thus only required that the qualifying parent company holds at least 5% of the share capital of the distributing company.

  The relevant regime was abrogated by Finance Law for 2016 (Law 2015-1918, December 29, 2016, article 91) although the French tax authorities had already taken into consideration the above-mentioned decision of the French constitutional court, specifying in its doctrine that the new regime applied as from February 3, 2016.

  However, it shall be underlined that the minimal 5% voting rights holding requirements is maintained for the capital gain participation exemption regime (we refer to question 18).

2. WHAT IS THE GENERAL APPROACH OF YOUR JURISDICTION REGARDING THE IMPLEMENTATION OF OECD BEPS ACTIONS (ACTION PLANS 6 AND 15 SPECIFICALLY) AND, IF APPLICABLE, THE AMENDMENTS TO THE EU PARENT-SUBSIDIARY DIRECTIVE AND ANTI-TAX AVOIDANCE DIRECTIVES?

The 2014 Finance Bill introduced a new anti-hybrid financing measure limiting the deductibility of interests accrued to related party lenders. The right to deduct interest on loans paid between related parties is subject to the following new demonstration: the borrower must be able to prove, upon the tax authorities' request, that, for the current fiscal year, the lender is subject to a corporate income tax on the interest income received which is equal to at least 25% of the corporate income tax that would be due if computed under the French general rules (i.e., 8.33%) without consideration of the effective tax payment by the lender. The new rule is applicable to the fiscal year ending on or after 25 September 2013.

The anti-hybrid rule represents France's first concrete step to give effect to the OECD base erosion and profit shifting (BEPS) project.

On 27 January 2015, the Council adopted an anti-abuse rule about the parent subsidiary regime.

This clause has been included in French law by the amended Finance Law for 2015 which provides that the parent subsidiary regime is not applicable "to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. (...) An arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality".

The new clause is applicable for fiscal years as from 1 January 2016.

To date, there have not been further major modification applied to French legislation as regards BEPS actions and the Parents-subsidiary regime since French legislation already complies with BEPS and parent-subsidiary regime requirements.

French legislation shall however be harmonized by the end of 2018 in order to comply with ATAD (Anti-tax avoidance Directive) requirements although there should not be major changes brought to French legislation in this respect since French legislation already provides for exit tax, CFC rule, or hybrid mismatches rules in compliance with ATAD.

Some adjustments might nevertheless be necessary, e.g., as regards interest deduction limitation rules, although the question remains whether ATAD provisions shall substitute or be added to the former French applicable regime in this purpose.

The same interrogation could be raised as regards the general anti avoidance rule provided for by ATAD which could either replace or be added to the former French general anti-abuse provisions.

GENERAL

3. WHAT ARE THE MAIN DIFFERENCES AMONG ACQUISITIONS MADE THROUGH A SHARE DEAL VERSUS AN ASSET DEAL IN YOUR COUNTRY?

The main difference between share deals and asset deals is that the target company's historical liabilities are transferred when the transaction is structured as a share deal (with a normal three-year statute of limitation, which can in some circumstances be extended to ten years). Asset deals (i.e. straight sales of assets or going concerns) do not result in the transfer of pre-closing liabilities relating to the assets or going concern being transferred (except for the going concern's taxes on assets or activities transferred in the year the transaction occurs, for which the buyer may become jointly liable for a limited period of time).

Asset deals generally trigger a higher tax cost for the buyer. Indeed, acquiring shares of a target company is subject to reduced registration duties, the rate of which depends on the target's corporate form (i.e. for Société Anonyme (SA) or Société par Actions Simplifiés (SAS) – shares, the rate is 0.1% of the sale price). For other company shares, except for real estate companies (see 'special considerations for companies whose main asset is real estate' below) the rate is 3% of the sale price (or of the fair market value, if higher than the price agreed). An allowance is deductible from the basis assessment of registration duty. This allowance is equal to the ratio of the number of shares purchased divided by the total number of shares issued by the acquired company, multiplied by EUR 23,000.

Some operations can be exempted from registration duty, in particular the acquisition of shares between companies forming part of the same group (controlled companies as defined by article L 233-3 of the Trade Code or tax-consolidated group), acquisition of shares further to operations (such as contribution of shares for shares and mergers) carried out under merger neutrality regimes, or acquisition of shares in companies placed under a safeguard procedure or judicial restructuring.

Asset deals, if the assets qualify all together as a going concern, are subject to transfer tax at:

- 0% up to EUR 23,000;
- 3% from EUR 23,000 to EUR 200,000;
- 5% of the sale price exceeding EUR 200,000;
- Or for real estate assets (at a rate of 5.09% plus additional duties).

From a VAT standpoint, both deals should be neutral, provided the assets sold all together form a going concern. It should be noted that VAT implications may arise for sales of isolated assets or real estate assets.

From a corporate income tax standpoint, share deals do not impact the ability of the target company to carry forward Net Operating Losses (NOLs), which remain available in normal circumstances (see question 6 below).

In asset deals, only assets are transferred – any NOLs remain with the target company provided that such sale does not qualify as a change of activity (see question 6). In addition, share deals (structured as straight sales) do not allow, in principle, any step-up in basis value and do not impact the target company's amortisation plan of its assets (in terms of duration and depreciation value). But asset deals mechanically imply a step-up in the assets' amortisation basis, which then corresponds to the purchase price paid allocated to each asset. However, in both cases no goodwill may be amortised. It should also be noted that, in the case of an acquisition mainly from treated parties at a price higher than the fair market value, the tax authorities could further challenge the allowance but not the amortisation basis.

Finally, there are other slight differences between share deals and asset deals. For instance, in share deals, the target company's business tax (so-called contribution économique territoriale) liability is not impacted in any way. However, asset deals could allow the buyer, subject to certain circumstances, to fall outside the scope of the business tax if the buyer is not the owner of the assets or going concern transferred on 1 January of the year the transaction occurs.

BUY-SIDE

4. WHAT STRATEGIES ARE IN PLACE, IF ANY, TO STEP UP THE VALUE OF THE TANGIBLE AND INTANGIBLE ASSETS IN CASE OF SHARE DEALS?

As a general principle, share deals do not allow any step-up in value of any of the target company's assets. Prior to the sale, however, the target company may consider a global step-up of all its tangibles and financial assets. It should be noted that capital gains are booked as non-available reserves and trigger taxation at the normal corporate income tax rate (of 34.43% globally).

Tax-free restructurings (i.e. merger favourable or merger neutrality regimes allow benefiting from deferred taxation on capital gains on assets transferred by the merged or the contributing company) may also be contemplated. Such operations generally do not offer step-up opportunities when implemented between related parties. However, such operations are performed at fair market value and therefore allow a step-up in basis when implemented between two independent parties (subject to additional conditions).

In parallel, a contribution of an isolated asset (such as real estate property or trademarks under conditions) to the target company prior to the sale is treated for tax purposes as a straight sale and allows a transaction at fair market value. In that case the value of shares of the target company that has benefited from the contribution corresponds to the fair market value of isolated assets contributed. However, such an operation triggers capital gains subject to tax at the normal corporate income tax rate and may not benefit from the merger-favourable regime and can imply registration duty exposures.

Operations such as straight sales or contributions of isolated assets within a tax-consolidated group are made at fair market value, while the related taxation is postponed until the end of the tax-consolidated group, the exit of the tax-consolidated group of one of the two companies, or the assets sold to a company that is not a member of the tax-consolidated group (correlatively, amortisation on the re-evaluated value is not possible).

5. WHAT ARE THE PARTICULAR RULES OF AMORTISATION OF GOODWILL IN YOUR COUNTRY?

In principle, the amortisation of goodwill is not allowed in France, either in share deals or asset deals. However, in some specific cases, pursuant to the regulation of the ANC dated 23 November 2015, depreciation can be recorded in the case there is any time limit on the use of the business asset (for example: concession).

Moreover, the regulation n° 2015-06 of the ANC also amended the accounting treatment of a "technical loss" resulting from a merger carried out at the net accounting value (difference, up to the latent capital gain on assets received in the frame of the merger, between (i) the net accounting value of the shares held by the absorbing company in the absorbed one; and (ii) the net asset value of the absorbed company). This "technical loss" was in principle recorded in the balance sheet of the absorbing company as a "goodwill" that could not be depreciated either from an accounting or tax standpoint.

Now, from an accounting purpose, if possible, such "technical loss" must be allocated to the underlying assets it relates to and be depreciated following the depreciation rules applicable to said underlying asset.

From a tax perspective, the depreciation of a business asset is not allowed. Therefore, extra-accounting adjustments will be necessary.

6. WHAT ARE THE LIMITATIONS TO THE DEDUCTIBILITY OF INTEREST ON BORROWINGS IN THE CASES OF ACQUISITION OF SHARES AND ASSETS?

There are several rules that relate to the deductibility of interest on borrowings.

Interest rate limitation

Under the interest rate limitation when interest expenses are paid to a direct shareholder, the annual deductible interest rate is capped at a rate determined by the Tax Administration (e.g. 2.03% for the full year closed on 31 December 2016). However, when interest is paid to a related-party company (whether shareholder or not), the annual tax-deductible interest rate can be higher, provided the borrowing entity may demonstrate, with the provision of a dedicated supporting file, that this rate is at arm's length (i.e. a rate the company could have obtained from third party financial institutions in similar circumstances).

Anti-hybrid legislation

The deduction of loan interest paid by a company subject to corporate income tax to a related company is allowed

provided that the lender is subject to tax on profits on the interest received amounting to at least 25% of the tax as determined under French tax rules (i.e. 8.33%). This mechanism was enacted to limit the use of hybrid instruments which take advantage of different legal qualifications of the same flow between two countries and allowing the deduction of the financial interest accrued in France and the exemption of the corresponding interest income received by the lender abroad. This rule is applicable to interest incurred since 25 September 2013, irrespective of the date the loan was granted.

Thin capitalisation rules

The amount of interest paid to related entities which exceeds the highest of the three following thresholds will not be tax deductible on a standalone basis:

- First threshold: amount of interest computed on one and a half times the net equity, i.e., the interest deductibility is limited by the following ratio: "net equity: debt from related parties = 1:1.5";
- Second threshold: 25% of the ordinary income before taxes, amortisation and interest paid to related entities;
- Third threshold: interest received from related parties.

In addition, third-party loans (including bank debt) which are guaranteed by a "related party" to the borrower are deemed to be related party debt for thin capitalisation purposes (or loans granted by a non-related company, guaranteed by a non-related company itself guaranteed by a related company to the borrower).

Moreover, it should be noted that specific rules apply within a tax-consolidated group. Indeed, subject to limitations, the parent company could be allowed to deduct from the group taxable income all or part of the non-deductible interest as determined on a standalone basis.

Finally, if the accounting consolidated group's debt/equity ratio is higher than the borrowing entity's own debt/equity ratio, the limitation on the deduction of interest paid to related entities will not apply.

The consolidated group is defined as all the French and foreign entities under the control of the same ultimate parent company.

For the purposes of this comparison, only debts owed to third parties are taken into account for computing group's debt/equity ratio, though both debts owed to third parties and related entities are taken into account for the computation of the debt/equity ratio of the borrowing entity.

In any case, if the fraction of non-deductible interest is lower than EUR 150K, there will be no limitation.

The non-deductible fraction of interest due on the application of the thin capitalisation provision may be carried forward to the following tax year (Y+1) and offset against 25% of the ordinary income before taxes and depreciation of fixed assets. The remaining amount may then be carried forward to the following tax years but with an annual deduction of 5%.

Acquisition of shares not controlled from France (Carrez amendment)

The deductibility of financial expenses linked to acquisition of shares qualifying as controlling interest is limited. Financial expenses are only deductible if the purchaser can demonstrate that it (or a company incorporated in France and belonging to the same economic group) actually makes the decisions relating to these shares and that it exercises a control or influence over the acquired company.

If the company fails to provide such evidence, a fraction of the expenses must be added back to its taxable income for the acquisition accounting period and the following eight years.

However the limitation does not apply when:

- The value of shares held by a company is less than EUR 1 million;
- The acquisition has not been financed by a loan;
- The debt ratio of its group is higher or equal to the purchaser's own debt ratio.

Proportional interest deduction restriction "French rabot"

Deduction of financial expenses of companies is now subject to a general limitation. For the accounting period ended as of 31 December 2012 companies have to add-back to their taxable result 25% of their "net financial expenses".

"Net financial expenses" are defined as the difference between the total amount of financial expenses incurred as a consideration for financing granted to the company and the total financial income received by the company in consideration for financing granted by the latter. Rents incurred under a moveable properties rental agreement between related parties or a leasing agreement are included in financial expenses after deduction of the amortisation, financial amortisation of the lessor and all costs invoiced by the lessee.

In a tax consolidated group, this limitation applies at the level of the tax result of the group.

There is no carry-forward mechanism of disallowed interest.

This limitation will not apply if the company's net financial expenses (or net financial expenses of the group for tax consolidation) are lower than EUR 3 million.

Financial expenses related to the acquisition or building of assets within the framework of public utilities' delegation, concession of public engineering and public-private partnership agreements or an administrative long-term lease concluded before 28 December 2012 are all excluded from this mechanism.

7. WHAT ARE USUAL STRATEGIES TO PUSH-DOWN THE DEBT ON ACQUISITIONS?

The most straightforward solutions to push-down debt consist in a dividend distribution up to the target company's distribution capacity or the relocation of assets between the target company and an affiliated company. Both operations would be financed by a loan granted by an affiliated company or third party (e.g. a bank).

As a consequence, the strategy in a debt push-down could consist in the creation of or increase in dividend distribution capacities (based on accounting rules) without triggering tax consequences. Such an outcome may be reached through operations made at fair market value with a limited tax impact, such as the straight sale of shares benefiting from the participation exemption regime (i.e. with an effective tax rate of 4.13%).

Another solution could be a relocation of assets (e.g. shares) held by the target company under the target company's subsidiary. Such an acquisition could be financed by debt. Further to this operation, the target company could distribute the capital gain realised to the holding company. In order to be tax neutral, the relocation of assets other than shares benefiting from the participation exemption regime could be contemplated between companies members of the same tax-consolidated group (see section 2 above and section 9 below).

French tax authorities try to deny the deduction of the interests related to the acquisition of a company if the holding company decides to merge the target company in a short period of time after the acquisition. However, the French tax authorities recently decided to allow the realisation of a quick merger between two holding companies, namely in the case of a secondary leveraged buy-out.

In any case, these schemes have to be analysed in light of French commercial law, which prohibits a company from financing its own acquisition.

8. ARE THERE ANY TAX INCENTIVES FOR EQUITY FINANCING?

There is no specific tax incentives for equity financing.

9. ARE LOSSES OF THE TARGET COMPANY(IES) AVAILABLE AFTER AN ACQUISITION IS MADE?

On a stand-alone basis

The acquisition of the target company's shares does not have any impact on the amount of the available losses carried forward by the target company, it being specified losses are not available unless the target company changes its activity.

An addition of business activity can characterise a change in activity where, during the fiscal year of the change or the following fiscal year in comparison with the fiscal year preceding the change, there is an increase of more than 50% of:

- The company's turnover;
- The average number of staff and the gross amount of fixed assets.

A surrender or transfer, even partial, of a business activity may also characterize a change in activity if there is a decrease of more than 50% of the previous criteria.

However, if the target company, which owns losses, is merged into another company, the losses can be transferred to the merging company only if a ruling is given by the French Tax Authorities. In particular, the activity of the merged company has to be maintained for at least three years. The transfer of tax losses is not allowed if the merged company is a holding company. Attention also has to be paid to the consequences of such merger on the merging entity's right to carry forward its own standalone tax losses further to the merger (i.e. impact on its own activity).

On a group basis

In principle, all the tax losses born within the tax consolidated group remain at the level of the head of the group when the said tax group vanishes. These tax losses are then only offsetable by the former head of the group against its own profits.

However, the former head of the tax group may elect for the enlarged basis imputation mechanism (i.e., "imputation des deficits fiscaux sur une base élargie") which allows the offset of the previous collective tax losses carried-forward and generated by the companies of the former tax group against the taxable profits realised by such companies and members of the new tax group.

It should be underlined that the significant change in the activity of a subsidiary member of a tax consolidated group does not trigger any vanishing of the carried-forward tax losses it transmitted to the tax consolidated group. The only tax losses which would be definitively lost are those eventually generated by this subsidiary before its entry in the tax consolidated group.

10. ARE THERE ANY ITEMS THAT SHOULD BE INCLUDED IN THE SCOPE OF A TAX DUE DILIGENCE THAT ARE VERY SPECIFIC TO YOUR COUNTRY?

Although it may be underlined that each transaction requires the performance of a tax due diligence on a case-by-case basis, i.e., the review of the tax specificities linked to the activity carried out by the target group, the following items should generally be considered every time a due diligence concerns a French company:

Losses carry-forward rules

- General rules

As from January 1st, 2004, losses may be carried forward indefinitely. However, it shall be specified the offsetable amount of losses carried forward is limited, i.e., losses carried-forward shall only be fully offsetable

against the following year taxable income up to EUR 1m, and for an amount equal to 50% of the portion of income exceeding 1 million (the remaining 50% of income shall be taxed at the general CIT rate).

With respect to carry back, it is limited to one year, capped to EUR 1m. Any excess tax loss is still available for carry forward.

- Change of activity

By way of principle, the cessation of a business activity causes notably the vanishing of the carried-forward tax losses of the company. Moreover, a significant change in the activity carried on by the company as well as the loss of its operating resources may trigger the same consequences (we refer to question 9 for a definition of the "change of activity" under the FTC).

Specific filing requirements

French companies are required to file several forms as notably Income from securities and interest returns ("IFU"), and Wages, commissions and fees tax returns ("DAS 2").

In case of a tax audit, failure to fill the above-mentioned forms entails the payment of a fine equal to 50% of the amount which should have been reported.

Capital gains whose taxation has been deferred upon a tax neutral operation must be followed-up by the filling of "54 septies" forms, otherwise a 5% penalty applies on the amount of deferred profits which were not included in the statement.

Statute of limitations

As a general rule, the FTA is entitled to audit a FY until the end of the third calendar year following the closing of the said FY. The FTA is in principle not entitled to conduct a new tax audit in the premises of a company which has already been tax audited in relation to the same tax and for the same FY. Other statutes of limitation are provided by French legislation, e.g. in the event of abuse of law.

However, when the company is in a tax loss position, the FTA is entitled to audit the validity of such losses until the end of the third year following the one during which losses have been offset.

Specific tax credits

French legislation provides for certain tax credits whose scope and modalities of application should be focused on, e.g. Research tax credit ("CIR").

11. IS THERE ANY INDIRECT TAX ON TRANSFER OF SHARES (STAMP DUTY, TRANSFER TAX, ETC.)?

The acquisition of shares is subject to reduced registration duties. The rate depends on the target company's corporate form. For SA or SAS companies, the rate is 0.1% of the sale price. For other company shares, except for real estate companies (see section 16 below), the rate is 3% of the sale price. An allowance is deductible from the basis of assessment of the registration duty. This allowance is equal to the ratio of number of shares purchased divided by total number of shares issued by the acquired company, multiplied by EUR 23,000.

12. ARE THERE ANY RESTRICTIONS ON THE CORPORATE TAX DEDUCTIBILITY OF ACQUISITION COSTS?

Acquisition costs of shares mainly include registration duties, commissions, fees (auditor fees, external appraiser fees, advisor fees) and deed expenses related to the acquisition.

From an accounting standpoint, these costs may be taken into consideration in the acquisition cost of the shares or deducted for the FY where they have been incurred.

From a tax standpoint, the costs incurred to acquire shares qualifying as a controlling interest must be incorporated into the acquisition cost of said controlling interest. However, the deduction of acquisition costs may be spread over a 5-year period. In case of acquisition in the course of a fiscal year, the first annuity is computed pro-rata temporarily.

13. CAN VAT (IF APPLICABLE) BE RECOVERED ON ACQUISITION COSTS?

As a matter of principle, based on ECJ case law and guidelines issued by the French tax administration, input VAT on acquisition costs may only be recoverable if the acquiring company provides services subject to VAT.

Note, however, that in the case where the acquiring company would receive non-ancillary financial income, its right to recover input VAT could be reduced.

In principle, the reception of dividends by the acquiring company from its subsidiaries should have no impact on its right to recover input VAT on acquisition costs.

The ECJ (in EUCJ, Beteilingungsgesellschaft Larentia + Minerva mbH & Co KG, C-108/14 & C-109/14, July 16, 2015) and the French Supreme Court (in CE 20 mai 2016 n° 371940, 8e et 3e ch réunies., min. c/ SA Groupe Ingénierie Europe Ginger) recently restated the principle that to the extent that the acquiring companies provides management services to each of its subsidiaries, input VAT related to acquisition costs should be fully deductible subject to its VAT taxation ratio.

However, it should be noted that in a recent case law, the French Supreme Court (in CE 23 janvier 2015 n° 365520, Sté Lagardère SCA) seems to limit the possibility of a holding company to recover the input VAT on recharged costs if no services are provided (pure holding company).

14. ARE THERE ANY PARTICULAR TAX ISSUES TO CONSIDER IN THE ACQUISITION BY FOREIGN COMPANIES?

We refer to question 20 and question 6 as regards the "Acquisition of shares not controlled from France (Carrez amendment)".

15. CAN THE GROUP REORGANISE AFTER THE ACQUISITION IN A TAX NEUTRAL ENVIRONMENT THROUGH MERGERS OR A TAX GROUP?

Under the Charasse amendment, anti-debt push down regulations provide for a partial recapture of the financial expenses borne by a tax consolidated group in case of transactions deemed to qualify as self-purchases.

The Charasse amendment applies:

When the shares of a company have been purchased by another company from parties who also directly or indirectly control (de jure or de facto) the acquiring company at the time of acquisition;

Where both the acquired company and acquiring company become members of the same tax-consolidated group after the transaction (including by way of merger).

This rule leads to the non-deductibility of the interest expense within the tax consolidated group up to an amount equal to: Financial expenses x [(acquisition price – amount of contribution in cash)/average group debt].

This reinstatement applies to the acquisition accounting period and the following eight years.

The Charasse amendment no longer applies to cases involving a change in control of the acquiring company. Moreover, the Charasse amendment is no longer triggered when a subsidiary held by a company directly acquired by the investor is immediately sold to a French holding company that elects to set up a tax consolidated group (relocation after an acquisition).

Mergers, spin-offs or split-offs may benefit from tax neutrality and are generally made within a group at book value (we refer to question 21).

16. IS THERE ANY PARTICULAR ISSUE TO CONSIDER IN CASE OF TARGET COMPANIES OF WHICH MAIN ASSETS ARE REAL ESTATE?

For capital gains tax purposes a real estate company is a company with assets made up of more than 50% of French real estate assets at the date of the transfer or at the closing date of the last fiscal year. Properties used for the purpose of a commercial activity are not deemed to be real estate assets for capital gain purposes.

For transfer tax purposes a real estate company is a company with assets made up of more than 50% of French real estate at any time of the year preceding the sale.

A) Share deal

Capital gains on the transfer of shares in real estate companies subject to corporate income tax are taxed at the normal corporate income tax rate (i.e. maximum effective rate of 34.43%). The favourable regime of participation exemption (i.e. effective tax rate of 4.13%) does not apply to the transfer of shares in real estate companies.

The acquisition of shares in a real estate company is subject to transfer duties at the rate of 5% of the fair market value of the shares.

B) Asset deal

Capital gains on the transfer of assets in real estate company subject to corporate income tax are taxed at the normal corporate income tax rate.

The acquisition of real estate asset is subject to transfer duties at the rate of 5.09% of the fair market value of the estate asset.

17. IS FISCAL UNITY/TAX GROUPING ALLOWED IN YOUR JURISDICTION AND IF SO, WHAT BENEFITS DOES IT GRANT?

French related companies subject to corporate tax may elect to form a tax-consolidated group provided that some conditions are met (e.g., companies held at more than 95% by the head company). It remains an election and companies should not elect before considering the overall advantages and disadvantages regarding this tax regime.

As far as advantages are concerned, the following main benefits may notably be granted by French tax group regime:

- The parent company files a consolidated return, thereby allowing the offset of losses of one group entity against the profits of the other consolidated companies. The parent company then pays CIT based on the tax group result, after certain adjustments are made (e.g. adjustments for intra-group provisions, debt waivers, capital gains realised on asset / share transfers).
- The 3% Contribution on dividend distributions is not applicable to dividends distributions made within members of the tax group. Please note that dividends distributions made to tax consolidation regime qualifying companies established in the EU are also exempt from the 3% Contribution on dividend distributions (we refer to question 1).
- As regards intra-group dividend distributions within a tax-consolidated group, further to Steria case law (ECJ Steria, Sept. 2, 2015,aff. C-386/14), two different regimes coexist:
- Where the parent subsidiary regime is not applicable, intra-group dividends are fully neutralised at the level of the group income as from the second FY of the tax consolidated group;
- Where the parent subsidiary regime is applicable, a 1% lump-sum amount remains taxable. This provision applies as from the first FY of the tax consolidated group. Please note that the taxation of a 1% lump-sum also applies for dividends paid by European subsidiaries which would satisfy conditions to enter in a French tax consolidated group if they were established in France.

- As regards the application of thin capitalisation rules to tax consolidated companies (Section 223 B of the FTC), thin capitalisation rules described under Question 6 apply to each company that is a member of the group taken separately.

Nevertheless, any excess interest recaptured in the individual results shall not be deductible at tax consolidated group level.

Subject to limitations, the parent company shall thus be allowed to deduct excess interest incurred at the level of the tax consolidated companies and to carry forward the remaining amount of excess interest to the following tax years after the annual deduction of 5%.

SELL-SIDE

18. HOW ARE CAPITAL GAINS TAXED IN YOUR COUNTRY?

A) Share deal

- Capital gains derived by French companies

Capital gains derived from the sale of qualifying participations are only subject to CIT on a 12% lump-sum, resulting in a taxation at the effective rate of 4.13%.

Qualifying participations must satisfy both of the following conditions:

- They must be qualified as controlling interest (specific class of shares for accounting purposes that enables the shareholder to have a controlling interest) or, be eligible for the dividend participation exemption regime (provided 5% of the voting rights in the subsidiary's capital are held);
- They must have been held for at least two years before their sale.

A reduced 15% tax rate applies to the following:

- Capital gains derived from sales of shares in venture mutual funds and venture capital investment companies if these shares have been held for a period of at least five years;
- Capital gains realised on patents or patentable rights held for at least two years, unless the disposal takes place between related companies.

Capital gains derived from sales of participating interests in companies that are predominantly real estate companies are subject to tax at the standard rate of 33.33%. For listed real estate companies, the rate is reduced to 19%.

- Capital gains derived by non-resident companies

For non-French tax resident companies subject to the provisions of relevant tax treaties having a substantial shareholding provision (e.g. those with Spain, Italy, Hungary, etc.), capital gains on shares held in a French company are subject to tax at a rate of 45% provided the foreign selling entity has held, at any time during the five years preceding the sale, directly or indirectly, more than 25% of the French company's share capital of the French company (section 244 bis-B of the French Tax Code).

According to the new French tax guidelines, the foreign seller is allowed to claim, under certain conditions and through formal claim, for a refund of the paid tax exceeding the effective tax burden.

B) Asset deal

If a French company sells assets, the capital gain is taxable at the normal corporate income tax rate (i.e., maximum effective rate of 34.43%).

19. IS THERE ANY FISCAL ADVANTAGE IF THE PROCEEDS FROM THE SALE OF SHARES ARE REINVESTED?

There is no specific advantage to reinvest the proceeds of a sale.

If the seller is a fund, subject to conditions, no taxation arises at the level of the fund's interest holders as long as no cash is distributed.

20. ARE THERE ANY LOCAL SUBSTANCE REQUIREMENTS FOR HOLDING COMPANIES?

The local substance requirements for holding companies are: minimum staff, offices, location of board meetings, decision power, etc.

However, the substance must be in relation to the activity of the company, i.e. the substance-level requirement is different between an operating company, a financial company and a non-operating holding which purpose is only management of its shareholding. Consequently, the substance level requirements for non-operating holdings are necessarily limited.

21. ARE THERE ANY SPECIAL TAX CONSIDERATIONS REGARDING MERGERS/SPIN-OFFS?

- **Accounting principles**

  As regards the transcription modalities of the transfer, it shall be noted that contributions have to be translated in the beneficiary company's books under the following accounting rules (French GAAP), i.e. at the net book value (usually where the parties involved are under common control, that is, when the merging company controls the merged company or when both of them are under the control of a third party) or at the fair market value (usually where parties involved are non-related parties and where the main shareholder of the merging company keeps the control of the remaining entity).

- **Tax principles**

- **CIT**

- **Common regime**

  Under common regime, mergers/spin-offs imply the consequences of enterprise cessation, i.e.:

  - Provisions and latent capital gains taxation at CIT;

  - Registration duties applicable to contributions made to a company (depending on the nature of the contribution).

- **Specific neutral regime**

  Under special regime, mergers/spin-offs benefit from favorable provisions as regards CIT and registration duties, provided certain requirements are met, including accounting requirements.

  Upon election, Section 210 A of the FTC contains a special system of CIT applicable to the mergers mainly resulting in the deferral of capital gains and provisions taxation (unless provisions are no longer required) at the level of the contributing company.

  In order for the merger/spin-off special regime to apply, in addition to the express election for the application of the special regime, the beneficiary company shall comply with several requirements to allow the future taxation of capital gains and provisions which were exempt from tax at the time of the merger/spin-off, e.g., record all the transferred assets for the value they had in the merged company books.

  However, if the merger is concluded with retroactive effect from the beginning of the FY, the normal business result would be included in the taxable profits of the beneficiary company.

At the level of the beneficiary company, the capital gains arising from the cancellation of its interest in the contributing company due on a merger are tax exempt.

VAT

VAT exemption is applicable where the transaction qualifies as a transfer of a going concern within the meaning of French and European Union law, such as a transfer of a business. On the transfer of a business, the exemption applies to the disposal, subject to payment, of all the assets constituting the business (i.e. intangible and tangible assets excluding real estate).

Registration duties

Pursuant to Section 816 of the FTC, mergers and assimilated operations benefiting from the merger tax regime of Section 210 A, trigger fixed registration duties amounting to EUR 500 (EUR 375 for companies whose share capital is less than EUR 225K).

Real estate properties transferred in the frame of a merger benefiting from the merger tax regime of Section 210 A are however subject to a real estate publicity fees (contribution de sécurité immobilière) amounting to 0.10% of the value of the properties received (Section 879 of the FTC).

If the real estate property transfer is realised in the frame of winding up, an additional real estate publicity fees of 0.715% (taxe de publicité foncière) will be due on the value of the property received.

Other considerations

- Tax losses

The transfer of carried-forward tax losses in case of merger or similar restructuring operation is notably subject to the condition that the activity that originated the tax losses did not suffer any significant change in terms of customers, staff, operating resources, nature and volume of activity, otherwise the transfer would be subject to a ruling granted by the FTA.

- Quick merger

French tax authorities try to deny the deduction of the interests related to the acquisition of a company if the holding company decides to merge the target company in a short period of time after the acquisition. However, the French tax authorities recently decided to allow the realisation of a quick merger between two holding companies, namely in the case of a secondary leveraged buy-out.

In any case, these schemes have to be analysed in light of French commercial law, which prohibits a company from financing its own acquisition.

- Acquisition costs

Where participation shares are transferred to the merging company due to the merger, and provided the merger benefits from the special regime above-mentioned, the absorbing company is allowed to continue to proceed to the amortisation or deduction of the acquisition costs included in the participation securities' cost price (on the time left to amortise).

Where participation shares are cancelled in the merging company's accounts following the merger, the gain or loss realised must be determined on the basis of the tax value of the cancelled shares, i.e., the cost value majored by the acquisition cost related to these shares, and minored by the amortisation or deduction amount already performed.

MANAGEMENT INCENTIVES

22. WHAT ARE THE TAX CONSIDERATIONS IN YOUR JURISDICTION FOR MANAGEMENT INCENTIVES?

Taxation of capital gains versus salary

The gain realised by managers benefiting from management incentives may be taxed differently depending on whether it is qualified by the FTA as a capital gain or as a salary.

Salaries are taxed at the maximum tax rate of circa 45% plus social security contributions (between circa 18% to 24% - a case by case analysis must be performed to determine the level of taxation), whereas capital gains may benefit from the application of allowances:

- Shares held for less than two years are subject to the effective tax rate of 62% (including 15.5% of social contributions, deductible of N+1 taxable income up to 5.1%);
- Shares held for more than 2 years are subject to the effective tax rate of 39.5% (including 15.5% of social contributions, deductible of N+1 taxable income up to 5.1%);
- Shares held for more than 8 years are subject to the effective tax rate of 32.75% (including 15.5% of social contributions, deductible of N+1 taxable income up to 5.1%).

Higher allowances may apply under certain circumstances (e.g., for small and medium sized companies).

Free shares plan

For free shares issued in relation with free share plans voted as from January 1, 2017, the following regime applies:

- The acquisition gain (the share value is fixed at the vesting date) is taxed as a capital gain up to EUR 300K (the allowance is computed from the vesting date to the date of the sale) and as a salary for the excess.

An employer contribution of 30% also applies at the date of the granting.

- Capital gains (difference between the selling price and the acquisition gain) are taxed as mentioned above, it being specified allowances are computed from the vesting date to the selling date.

The tax is due at the time of the sale of the shares.

Risk in relation with management packages

The FTA reserves the right to deny the qualification of "capital gain" and requalify in "salary" the gain realised by managers where the latter have not borne a real investor's risk, i.e., where managers have benefited from a more favorable treatment due to their salaried activity.

To date, based on case law, the FTA notably pays particular attention to the following key elements:

- the link between the investment realised and the function performed, i.e., whether the management package replaces an element of remuneration of the manager (link with the manager's salaried activity);
- advantages eventually granted at the entry and at the exit to the managers, i.e., whether the management package constitutes a risky capital investment or not.

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