International Bar Association Annual Conference 2020

Recent Developments in International Taxation

France

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Tax residence of managers of large French companies

According to Article 4B of the French Tax Code (FTC), a person is considered as having his/her tax residency in France, for income tax, wealth tax and gift or inheritance tax, if he/she fulfils one of the following conditions:

- his/her household or principal place of abode is in France;
- he/she carries out his/her principal professional activity in France, whether or not it is a salaried activity;
- the centre of his/her economic interests is in France.

The French tax authorities can use one of the aforementioned criteria. The second criterion, related to professional activity, applies to people who carry out a professional activity in France, whether or not it is a salaried activity, unless they can justify that this activity is carried out as a secondary activity.

The Finance Law for 2020[1] added a presumption with respect to the second criteria of professional activity, whereby officers of large companies for which the registered seat is located in France are deemed to run their main professional activity in France. The large companies considered are those whose yearly turnover exceeds €250m or the controlling affiliate has a consolidated turnover that exceeds this amount. Limited officer functions subject to this presumption include executive officers, such as the chief executive officer (CEO), deputy CEO or chairperson of the executive board in a corporation (*société anonyme* or SA); and managers of a private limited company (*société à responsabilité limitée* or SARL) or partnership. This only constitutes a presumption, that is, a manager is still entitled to prove that he/she does not perform his/her main professional activity in France based on the criteria of the time spent in France or the portion of professional income derived therefrom.

The domestic criteria apply subject to the tax residence tie-breaker rule set out by a double tax treaty when applicable. However, most of the double tax treaties concluded by France only cover individual income tax. The French tax authorities admit that the tax residence test resulting from the tax treaty also applies regarding wealth tax liability, but not with respect to French inheritance tax and gift tax.

[1] Finance Law for 2020 No 2019-1479 Art 13.

Accordingly, the territorial scope of the French estate tax could be increased by this new measure, allowing it to be applied to a foreigner occupying an executive officer's function in a large French group company if the state of his/her residence did not sign a tax treaty with France covering gift and/or inheritance tax.

Compliance of French withholding taxes with European Union law

Recent case law has pointed out that several aspects of the French withholding tax regimes applicable to French source payments derived by foreign recipients are not in line with EU rules. The Finance Law for 2020 amended these rules to make them compliant with EU law.

Amendment to the branch tax

Subject to tax treaties concluded by France, the French branch tax[2] applies to French profit subject to corporate income tax in France realised by a foreign company (including French permanent establishment profits or French real estate profits). Companies established in an EU state should be exempt from this branch tax, provided that these companies have their effective place of management in an EU state and are subject in this EU state to corporate income tax under standard conditions. The French branch tax mechanism is based on the presumption that the considered foreign company will distribute the entire French profits resulting from its French operations to shareholders who are not tax resident in France. In this respect, the branch tax could be later totally or partially refunded if the foreign company is able to prove that it did not distribute any dividends to its shareholders; if the actual amount of its effective distribution did not cover the full amount of the French profit; or if its shareholders are French residents. Based on this rationale, the branch tax rate is identical to the withholding tax rate applicable to dividend distribution, that is, 28 per cent in 2020. However, in Cofinimmo case law[3] dated 10 July 2019, the French Supreme administrative court considered that this strict presumption mechanism infringes the EU freedom of establishment. According to the court, the setting up of a branch is less favourable than the incorporation of a subsidiary due to this presumption because, after the submission to corporate income tax, subsidiary profits would be subject to taxation only upon an effective distribution, whereas branch profits could be subject to the French branch tax irrespective of any real disinvestment of the corresponding funds. In order to correct this, the Finance Law for 2020[4] added a new case of a branch tax refund benefiting companies that have their registered seats in an EU state that cannot benefit from the aforementioned exemption (eg, EU investment funds exempt from corporate income tax), in Iceland, Norway or Liechtenstein. These companies could also claim a refund of the French branch tax by proving that their French profits have not been disinvested from France. The demonstration of such an absence of disinvestment could consist of showing that these French profits were reinvested in French activities or were put in reserve.

Withholding tax on French source income derived by foreign loss-making companies

Before the Finance Law for 2020, the loss-making situation of a foreign company did eliminate the levying of the French withholding tax liability on French source income. This legal solution was considered as infringing the EU free movement of capital (Sofina case law CJEU 22 November 2018,[5] then confirmed by the French Supreme Administrative Court 27 February 2019[6]). As a result, a new tax mechanism was set up as of 2020 by the Finance Law for 2020,[7] whereby foreign companies can

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[2] Pursuant to Art 115 quinquies of the FTC.
[3] Supreme Administrative Court 9e-10e ch 10 July 2019 no 412581, Sté Cofinimmo SA.
[4] Finance Law for 2020 No 2019-1479 Art 42, I-1° et II.
[5] CJEU 22 November 2018 case No 575/17, Sofina SA ea.
[6] Supreme Administrative Court 9e-10e ch 27-2-2019 no 398662, Sté Sofina et autres.
[7] Finance Law for 2020 No 2019-1479 Art 42, I-2° et II.

claim a refund of French withholding taxes. Until now, this withholding tax exemption was only available for EU foreign loss-making companies subject to a judicial liquidation procedure. Since 1 January 2020, the judicial liquidation procedure is no longer required. Foreign companies established in an EU state or cooperative European Economic Area (EEA) state could benefit from this refund with respect to French withholding tax on French source capital gains, royalties or compensation for services rendered in France during a fiscal year, provided these companies are in a loss-making situation for this same fiscal year. The scope is enlarged to foreign companies established in a cooperative non-EU or non-EEA state regarding withholding tax on dividends paid by a French company. If the foreign company can prove its loss-making situation, the French withholding tax initially levied on French source income derived by this foreign company shall be refunded. However, it is not a definitive exemption: the French withholding tax is only deferred until the foreign company ceases to make losses. If the company becomes profitable again, the exempted withholding tax should be repaid to the tax authorities.

New general measures against hybrid mismatch arrangements

Cross-border hybrid mismatch arrangements trigger multiple deductions for a single expense or a deduction in one jurisdiction with no corresponding taxation in the other jurisdiction based on a discrepancy regarding the tax qualification of a same payment between two jurisdictions or by way of a partnership interposition. To date, the French tax law did not provide for any general measure against hybrid mismatch arrangements, except the abuse of law qualification. As an exemption, a specific provision already denied the deduction of interest payments paid to a related company, where the recipient benefits from low taxation (less than 25 per cent of the standard French corporate income tax rate, that is, less than seven per cent in 2020) on the considered interest in its jurisdiction.[8] The Finance Law for 2020[9] implemented the EU ATADs regarding anti-hybrid mismatch arrangements to neutralise the attached tax effects by way of objective rules. The new measures should apply regarding payments between two related companies, for instance, members of the same group of companies, or even between unrelated companies in case of structured financing.

The two following situations are covered by these new provisions, which aim at preventing the deductibility of the considering payment from the French corporate income tax profit:

- In the first case of asymmetry between the deduction and taxation of the same payment in the debtor state and recipient state, where the payer is located in France, tax deductibility is denied. Where the recipient is located in France, the payment is included in the taxable profit of the recipient, provided that the deduction of the payment has not been refused in the other state.

- In the second case of a potential double deduction of the same payment, the tax deduction is denied where the payer is located in France, provided that tax deductibility has not been refused at the level of the foreign investor. When the recipient is in France, tax deductibility is denied in France at the level of the foreign investor.

Taxation of operations between a branch and his headquarters

Payment of interest

In BNP Paribas 1 case law dated 19 July 2019,[10] the French Supreme Administrative Court ruled on the tax treatment in France of interest payments between foreign branches of a French bank. The

[8] Art 212 I b of the FTC.
[9] Finance Law for 2020 No 2019-1479 Art 45.
[10] Supreme Administrative Court 8e-3e ch 10 July 2019 No 418108, Sté BNP Paribas.

branches located in China, the Philippines, India, Singapore and Thailand were subject to a withholding tax in their state of location on interest deemed as 'paid' to the French headquarters in consideration of financial advances granted to these branches. The disputed question was whether the French company was entitled to benefit from the double tax treaty concluded with the states of location of these branches, especially the treaty provision dealing with interest. The French company claimed the benefit of the tax credit resulting from the taxation of interest payments in the state of source. The position of the court was not obvious because, from a traditional French perspective, a permanent establishment/branch cannot be considered a tax resident in its state of location for double tax treaty application purposes. In addition, the payments between a branch and the headquarters are disregarded for tax purposes because they are the same legal entity. However, in this case, the Supreme Court considered that, for the application of the interest clause of the tax treaties, the said interest payments could be considered as having their source in the foreign state, even if the French company is not a resident in this foreign state. In addition, the Supreme Court considered that the French company could be regarded as the recipient of the interest payments. This legal solution allows the French company to benefit from the treaty tax credit corresponding to the foreign withholding tax applied in accordance with the treaty interest clause.

Allocation of assets

The Supreme Administrative Court ruled on another related issue involving the transfer of assets between the headquarters and a foreign branch in Fromageries Bel case law dated 27 May 2020.[11] In this case, a French company, which owned a business running distribution activities in the United States and Canada, was acquired by another French company. The acquiring French company booked the distribution business as an asset of its own existing US branch. The said distribution business was not directly operated by the selling company itself but was leased to a third party until the acquisition. The Supreme Court recognised that the US branch of the French acquiring company should be treated as a US permanent establishment of the French company for France-US double tax treaty purposes. As a result, the court considered that the allocation of the newly acquired distribution business to the existing US branch in order to operate it directly should be treated in France as the sale of the said business, triggering the corporate income taxation of the latent gain on this business.

Digital tax

On 24 July 2019, France adopted a three per cent tax on certain digital services provided in France from 2019.[12] The following digital services fall into the scope of this three per cent tax when provided in France:

- The provision, by means of electronic communications (computer, smartphones, etc) of a digital interface that allows users to contact and interact with other users, in particular for the purpose of delivering goods or services directly between those users, for example, a marketplace. However, it does not include websites that sell their own products or services through an interface. In addition, for this first category, some services of the digital interface are expressly excluded, notably:
    - services consisting in the provision of digital products, that is, software, music, videos; provision of communications services; and provision of payment services; and
    - regulated financial services.

[11] Supreme Administrative Court 8e-3e ch 27 May 2020, No 434412, société Fromageries Bel.
[12] Law No 2019-759 du 24 July 2019 Art 1.

- Services marketed to advertisers, or their agents, allowing them to purchase advertising space located on a digital interface accessible by electronic communications to place targeted advertising based on data from users who consult that interface. These services include, in particular, services for the purchase, storage and distribution of advertising; and advertising control and performance measurement; as well as services for the management and transmission of user data.

For both categories, intragroup services are not included in the scope of the new tax.

Only enterprises or group of companies that (1) realise a worldwide turnover in relation to these services higher than €750m; and (2) whose French turnover in relation to these services is higher than €25m, are subject to the three per cent tax.

When the digital interface allows a supply of goods or services to be made between users, digital interface services are regarded as provided in France if one of the users who concludes the transaction by means of the digital interface is located in France.

The three per cent tax should be declared and paid by enterprises, irrespective of their location, providing the covered services in France. The taxpayer is the company that receives the payments in compensation for the provision of the taxable services.

Update of the non-cooperative states or territories list

Since 2010, a list of non-cooperative states or territories for tax purposes has been established by France and regularly updated. Operations and payments with persons or entities located in these states or territories, or payments through bank accounts opened in these states or territories are subject to specific French anti-avoidance measures (constraining burden of proof provisions, reinforced transfer pricing rules, denial of parent-subsidiary favourable tax regimes, increased tax rate up to 75 per cent, etc).

The list had not been updated since 2016. A new list was published by the French tax authorities on 6 January 2020, which now includes Anguilla, the Bahamas, the British Virgin Islands, Panama, the Seychelles and Vanuatu. In addition, and for the first time, the list was extended to the following states and territories included in the EU blacklist of tax havens: Fiji, Guam, the US Virgin Islands, Oman, American Samoa, Samoa, and Trinidad and Tobago. The tax effects of the inclusion of a state or territory within this list started on 1 April 2020.

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