May 2017

SIMPLIFIED DESCRIPTION OF TAX SYSTEMS: US versus FRANCE

GENERAL

A) CAPITAL GAINS FROM SALE OF EQUITY INVESTMENTS MADE BY CORPORATIONS AND INDIVIDUALS (Non Real Estate)

1. CORPORATIONS:

The **US** does not have specific capital gain taxation rules for capital gains income earned by corporations on their investments. This taxation rule may only differ as to the use of this gain against losses depending on the time the investment was held.

In some European countries, (subject to few limited restrictions), there is no taxation on capital gains earned by a taxable legal entity on the sale of investments in other companies. There are restrictions pertaining to the duration of ownership that limits the use of this exemption (minimum of one or two years).

In **France**, capital gains on sale of stocks, bonds etc. are taxable. When realized only they are taxable under the ordinary corporate rate using either the (FIFO) first in first out method for cost determination or the Average Cost Methodology for successive acquisitions.

When the investment in a single company represents 5% or more of the issued capital and it was held for a minimum period of two years the tax basis is limited to 12% of the capital gain.

A leaflet published by our firm covers corporate taxation of holding companies for most of the countries of Continental Europe (see web site “library”)

For reorganization (mergers.) subjects to conditions (see also our leaflet on “Reorganizations”) a status exempts them from taxation on derived capital gains when no cash or below 10% is withdrawn.

2. INDIVIDUALS:

Individuals are only taxable in the country they are taxpayers of, subject to the international tax treaty with the exception of important stake (see the end of this note).

For **US** tax residents see our leaflet regarding capital gains under Federal law.

For **French** tax residents, capital gains on shares and other equity instruments are taxable at the ordinary income progressive general tax schedule after a rebate on the basis depending on the time the shares were held by the tax payer, 50% for more than two up to six years, 65 % for eight years and over.

Capital gains on bonds and other forward financial instruments as derivatives and options are taxable under the general tax schedule without any rebate. One has to consider if the sales is typical to a trading transaction or if it is unusual or unusual for the tax payer. Taxation will be different.

The so called social contribution (CSG-CRDS) of 15.5 % in total is an additional tax burden which combined and may raise the global tax burden to 60.5%. With the rebates for duration the effective rate may reduce to 30.25 % or 21.175% maximum.

Furthermore the, 5.5 % of the prior year paid social contribution is deductible from the global taxable income (not from the tax) slightly reducing the effective global tax rate. The CSG is withhold by the payer (usually a bank) and will be offset from tax liability at the time of filling

By exception, founders of companies, retiring managers, and members of family group will benefit of a special regime, called "Reinforced Rebate". Retiring stockholder have to sell their entire stake but granted a 50% rebate on the capital gain when held for a period of one to four years, 65% if between four to eight years and 85% if eight and more. The family groups should have detained at least 25% of the issued equity of the company for a continuous period of 5 years. The company should have been created at least 10 years ago, be a SME based in the European Union be submitted to the corporate tax and be detained for at least 75% by stockholders complying to the same criteria (SMEs European definition is: less than 250 employees and a yearly revenue not exceeding 50 million € or a balance total of less than 43 million). Within a family group sold shares should not be resold within 5 years. The company should have been engaged for the last 10 years in industry, services, an independent profession, workman craft or agriculture. The seller should either be an employee of the sold interest or a manager of it for at least 5 years continuously. The deriving income from these two possible positions should represent at least 50% of the taxpayers' professional income.

Subject to similar restrictions, retiring managers of SMEs up to 2017 can benefit from the reinforced rebate on their capital gains (article 150D). They are granted before it applies a general € 500,000 exemption basis.

The years' periods are computed from the day of entering the taxpayer assets and the date of sale.

In case of successive acquisitions the capital gain determination is based on the average cost method. The administration provides with special cost appraisal rule if shares were acquired before January 1st, 1979. For the duration determination the FIFO method will apply.

A special rule also exists for sellers who reinvest at least 50% of the proceeds of their investment sale in another company within a period not exceeding 24 months. This regime must be completed with details by the administration.

There are many favorable status for options granted to start-uppers and employees.

These regimes will probably end with the implementation of a simpler flat tax system in 2018.

RESTRICTIONS FOR NON TAX RESIDENTS

Subject to tax treaty non-residents holding a 25% or more interest in a corporation at any time during the five years preceding the sale of such interest may be taxable at a 45% withholding tax rate. Nevertheless, these taxpayers may be reimbursed of the difference between the tax due on French source income at ordinary schedule and this 45% withholding not to reduce the average rate under 20 % (subject that their applicable French average rate on a global worldwide income would not be lower and in such case they would be reimbursed for the difference). When the non-resident is tax wise from a non-cooperative country, the rate is raised to 75%.

US TAX PAYERS RESIDING IN FRANCE:

Due to tax treaty between the two countries the taxpayer is exempt in France on the capital gains of sale of shares and bonds (from the income tax but not from the 15.5% CSG)

B) CORPORATION TAX

1. Standard rate

The standard rate is 33.33%. Law was taken to decrease this rate progressively over years down to 28% (the standard rate in the EU). The new administration intends to reduce over years the maximum tax rate to **25%**. As in the US declarations and sometime laws have proposed in many other countries to aggressively decrease the top rates (see our leaflet on most holdings throughout Europe). For many countries budget may not allow such decrease and expectations deceived.

There is no major French specific rule about expenses deductibility and all expenses made in the course of normal operations are deductible except for those to be capitalized. Several incentives did exist as to industrial investments (40% over amortization rule recently ended) and overall for research activities (special leaflet) which are given some tax holidays (and overall social charges exemptions for the JEI).

There is a consolidation rule whereas dividends received by a corporation on an investment stake of 5% detained for one year are only taxable on a 5% or 1% basis meaning mostly exempt.

2. Capital gains on such investment are only taxable on a basis reduced to 12% (see above)

3. Reorganizations (mergers…) can also be exempt with similar rule as in the US.

4 Abuses

There are several provisions in the tax code regarding abuses of tax heavens (50% limit comparison). In summary companies being used to locate profits must have business activity and not be only a shell. Price transfers deductibility limits are also framed under OCDE principles.

C) Advance tax agreements – Coordination Centers- Head-Quarters

French taxation process allows advance tax agreements to give guarantees to the tax payer (LPF article 80, 7th BOI – SJ – RES 20).

This process is very useful for those who handle large international transfers and are at risk for tax re-assessments with the sanctions attached.

Coordination centers and Head-Quarters (BOI – SJ – RES – 30 and subsequent)

The advance tax agreement process is the right way to determine profits of headquarters, coordination, logistics and research centers. Taxable profits whenever are not determined by a full P & L with sales but based on a negotiated expenses ratio.

Conclusion

France with a sensible maximum corporate tax rate is a competitive place to locate vast operations whatever they are subject to analysis about activities to settle and consequent staffing needs.

Tax rules in place for Research and Development expenses should be used to fully benefit from the favorable environment. Logistic centers should be placed under advance tax agreements. Many specialized set ups are also available for investors similar to those exiting in the US and adapt to the landscape of equity investors (for instance Société de Libre Partenariat) to fully benefit from European space and avoid tax withholding.

Specialized agencies (Business France) are also available to help foreign investors and their staff.