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# THE OVERHAUL OF FRANCE'S TAX LAWS HAS BEEN ENACTED – WHAT WILL THE 2018 FINANCE ACT CHANGE?

To Our Clients and Friends:

On December 21st, 2017, the French Parliament approved the first Finance Laws of Emmanuel Macron's presidency (the "Finance Act")[1]. The general objective pursued by the French Parliament through this tax reform is to sustain French economy's attractiveness and competitiveness and to attract a significant part of the population's savings into the productive economy and, hence, company stocks.

We lay out below some of the key measures of the tax reform, which brings about new opportunities for our international clients. Such key measures can be summarized as follows:

For companies:

- Progressive reduction of corporate income tax rate from 33 1/3% to 25% as of 2022;
- Repeal of the 3%-distribution tax;
- Cancellation of the Carrez interest deduction limitation rule for EU companies.

For individuals:

- Introduction of a 30% "flat tax" on income and gains from capital for individuals;
- Improvement of the Free Shares social and tax regime; and
- Narrowing the scope of the wealth tax to real estate assets only.

## I. TAXATION OF COMPANIES

### 1.1 Progressive reduction of the 33 1/3% Corporate Income Tax rate to 25%

The Finance Law provides for a gradual decrease of the CIT rate from 33 1/3% to 25% from 2019 to 2022.

| Fiscal years beginning | Applicable CIT rates |
|---|---|
| 2019 | 31% (28% below €500,000) |
| 2020 | 28% |
| 2021 | 26.5% |
| 2022 | 25% |

In 2022, the effective rate will be as low as 25.8% (including the 3.3% social surcharge which will continue to apply to the CIT for profit in excess of €2,289,000[2]).

### 1.2 Repeal of the 3%-distribution tax

Since 2012, a 3%-tax is due by French companies on their dividend distributions (in addition to the CIT applicable on their taxable profits).

Following several court decisions challenging the legality of such tax[3], the tax is repealed for dividends paid as from January 1, 2018.

However, the French Parliament has approved an exceptional contribution on profits in order to finance the reimbursement of the 3%-tax refund claims (amounting to c. € 10 billions) filed by taxpayers. The rate of such exceptional contribution depends on the companies' turnover. Less than 300 companies should be impacted by such temporary rate increase. In practice, for financial years opened in 2017 only:

- Companies whose turnover exceeds €1 billion will be subject to an effective CIT rate of 39.5%;
- Companies whose turnover exceeds €3 billion will be subject to an effective CIT rate of 44.5%.

### 1.3 Cancellation of the Carrez rule on interest deduction limitations for EU companies

Applicable to financial years starting on or after January 1st, 2012, the Carrez rule disallows the deduction of financial expenses related to the acquisition of shares in subsidiaries for an eight-year period if the holding companies are unable to demonstrate:

- that they effectively take the decisions regarding their subsidiaries in France; and
- that they effectively exercise control or influence over the acquired subsidiaries from France.

The purpose of this rule is to prevent the artificial allocation of debt in France where French companies controlled by non-French investors would be interposed to acquire shares of French or foreign subsidiaries.

Due to the potential incompatibility of such provision with the European Union freedom of establishment principle, the Finance Law repeals the Carrez rule for the years ended as of December 31st, 2017, where the decisions, control or influence are made by EU holding companies. On the other hand, the Carrez rule continues to apply if such decisions and control or influence are made by non-EU companies. Such a situation could raise a discrimination issue with respect to French companies held by shareholders based in States having entered into a tax treaty with France containing a non-discrimination clause (such as the France/US tax treaty).

## 2. TAXATION OF INDIVIDUALS

### 2.1 Introduction of a 30% flat tax on income and gains from capital as from January 1st, 2018

The Finance Law introduces a flat rate on personal income tax of 30% on investment income (such as interest and dividends) and on capital gains on shares of non-real estate companies/entities (vs. a marginal rate that could be as high as 60.5% for prior years). A 3% to 4% additional contribution continues to apply for high income earners (above €500,000 for single or €1,000,000 for couples).

### 2.2 Reform of the Free Shares regime

Regarding Free Shares and up to K€ 300 of acquisition gain (equal to the fair market value of the shares on the date of vesting), such gain will be taxed at the graduated scale of income tax rates after the application of a 50% rebate. Unlike the previous regime, the benefit of such rebate is not subject to a minimal holding period of the shares. In practice, such gain will most generally be taxed at the rate of 22.5%, plus social contributions at the rate of 17.2%, i.e. 39.7%.

Above K€ 300, the acquisition gain remains taxed at the graduated scale of income tax rates (up to 45%, plus, if applicable the 3% to 4% additional contribution for high income earners) without any rebate and a 10% employee social contribution continues to apply to such gain.

On the other hand, the rate of the 30% social contribution due by the employer (which applies from the first euro of acquisition gain) is reduced to 20%.

The new Free Share regime applies to Free Shares attributed pursuant to Free Shares plans approved by AGM held after December 31st, 2017.

### 2.3 Wealth tax's scope narrowed to real estate assets only

Starting on January 1st, 2018, the French *Impôt de Solidarité sur la Fortune* will be replaced by the *Impôt sur la Fortune Immobilière* ("IFI").

In comparison with the former wealth tax, the taxable basis of the IFI is narrowed to real estate assets and property rights only. It also includes securities of companies or entities owned by the taxpayer up to the fraction of the real estate assets held directly or indirectly by such entities (except if such assets are used for business purposes such as for commercial, industrial or hotel activities). Most tax treaties concluded by France with foreign states should generally prevent such transparency rule to apply as far as non-(French) tax residents are concerned (except where more than 50% of the value of the company is derived from French real estate assets).

Units or shares of OPCVM, investment funds or investment companies with fixed capital (*Société d'Investissement à Capital Fixe, SICAF*) holding real estate or property rights will be excluded from the new taxable basis if the taxpayer holds less than 10% of rights and if the assets of the fund are composed for less than 20% of real property rights. Moreover, shares of listed real estate investment companies (*SIIC*) will be exempt from the tax if the taxpayer holds less than 5% of the share capital of the SIIC.

Several anti-abuse provisions have been inserted in order to disallow or minimize the deductibility of back-to-back family financings or bullet loans entered into by taxpayers. In addition, when the value of the taxable real estate assets is greater than € 5 million and the amount of deductible debt of the taxpayer exceeds 60% of this value, only 50% of the fraction of the debts exceeding this limit is deductible.

The IFI threshold remains set at €1,300,000 and the tax brackets and rates are the same as for the former wealth tax.

| **Portion of the net taxable value of the estate** | **Rate (in percentage)** |
|---|---|
| Not exceeding €800,000 | 0 |
| Above €800,000 and below or equal to €1,300,000 | 0.50 |
| Above €1,300,000 and below or equal to €2,570,000 | 0.70 |
| Above €2,570,000 and below or equal to €5,000,000 | 1 |
| Above €5,000,000 and below or equal to €10,000,000 | 1.25 |
| Above €10,000,000 | 1.50 |

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*[1] 2018 Finance Law n° 2017-1837 of December 30th, 2017*

*[2] Effective rates would therefore be respectively 32% (28.9% below €500,000) in 2019, 28.9% in 2020 and 27.4% in 2021 for profit in excess of €2,289,000.*

*[3] ECJ May 17, 2017, AFEP, C-365/16 ; French Constitutional Court Decision n°2017-660 QPC October 6, 2017, Société de participations financière.*

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*Gibson, Dunn & Crutcher lawyers are available to assist in addressing any questions you may have regarding these issues. Please contact the Gibson Dunn lawyer with whom you usually work, or the authors, Jérôme Delaurière, Ariel Harroch and Jeffrey M. Trinklein.*


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