

**FRENCH TAXATION
OF INBOUND INVESTMENTS**

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Economic and financial flows between France and foreign countries have dramatically increased in recent years. More and more foreign companies and businessmen become involved in business affairs in France, either directly from their home countries, or by incorporating or acquiring a French company.

It is necessary, with this in view, that foreign businesses be aware of French taxation, whether applicable to companies or individuals.

In fact, French tax law evolved to a considerable extent over the last few years, in order to make France more attractive to foreign investments.

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INTRODUCTION

In general, a foreign company willing to develop business in France incorporates a French subsidiary or purchases a French company.

In order to do that, a foreign investor should take into account:

- the corporate tax rate which applies to his subsidiary,
- the scheme usually implemented in order to acquire a French company.

It might also be interesting to incorporate a holding company in France which could hold the shares of other European subsidiaries.

Finally, it is profitable to be aware of the taxation of flows between a French subsidiary and its foreign parent company, as well as to have accurate knowledge of the bilateral tax treaties.

On the other hand, some foreign businesses prefer to operate directly from their home countries in order to pursue business affairs in France without having subsidiary at their disposal. It is therefore pertinent to guard oneself against the risk of being taxed in France as a permanent establishment.

As regards foreign employees seconded to a French subsidiary, they may find some tax rebates quite profitable.

The ensuing elaborations only constitute a summary of French tax provisions and should by no means be treated as official legal advice, which would bring to bear any responsibility on the authors of the document in hand.

I. FRENCH CORPORATE TAX RATE

Standard corporate tax rate amounts to 33.33% of the profits generated by a company.

Companies which pay an amount of corporate tax higher than 763,000 euros, except the ones which are held by individuals at a rate higher than 75%, are taxed at a corporate tax rate of 34.43%.

However, the standard corporate tax rate will be gradually lowered to 25% by 2022. In 2019 the CIT rate is of 28% for the part of profit less than 500,000 euros and 33.33% for the exceeding part, except for companies which have a turnover less than 250 million euros a year for which it is 31%. In 2020 the CIT rate for this second kind of companies will be lowered to 28%.

Small and medium enterprises specialized in research (young innovating enterprises) or participating in research projects located in specific zones (poles of competition) may benefit from temporary corporate tax exemptions.

Different tax credits are also provided by the French tax code.

One of the most important tax credits regards the area of research. Companies may thus benefit from a research tax credit which amounts to 30% on a fraction of their expenses addressed to research, within the limit of a ceiling amounting to 100 million euros and to 5% of the expenses exceeding this limit.

Some tax credits are also available for movie industry.

It is possible for companies to carry forward losses with no time limit. Companies can offset against their profits carry forward losses on the following FY for a maximum of 1 million euros plus 50% of the part of the profit above 1 million euros.

Tax losses can also be carried back, but only against the profit of the former FY and in a ceiling of 1 million euros. The amount not carried back can be carried forward during the following years under the above conditions.

II. ACQUISITION OF A FRENCH COMPANY

The acquisition of shares of a French company by a foreign investor will trigger a stamp duty at a rate of:

- If the company is a corporation (SA, SAS) with:
 - o shares traded on a regulated market of financial instruments or on a multilateral trading system:
 - 0.1% of the price of the acquisition of the shares if the transaction is recorded in a deed;
 - No taxation if the transaction is not recorded in a deed.
 - o unlisted shares:
 - 0.1% of the price of the acquisition of the shares.
- If the company is not a corporation, the share capital of which is not divided in stock (SARL, SNC...):
 - 3% of the price of the acquisition of the shares after an allowance. This allowance represents the proportion of the transferred shares times 23,000 euros, on the total number of shares of the company. It concerns companies that have less than 50% of real estate assets.
- If the value of the company's real estate assets constitutes more than half the value of its total assets:
 - 5% of the price of the acquisition of the shares (except if the shares are listed, see above).

If a deed is recorded outside of France, there will be a tax credit equal to the foreign tax stamp duty, if any.

III. TAX REGIME OF FRENCH HOLDING COMPANIES

It is recommended to incorporate a French holding company in order to acquire the shares of the French target company and to implement, subsequently, a fiscal unity between the two companies.

The loan interests of the holding company may thus be offset against the profits of the target company.

The rate for borrowings interests paid to affiliated companies must not exceed a rate published they do not exceed the annual average of the average interest rates provided by the credit institutions for fluctuating rate loans to enterprises and for an initial duration higher than two years and provided,

Borrowing interests are deductible for their total amount, provided that the difference between paid interests and received interests from other companies does not exceed 3,000,000 euros. Otherwise, the interest deduction will be capped to 30% of EBITDA.

When a French company is thin-capitalized, i.e. when loans granted (or guaranteed) by affiliated companies (foreign shareholders, for instance) exceed by one and a half times the equity of the French company benefiting from the loan, the deduction of interests paid to affiliated company will be capped to 10% of EBITDA.

Inside fiscal unity dividends paid by the French target company to the French holding company are not taxed; in return, a portion of expenses and charges estimated in a lump sum of 1% of the amount of the dividend collected is, however, reintegrated to the taxable income.

Dividends received from other French or foreign subsidiaries (held at a rate higher than 5%) are not taxed; in return, a portion of expenses and charges estimated in a lump sum of 5% of the amount of the dividend collected is, however, reintegrated to the taxable income. This amount is lowered to 1% if the subsidiary is located in an other EU country and could have been member of a fiscal unity if it were a French company.

The capital gains from the sale of shares of French or foreign subsidiary companies (held at a rate higher than 5%) which has taken place more than two years after their acquisition are not taxed (in return, a portion of expenses and charges estimated in a lump sum of 12% of the amount of the achieved capital gain is reintegrated to the taxable income).

No registration duty is due, in case of contribution of shares to a French company.

IV. TAXATION OF FLOWS BETWEEN A FRENCH CORPORATION AND ITS FOREIGN PARENT COMPANY

Taxation applicable to the different flows between a French company and its foreign parent company is governed by the European Union (EU) Directives and by the tax treaty executed between France and the country in question.

a) Dividends

According to domestic law, dividends paid by a French company to foreign shareholders are subject to a withholding tax of 30%.

Dividends paid to companies located in a treaty country and which hold at least 10% of the share capital of the French subsidiary, are subject, in France, to a withholding tax of 5%. In the other cases (parent companies holding less than 10% or individual shareholders), the amount of the withholding tax is generally 15%. In the two cases, the withholding tax paid in France gives right to a tax credit for the foreign parent company which may use it to pay domestic tax corresponding to these dividends, if the dividends are taxable in its country.

However, if the parent company is located in the European Union, and is subject to corporate tax and holds more than 10% of the share capital of the French company during at least two years, no withholding tax will be due.

b) Interests

According to domestic law, interests paid by a French company to foreign creditors are exempt from withholding tax.

c) Royalties

According to domestic law, royalties paid by a French company to a foreign person are subject to a withholding tax of 33.33%.

However, when the foreign person is a company located in the European Union and subject to corporate tax, there is no withholding tax if:

- the foreign company is a parent company holding at least 25% of the share capital of the French company,
- the French company holds at least 25% of the share capital of the foreign company,
- a European company holds at least 25% of the share capital of the French company and of the foreign company.

Generally, royalties paid to treaty persons benefit from an exemption or a reduced rate of 5% or 10%.

Royalties paid by a French company to a foreign company are deductible from its taxable income, if their amount is comparable to royalties to the one to which two independent companies would have agreed.

d) Transfer pricing regulation

Relations between a French company and foreign affiliated companies must be arranged according to the same conditions to which non-affiliated companies would have agreed. Otherwise, the French tax administration may correct the profit of the French company, a fact which leads to a double taxation which may only be resolved by a mutual agreement procedure (MAP) between the competent authorities of France and the country in question.

French companies must have at their disposal documents justifying their transfer prices in their transactions with foreign affiliated companies. These documents must clarify the functional analysis used so as to fix the pricing of the transactions and must include the agreements executed with the foreign companies (distribution agreements, licensing of patents or software...).

Entities established in France that meet a turnover or gross assets threshold of 400 million euros (or that own, or are owned by, directly and indirectly, more than a half of a corporation's capital that exceeds that threshold), are to make the documentation available to the French tax authorities at the outset of a tax audit. Entities established in France that meet the said threshold reduced to 50 million euros of turnover or gross assets (or are part of a fiscal unity including a company that meets this threshold) are required to file each year a limited transfer pricing documentation with the tax authorities.

Companies that prepare consolidated accounts and belong to a group with a consolidated turnover of at least 750 million euros, and have foreign branches or hold or control, directly or indirectly, foreign entities, are required to file a country-by-country ("CbC") report including group revenues, financial accounting and tax ratios, nature of the main business activities, and jurisdictions where all the group entities are tax resident. This CbC report must be submitted online within 12 months after the end of the group's financial year, for accounting periods beginning on or after January 1st, 2016. It will have to be filed by December 31st, 2019, for instance, for a year-end at December 31st, 2018.

It is also possible for the French company to obtain the French tax authorities' approval of the level of its transfer prices. The approval granted may bind either solely the French administration or also the foreign one. In the latter case, the two administrations (The general Direction of Taxation in France and the competent foreign one) shall deliver a bilateral advanced price agreement (APA) on the transfer prices.

<p style="text-align: center;">V. SERVICES SUPPLIED IN FRANCE BY A FOREIGN COMPANY - RISK OF PERMANENT ESTABLISHMENT</p>

Foreign companies, and in particular small and medium enterprises, sometimes operate directly in France without incorporating a French subsidiary: they either canvass for French clients from their home country by undertaking commercial trips to France or they serve French clients during travels in France. The risk then for the company is to be considered by the French authorities as having a permanent establishment in France and thus as subject to French corporate tax with respect to the profit made by the foreign company, which results in a double taxation, in France and abroad.

This double taxation can only be eliminated by an agreement between the competent authorities of the two countries in case of a tax treaty, which however is not obvious and takes, in any case, a lot of time.

A foreign company has a permanent establishment in France if it has in France a fixed place of business through which its business is wholly or partly carried on. In specific, a branch or an office is a permanent establishment.

On the contrary, a fixed place of business which is used only to carry out an activity of a preparatory or auxiliary character is not included in the term “permanent establishment”.

If the foreign company turns to a French agent to carry on its business, this agent will be a permanent establishment only if the two following conditions are met: it has the authority to execute agreements in the name of the enterprise and is dependent on the latter (it works only for this company, for example).

In order to ensure that it does not have a permanent establishment in France, the foreign company can ask the French tax authorities for the confirmation that it does not own a permanent establishment by providing them with a precise and comprehensive written presentation of its situation. If the authorities fail to answer within a three month-period, the confirmation sought will be considered as granted.

VI. TAXATION OF FOREIGN EMPLOYEES SECONDED TO FRANCE

A foreign group of companies may wish to second to the subsidiary it owns in France some of its employees for a limited period of time.

The latter will become French tax residents and all of their incomes will be subject to the French income tax.

French income tax has been withheld at source by the employer since January 1st 2019. Employees must declare every year, during May, the incomes of the previous year. Income tax is then calculated by the tax authorities. The tax due corresponding to one year's incomes is thus to be paid no earlier than the following year.

The French income tax rate progresses along with the income; the maximum rate amounts to 45%.

Nevertheless, the employees benefit from an allowance of 10%, as a result of which the employee is taxed on 90% of his/her salary (however, the profit generated by this allowance has a ceiling).

Furthermore, French taxpayers benefit from tax cuts according to the size of their tax household, which allow a considerable decrease in the average rate of income tax that they are liable to.

Moreover, there are specific provisions which benefit employees seconded to France by a foreign employer, in order for them to hold a post.

Thus, the supplements of additional remuneration (known as "*primes d'impatriation*") granted to foreign employees seconded by a foreign company to work within a French subsidiary will be exempt from income tax (within certain limits) for eight years.

Further, National Insurance contributions that the foreign employees will continue to pay to their countries' basic systems of social security will be deductible from their taxable income.

If the foreign employee seconded to France moves abroad as part of his/her French employment, the supplements of remuneration granted for this reason (known as "*primes d'expatriation*") are exempt from income tax.

It should be mentioned, in addition, that the employer will have to pay a certain number of payroll taxes: the "generalized social security contribution" (CSG) at the rate of 7.5%, the "contribution to the repayment of the social debt" (CRDS) at the rate of 0.5% as well as the employee and employer's contributions to the various social security systems (health insurance, basic and supplementary pensions, family allowances, unemployment insurance...) which can rise up to more than 60% of the wage. This rate is inversely proportional to the wage. Therefore, it can decrease down to 40% for higher wages.

VII. VAT

EU VAT 2006 Directive is applicable in France.

So domestic supplies of goods or of services are VAT taxable in France.

Exports and intracommunity supplies are zero rated. Imports and intracommunity acquisitions are taxable. Some activities are exempted (bank and insurance, health care).

VAT standard rate is 20%.

There are also three reduced rates:

- 10%: transportation of people, restaurants...
- 5.5%: food and non-alcoholic beverages, books...
- 2.1%: medicine, newspapers...

VAT on purchases of goods or services is deductible, except VAT on transportation of people or on cars and on housing of company's employees.

When part of the company's turnover is exempted from VAT, VAT on purchases can be deducted only on a pro rata basis.

Excess deductible VAT can be refunded.

Foreign companies which bear French VAT on their purchases of goods or services in France can get a refund of this VAT.

CONCLUSION

Foreign investors must be well aware of the French tax law which they will be subject to before going into business in France.

They should avoid all tax risks related to an insufficient preparation/planning of their methods of operation.

They can also benefit from various tax advantages.

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