2014 FINANCE ACT – 2013 AMENDING FINANCE ACT – TAX FRAUD ACT

TAX MEASURES CONCERNING COMPANIES IN GENERAL

• **Increase of the effective company income tax rate applicable to large companies, due to an increase in the rate of the special additional tax on high turnovers** (Article 16 of the 2014 Finance Act)

The rate of the special additional tax on high turnovers has been increased from 5% to 10.7% for financial years ending as from 31 December 2013.

Taking into account this increase and the social security tax rate of 3.3%, the overall rate of company income tax is 37.99612% for companies whose turnover exceeds M€ 250 (plus the 3% tax on dividends paid).

• **Transfer pricing**

The law against tax fraud and large-scale economic and financial crime dated 6 December 2013, which came into force on 8 December 2013, imposes new requirements on companies (Article 45 of the 2014 Finance Act, and newly created Article 223 *quinquies* B of the French Tax Code).

These requirements concern legal entities established in France, referred to in Article L. 13 AA of the Tax Procedures Guide, i.e. legal entities fulfilling at least one of the following conditions:

a) legal entities whose annual turnover (excluding VAT), or whose gross assets booked on the balance sheet amount to M€ 400 or more, or

b) legal entities directly or indirectly holding, at year-end, more than half the share capital or voting rights of a legal entity fulfilling one of the conditions referred to in paragraph (a), or

c) legal entities more than half of whose share capital or voting rights are directly or indirectly held at year-end by a legal entity fulfilling one of the conditions referred to in paragraph (a), or

d) legal entities belonging to a tax consolidated group of companies, where said group contains at least one legal entity fulfilling one of the conditions referred to in paragraphs (a), (b) or (c).

Existing requirements: these companies are required to keep full documentation at the disposal of the tax authorities justifying their transfer pricing policy for all transactions with affiliated companies.

The Law dated 6 December 2013 imposes new requirements on these companies including, in particular, the compulsory filing of “summary documentation” relating to transfer pricing.

Indeed, **companies are required, within a period of six months following the date they are due to file their tax return package, to automatically provide:**

- **general information on the group of affiliates**; and
- **specific information on the company concerned**.

The information required includes the following:

- general information on the group of affiliates: a general description of the group’s transfer pricing policy and of any amendments made to the policy during the financial year concerned;
- specific information on the company concerned: a presentation explaining the method(s) used to calculate transfer prices compliant with arm’s length principles, and indicating the main method used and any amendment of it during the financial year concerned.

Thus, companies concerned are now required to prepare two sets of transfer pricing documentation, i.e. a full version to be provided in the event of a tax inspection, and a summary version to be automatically filed with the tax authorities on an annual basis.

The summary documentation will allow the tax authorities to screen companies before they decide to carry out a tax inspection; it is therefore important to prepare it adequately.

As a reminder, companies having a computer-based bookkeeping system will be required, as from 1 January 2014, to provide a copy of their general ledger in computer file format to the tax inspector in the event of a tax inspection.

Failure to provide this computer file will be subject to a fine of € 1,500. In addition, any incomplete and/or inoperative computer file provided may result in a default assessment procedure, and any doubt concerning the reliability or sincerity of the file may lead to the rejection of the general ledger.

- **Creation of a special tax on high income earners** (Article 15 of the 2014 Finance Act)

This special tax on high income earners, which is a new version of the 75% tax on high incomes, will be required to be paid by companies in relation to any compensations exceeding M€ 1 that they pay to their employees. It is applicable to compensations paid or allocated in 2013 and 2014. This new version of the tax on high incomes was validated by a decision of the Constitutional Council dated 29 December 2013.

La Bruyère avocats
190, boulevard Haussmann 75008 - Paris
www.labruyereavocats.com
Tél. : 01.56.88.38.56

The tax will be calculated by applying a rate of 50% to the portion of the compensation exceeding M€ 1 and will be capped at 5% of the turnover achieved by the company in the year concerning which it is due.

The Law provides a very wide interpretation of the term “compensation”, which includes all individual compensations that are potentially deductible from the company’s taxable income (compensations and salaries, attendance fees, retirement benefit, stock-options, etc.).

• **New restriction on the deductibility of interest paid to affiliated companies under intercompany loans** (Article 22 of the 2014 Finance Act)

Interest on loans and financial charges in general are deductible, in principle, from taxable income. However, several restrictions exist regarding the deductibility of interest on loans, in particular in the case of affiliates.

The currently existing restrictions are as follows:

- limited deduction of interest paid to affiliates at a rate exceeding the rate provided for in Title I, paragraph 3 of Article 39 of the French Tax Code concerning interest paid to affiliates or, if higher, the rate that the company could potentially obtain from an independent bank (Article 212, I of the French Tax Code);
- limited deduction in the scope of anti-thin capitalisation rules (Article 212, II of the French Tax Code);
- limited deduction of financial charges in the scope of the acquisition of certain equity interests (Article 209, IX of the French Tax Code);
- limited deduction specific to tax-consolidated groups of companies, known as the “Charasse” amendment, in the event of purchase by a company from its majority shareholder of shares of a company in the group (Article 223 B of the French Tax Code).

The 2014 Finance Act adds another condition for the deductibility of interest paid to an affiliated company, with a view to preventing tax optimization through artificial indebtedness.

In order to be deductible at the French borrowing company’s level, interest paid to an affiliated company must, in addition to being compliant with maximum rate requirements (Article 212, I of the French Tax Code), be taxed at the level of the French or foreign debtor at a rate at least equal to a quarter of the standard French company income tax rate, meaning 8.33% (Article 212, I, (b) of the French Tax Code).

The burden of proof with regard to this minimum tax lies with the borrowing company.

Important: the above rules are applicable **to financial years ending as from 25 September 2013**. Thus, companies with a financial year beginning on 1 January and ending on 31 December each year will be subject to these rules as from the financial year ended 31 December 2013.

La Bruyère avocats
190, boulevard Haussmann 75008 - Paris
www.labruyereavocats.com
Tél. : 01.56.88.38.56

MEASURES SPECIFICALLY CONCERNING SMES AND START-UPS

• **Special amortization of investments in the share capital of innovative SMEs** (Article 15 of the 2013 Amending Finance Act)

With a view to encouraging the financing of innovative SMEs, the French government has implemented an incentive for corporate capital investment.

Companies that are subject to company income tax and that invest, directly or via a venture capital fund or investment company (known in France as FCPRs, FCPIs or SCRs), in innovative SMEs will be entitled to amortize their investment over 5 years, under certain conditions.

SMEs are considered as innovative if:

- they meet the criteria set by EC legislation, i.e. have less than 250 employees and (i) an annual turnover of less than M€ 50, or (ii) a balance sheet total of less than M€ 43;
- they meet one of the criteria hereunder:
    - their R&D costs for the previous financial year represent at least 15% of their deductible costs (10% for industrial companies);
    - they bring evidence of the creation of products, processes or techniques that are recognized as innovative and that provide potential for economic development, as well as of the corresponding financing requirements.

Two conditions must be met to benefit from this incentive:

- equity interests held by companies in SMEs must remain minority interests and must not exceed, directly or indirectly, 20% of the share capital or voting rights of the innovative SME concerned;
- interests held in innovative SMEs must be maintained for at least two years.

<u>**Entry into force**</u>: this measure being considered as a State aid, it is required to be validated by the European Commission before becoming applicable. It must be submitted to the Commission by the French government.
The procedure for validation by the European Commission can take from two to eighteen months, depending on whether or not the Commission requires additional information to be provided.
The date of entry into force of this incentive will then be fixed subject to a decree to be issued within six months of receipt of the Commission's reply.

- **The exemption from company income tax applicable to innovative start-ups is extended for start-ups created up to 31 December 2016.**