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# France

Olivier Dauchez & Alexandre Bochu  
Gide Loyrette Nouel A.A.R.P.I.

## **Overview of corporate tax work over the last year**

While starting at a strong pace, the M&A market has suffered a significant downturn since the last quarter of 2022, fuelled as much by uncertainties in the economic climate as by a drop in investor confidence.

This trend has continued into 2023: according to Refinitiv's preliminary data as at 20 March, M&A volume involving a French party reached \$22.1 billion in the first quarter of 2023, down 59% on the first quarter of 2022. This is the lowest total recorded in 10 years. The number of announced deals fell by 43% year-on-year.

Transactions targeting a French target in Q1 2023 only reached \$12.2 billion, representing a 58% year-on-year decline and a five-year low. Domestic operations account for 83% of these deals, while 17% are carried out by foreign buyers. Since January, France has slipped back to seventh place among the countries whose companies are the most targeted worldwide, from fifth in the first quarter of 2022. In Europe, France occupies second place behind the UK.

French companies have virtually frozen their international investments, with volumes down 73% year-on-year to \$4.3 billion, of which Sanofi's acquisition of Provention Bio alone accounted for almost two-thirds.

### Types of corporate tax work

While, in the first half of 2022, M&A transactions and private equity represented a high percentage of corporate tax work, from the fourth quarter of 2022, a downturn in the cycle changed activity, which reflected the contrast in clients' situations.

Certain clients are dealing with exceptional profits and the potential special taxation anticipated, while the refinancing of certain groups or investments has proved to be more challenging than usual.

Investment funds structuring was very active at the end of 2022 and into early 2023, which shows that institutional and international investors are putting their ducks in a row for re-entering the real estate and private equity market as and when improvements begin to be seen.

## **Key developments affecting corporate tax law and practice**

### Domestic landscape

*Legislative environment: steady as she goes*

French corporate tax legislation has remained relatively stable over the last few years, experiencing adjustments and modernisations rather than major changes.

The most notable changes are:

- The suppression of the *cotisation sur la valeur ajoutée des entreprises* (Company Value Added Contribution, or “CVAE”).

The Finance Law of 2023 provided for a two-year phase-out of the CVAE. Companies or persons engaged in a self-employed activity and generating annual turnover above €500,000 are liable for this contribution based on the added value pursuant to a progressive scale with a maximum rate that used to be 0.75%. The first step in this phase-out will be the halving of the CVAE in 2023. This means that the total tax rates of the CVAE will be divided by two. No CVAE will apply from 2024 onwards.

- The creation of a VAT group regime, i.e. the possibility offered to different entities of the same group (i.e. entities closely linked to each other from a financial, economic or organisational standpoint) to become a single VAT taxable person. The sought advantages are (i) enabling VAT payments to be consolidated at group level, and (ii) reducing the number of transactions that have to be declared, since internal transactions between group members will not be subject to VAT.

This regime has been available since 1 January 2023 and has been used mostly in the banking and insurance industry thus far. The fact that the French tax authorities’ guidelines were only recently published on 25 October 2022 while the election of applying this regime in 2023 had to be made on 31 October may also be a reason for this regime not having been more widely adopted.

#### *Tax audits and case law: rise of the beneficial ownership concept*

As regards case law, the hot topic in France is the development of the beneficial ownership concept. Four years after the upheaval caused by the Danish cases rendered by the Court of Justice of the European Union (“CJEU”) on 26 February 2019, the French tax authorities and French courts seem to have fully grasped the potential of this concept for challenging the application of the benefits provided by double tax treaties or EU directives, in particular to outbound dividends paid by French companies.

From 2021 onwards, a number of decisions by administrative courts have confirmed that the tax authorities can rely on the concept of beneficial owner, without any abuse of rights or fraud being invoked, but in contexts that are still marked by a certain specificity, such as:

- the redistribution by a British company of copyright royalties to the artists who had commissioned it to collect them (CE, 5 February 2021, nos 430954 and 432845, Performing Rights Society);
- the full repayment by a Dutch company of royalties received from a French company to the company owning a trademark established in the British Virgin Islands, and then in Panama (CE, 24 June 2022, no. 459154, Meltex); and
- more recently, in a case involving the structuring of a French property investment via two Luxembourg holding companies, where the Paris Administrative Court of Appeal refused to apply the parent-subsidiary regime and the France-Luxembourg tax treaty to dividends paid by the French property company to the intermediary Luxembourg holding company, which redistributed them in full the following day to the lead Luxembourg holding company (CAA Paris, 7 December 2022, no. 21PA05986, Foncière Vélizy Rose).

This saga of case law and the increasing tendency of the tax authorities to invoke the beneficial ownership criterion encourage international investors, as well as French institutions paying withholding tax, to pay particular attention to the substance of holding companies receiving cross-border flows and their autonomy in managing these flows.

## Changes resulting from/inspired by international developments

Corporate groups are preparing for the changes that are expected to result from several EU directives.

### *ATAD 3 is in the air*

In combination with the beneficial ownership concept being very popular, the attention given to foreign holdings is increased by the possibility that ATAD 3 may be transposed in the coming months or years.

### *DEBRA*

The overhaul of the interest deduction rules that will result from the DEBRA directive has not yet modified the financing strategies of groups and private equity investors, which currently mostly design the financing in light of the current French thin capitalisation rules. However, convertible bonds have seemed to become more popular, which may be related to this foreseeable change as conversion of bonds into shares may be useful to accommodate the future rules (equity financing may be more efficient than debt financings as a result of the directive).

### *Pillar 2*

It is anticipated that the Pillar 2 directive adopted on 15 December 2022 will be part of the finance bill for 2024 and that French implementation will strictly correspond to the directive.

## **Tax climate in France**

Generally speaking, the French government is keen to maintain a business-friendly tax environment, despite France's generally relatively high level of tax and social levies. This endeavour materialises in a rather stable tax environment. Finance bills in recent years have not included particularly significant reforms of the tax system, but rather adjustments and modernisations of the system.

The corporate income tax rate, which had decreased progressively from 33.33% in 2018 to 25% in 2022, will be maintained despite increases being reported in certain other countries. In the meantime, France maintains its efforts to promote tax transparency and combat tax evasion and fraud.

## **Developments affecting the attractiveness of holding companies**

Recent finance laws have not affected the tax regime of French holdings, and we are not aware of any intention of the French government to significantly affect their treatment, which is generally regarded as favourable.

French holdings are, in principle, subject to French corporate income tax on their profits, but in practice benefit from a nearly complete exemption on dividends and capital gains derived from significant shareholdings:

- Dividends received from a company in which the holding holds at least 5% of the share capital for at least two years are 95% exempt (in fact, fully exempt with the add-back of a 5% lump sum), resulting in an effective taxation rate of 1.25%.  
Furthermore, dividends received from subsidiaries that are members of the holding's tax consolidation group (or from foreign subsidiaries that would fulfil the conditions required to enter the group if they were French, i.e. 95% held by a French parent company) are 99% exempt (resulting in an effective taxation rate of 0.25%).

- Capital gains derived from the sale of shares in subsidiaries that are not land-rich companies and in which the selling French parent company has held at least 5% of the share capital for at least two years are 88% exempt (in fact, fully exempt with the add-back of a 12% lump sum), resulting in an effective taxation rate of 1.25%.

Recent favourable French court decisions have tended to make the tax regime of French holdings more attractive. In particular, regarding dividends from foreign subsidiaries, the French higher administrative court (the *Conseil d'Etat*) has held that foreign tax credits may be offset against the corporate income tax generated by the add-back of the 5% lump sum, provided that the French parent company's expenses in relation to managing the participation are inferior to this 5% lump sum (*Conseil d'Etat*, 5 July 2022, no. 463021, Sté Axa). The court has considered that the 5% lump sum must be considered “*as aiming to subject to tax, when the amount of the charges is less than this flat-rate share, a fraction of the income from holdings benefiting from the parent company regime*”.

## Industry sector focus

### Banking and finance

At the end of March, France's National Financial Prosecutor (“PNF”) shook the financial world by unleashing a series of unprecedented searches. Five major financial institutions were in the crosshairs, suspected of being involved in the so-called “CumCum scandal” revealed in 2018 where banks were suspected of having circumvented dividend withholding taxes through dividend arbitration arrangements.

To support their tax reassessments, the tax authorities published guidelines in March 2023 that specifically target these schemes through the use of the beneficial ownership concept. These comments provide for quite innovative solutions, such as including manufactured dividends within the scope of the dividend withholding tax, which does not seem in line with French legislation. These comments are currently being challenged before the courts by the French Banking Federation (“FBF”), which seeks to have them declared unlawful and cancelled.

### Private equity – management packages

Over the last few years, French case law has been very severe with respect to management packages granted to managers notably in the context of leveraged buyouts.

Generally speaking, where a significant gain is made in a limited period of time, the tax authorities try to consider that the gains made are of an “employee remuneration” nature, resulting in the application of the progressive scale of income tax (a rate of up to 45%, plus potentially a 3% or 4% contribution on high income plus social contributions, and penalties/interest for late payment) instead of the taxation of capital gains (a 30% flat tax, which includes social contributions). A URSSAF reassessment is also likely to be made at the company level.

Recently, three decisions by the *Conseil d'Etat* (*Conseil d'Etat*, 13 July 2021, nos 428506, 435452 and 437498) have raised major concerns on management packages.

These decisions confirmed the possibility of reclassifying gains from management packages as “salaries” where there is a link between the gain realised at the end of a transaction and the functions performed within the group. The new interpretation grid drawn up by the *Conseil d'Etat* still needs to be refined, but a number of markers (relating in particular to the lack of liquidity and the nature of the instruments) have already been identified as factors likely to lead to the reclassification of these gains.

However, the *Conseil d'Etat* recently rendered a rather reassuring decision (*Conseil d'Etat*, 11 March 2022, no. 453016, SARL Alone & Co). In this case, a holding company had awarded an advantage to the sales director of a subsidiary by granting him a unilateral call option allowing this director to acquire the shares at a price (significantly) below their market value at any time during a period of five years from the date of signature of the option. The employee eventually exercised the call option and realised a gain of c. €200,000 by selling his shares to another company of the group. The *Conseil d'Etat* cancelled the recharacterisation of the gains as salaries, clarifying that certain circumstances must be considered:

- the fact that the director was not an employee of the holding company was not such as to prevent the company from having an interest of its own in encouraging him to develop its subsidiary (taking into account the consequences that it could expect on the valuation of its shareholding);
- the employee's skills, commercial experience and commitment were such as to increase the subsidiary's sales;
- the exercise price of €1 could be considered close to the market value of Alone & Co shares on the date the promise was granted; and
- the subsidiary's growth prospects were not certain.

In our view, this decision sends out a message of appeasement from the *Conseil d'Etat* (although it does not rule on the tax classification of the income in question).

#### Fund management – VAT exemption

In 2020, France broadened the VAT exemption applicable to fund management to all types of alternative investment funds to align French legislation with the VAT directive. VAT may nevertheless be applied if the management company elects for VAT. As from 2022, French legislation has been modified and the election is no longer global: the management companies may choose to elect for VAT for certain services only. The French tax authorities' guidelines published in June 2022 further indicated that the election may be made for each invoice, allowing for complete flexibility.

#### Real estate

##### *French REITS (sociétés d'investissement immobilier cotées, or "SIIC")*

A trend of tax reassessment has been observed regarding French REIT subsidiaries at the time when these subsidiaries sell their last real estate asset. The French tax authorities have taken the view that, as a result of this sale, the subsidiary does not comply with its corporate purpose, which must be principally to invest in real estate assets. Therefore, the subsidiary is considered to lose its corporate income tax exemption as from the first day of the ongoing financial year (notably, the capital gain realised on the sale of the last property is then subject to corporate income tax). Taxpayers are arguing against this position. Should the tax authorities maintain these reassessments, tax litigations before the French court will commence.

##### *Foreign real estate funds investing in France*

A recent decision rendered by the CJEU (*L Fund v. Finanzamt D*, 27 April 2023, C-537/20) will give grounds for foreign real estate funds and REITs holding real estate assets in France to claim that the profits and gains derived from these assets should be exempt from corporate income tax in France.

Indeed, it stems from this *L Fund* decision that the situation in which resident real estate investment vehicles are able to obtain a withholding tax on their real estate income while non-resident real estate investment vehicles do not benefit from such an exemption gives rise to a difference in treatment that is detrimental to foreign investment vehicles and constitutes a prohibited obstacle to the free movement of capital provided under the EU treaties.

*New France-Belgium double tax treaty to enter into force*

France and Belgium entered into a new double tax treaty on 9 November 2021, which is expected to enter into force on 1 January 2024 or 2025. This new double tax treaty provides for new rules for real estate investment. Belgian REITs that generally invest in France through a permanent establishment are particularly concerned as the rate of branch tax (withholding tax on the dividends deemed to be distributed out of the permanent establishment's profits) will increase from 5% to 25%.

**The year ahead**

From a market perspective, the stabilisation of interest rates is expected to allow private equity and real estate transactions to pick up again. In the meantime, financing and refinancing may remain a challenging issue for a significant number of French corporate groups and investment vehicles.

In this context, the optimisation of tax losses, as well as the tax advantages that can be derived from insolvency procedures (notably with respect to the tax treatment of debt waivers), will probably be a leverage that taxpayers will consider with attention.

More generally, in a relatively stable legislative landscape, focus will be on the preparation for the entry into force of the domestic implementation of supranational sets of rules, i.e. Pillar 2, DEBRA and, as the case may be, ATAD 3.





### Olivier Dauchez

**Tel: +33 1 40 75 61 35 / Email: [dauchez@gide.com](mailto:dauchez@gide.com)**

Olivier Dauchez is the head of Gide's Paris tax team. Olivier specialises in tax law, primarily transactional and international taxation, including M&A – including of listed companies – corporate restructuring, investments – especially in real estate – and financial transactions involving significant international aspects. He also advises high-net-worth families and individuals, both French and foreign.

As part of his practice, Olivier regularly represents clients in their dealings with the French tax authorities – when requesting a preliminary ruling or facing a tax audit, for example, as well as before the courts or in arbitration proceedings on tax disputes.

His clients include major multinationals, investment funds, sovereign wealth funds, financial institutions and high-profile families based in France as well as elsewhere around the world. He also on occasion works alongside the French government, advising them when they are drawing up new tax legislation or renegotiating tax treaties.

When working in an international context, Olivier can draw on his experience in Japan and the People's Republic of China, where he practised for seven years, as well as his close contacts with tax lawyers worldwide, from North America to Europe and Asia.

As a Board member of the IACF (French Institute of Tax Lawyers), he heads up the Institute's international tax commission. He also sits on the editorial board of quarterly *Fiscalité Internationale* and is a member of CFE Tax Advisers Europe's direct tax committee.



### Alexandre Bochu

**Tel: +33 1 40 75 29 49 / Email: [bochu@gide.com](mailto:bochu@gide.com)**

Alexandre Bochu is a Partner of Gide's tax team in Paris, which he joined in 2011. He specialises in French and international tax issues for both companies and private individuals, covering in particular M&A transactions and corporate reorganisations, funds structuring, and real estate tax.

Alexandre has significant experience regarding the taxation of corporate groups and investment structuring. He regularly acts for funds and management companies, recently advising BlackRock, Swiss Life Reim and KKR on acquisition operations and structuring property funds, as well as first-tier banks on structuring of investments.

He has also been involved in significant real estate transactions, regularly advising listed real estate companies, particularly as regards acquisitions or reorganisations.

Alexandre has also developed significant experience in financial and capital markets transactions, working on a number of IPOs in France and on Nasdaq. He is a graduate of the University of Montpellier (Magistère in corporate law and corporate law diploma (DJCE)), and also holds a certificate of specialised studies in tax law and economic law. He is fluent in French and English.

Alexandre was named "Rising Star" for tax law by *Expert Guides* and is named in the *Best Lawyers* ranking.

## Gide Loyrette Nouel A.A.R.P.I.

15 rue de Laborde, Paris (75008), France  
Tel: +33 1 40 75 60 00 / URL: [www.gide.com](http://www.gide.com)

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