TAG Tax
EUROPEAN REPORT
Edition n°1-2012

December 2012

The contents of this report has been contributed by independent law and accounting firms. Each firm is a separate entity and all are participants of TAGLaw, LLC or The International Accounting Group, LLC. (TIAG). TAGLaw, TIAG and The Appleton Group, Inc. assume no responsibility for the contents of this publication.

Content:

Country Review

- **France:**
  - **Third Finance Bill for 2012**
    A set of measures aimed to reduce the state deficit affect individuals (gift and wealth taxes) and corporations, in particular through a 3% tax surcharge on distributed profits for medium-sized and large firms.
  - **Draft Bill for 2013**
    The Draft Bill for 2013 currently being discussed includes a fiscal austerity package which mainly attempts to increase the taxable basis retained for Corporate Income Tax (herein after the "CIT") purposes, mainly by restricting the ability of companies to deduct some of their expenses.
- **Germany:**
  - **Annual Tax Bill for 2013 and changes in the Insurance Tax Act**
    Numerous measures in order to reduce loopholes partly caused by German tax courts as well as by ECJ decisions and scope of insurance tax broadened for contracts concluded with non-EU insurance companies.

EU Developments

- **ECJ: Santander Case (Cases C338/11 to C347/11) :**
  No Withholding Tax can be withheld on dividends paid to foreign UCITS when payments to national UCITS remain tax exempt

Focus

- **France-Netherlands hybrid financing arrangement**
  Through appropriate structuring, interest deducted in France might remain tax exempt in the Netherlands.

FRANCE : Third Finance Bill for 2012: New Taxes as First Step of a Plan to Reduce State Deficits

The newly elected French Government initiated the Third Draft Finance Bill for 2012, adopted on 4 July 2012. The Bill introduces a series of new tax measures some of which will come to effect immediately.

The Bill is aimed to be a first step of a plan to bring the State deficits to an acceptable level in the next five years. A second set of tax reforms has already been announced to be introduced by the end of the year.

We outline below the most important tax provisions for individuals and businesses.

---

1. Tax measures for Individuals

- **Wealth Tax**

Individuals with net taxable assets valued at 1.3 million euros or more will be subject to an exceptional tax payable by 15 November 2012 in addition to the 2012 wealth tax. The new tax will be levied at progressive rates ranging from 0.55 % for assets valued at 1.310 million and 1.80 % for assets above 16.790 million euros.

- **Gift and Estate Taxes**

The tax free allowance on donations and inheritance in direct line will be reduced from **159,325 euros to 100,000 euros**. The gap between two tax free donations will be extended from **10 to 15 years**. The yearly adjustment of the tax rates is abrogated.

- **New Taxes on Non-French Tax Residents With French Properties**

Non-French tax residents individuals will be subject to social tax levies of 15.5 % on income and gains from their French real property investments. Such income and gains are currently only subject to income tax.

2. Tax Measures Affecting Businesses

Corporate Income Tax

- **Additional CIT surtax of 3 % on Profit Distributions**

Businesses subject to CIT will be liable to a 3 % tax on their distributions. The tax is assessed on dividends but also on deemed distributions. The surtax will not impact small and medium-sized businesses, i.e. those who do not (together with related entities) exeed 2 of following ceilings:250 employees, 50 million euros turnover and BS amount 43 million euros. Investment funds (UCITS) and dividend distributions within a tax consolidated group are also excluded.

- **Neutralization of various tax optimization strategies**

The tax treatment of debt restructuring is substantially modified. **The restructuring of the net equity of a French or foreign subsidiary through forgiveness of debt or grant of subsidies** will only create a tax deduction for the parent company if the debt restructuring is motivated by commercial reasons. A debt restructuring for mere financial purposes will no longer create a tax deduction.

The tax deduction of losses in relation to the depreciation of participation shares will be limited.

- **Restriction to the Use of Tax Losses**

The use of tax losses has been restricted in several respects. In particular, a legal definition of a “change of business” that may result in the forfeiture of tax losses carried forward has been inserted in the Tax Code. Various events affecting the business such as the transfer of equipment, the variation in the workforce or the turnover will play an important role when assessing a change of the business activity.

This article has been submitted by Pascal Schultze who is responsible for its content. For more information, contact:

GGV Grützmacher / Gravert / Viegener
Pascal Schultze, Avocat à la Cour
Mail : schultze@gg-v.net
Pascal Ngatsing, Avocat à la Cour
Mail : ngatsing@gg-v.net

TAG TAX
EUROPEAN REPORT

TAG Tax GROUP
A GLOBAL ALLIANCE OF TAX LAWYERS & ACCOUNTANTS

Country Review: FRANCE

FRANCE : The Draft Bill for 2013 currently being discussed includes a fiscal austerity package which mainly attempts to increase the taxable basis retained for Corporate Income Tax (herein after the "CIT") purposes, mainly by restricting the ability of companies to deduct some of their expenses.

Regarding individuals, the Draft Bill provides several measures which essentially aim at increasing the tax burden of wealthiest people.

Further tightening of tax deduction rules

1. Main Corporate Income Tax Amendments

1.1 Tax losses – further tightening of the rules

Based on existing tax rules, tax losses in excess of €1m may be carried forward up to an amount equal to 60% of the companies' taxable income.

For tax losses recognized on fiscal years (herein after "**FY**") ending as from the 31 December 2012, it is proposed to decrease the 60% ceiling to 50%. As a result, without prejudice of the €1m rebate mentioned above, companies subject to French CIT will remain taxable on at least 50% of their taxable income (instead of 40% before). This limitation should apply for FY ending on 31 December 2012.

1.2 Financial expenses

For FY starting on 1st January 2012, it is proposed to cap the deductibility of financial charges at 85% of their net amount. The 85% rate is transitional and will be increased up to 75% for FY starting as from 1st January 2014. The limitation does not apply if the annual amount of financial charges incurred by the taxpayer is lower than €3m.

Based on the current drafting of the Draft Bill, the definition of financial charges is wide and notably includes:

- remunerations paid to lenders (bank and related party loans) for making funds available to the borrowers;
- financial lease expenses; and
- rents payable to related parties.

These rules apply in addition to thin capitalization rules.

For tax consolidated group, the limitation is based on the net financial expenses incurred by each member of the tax group and deriving from financing granted by companies outside of the tax consolidated group. The €3m threshold is assessed at the tax group's level (i.e. the limitation does not apply where the net financial expenses incurred by the group is lower than €3m).

1.3 Increasing the tax burden: additional burden for the capital gain participation-exemption regime

The current participation exemption regime provides for an exemption of capital gains triggered upon disposal of eligible securities, but for a 10% portion assessed on the net capital gain earned by the taxpayer in respect of a given FY (the so-called "Quote Part de Frais et Charges" herein after the "**QPFC**").

The proposed amendment of the participation exemption regime aims at changing the computation basis of the QPFC. For FY starting on 1st January 2013, the QPFC will be computed based on the gross amount of the capital gain generated by the taxpayer.

1.4 Extension of the extraordinary contribution on CIT applicable to biggest companies

The 5% additional surtax applicable to companies which turnover exceeds 250m€ introduced by the amended Finance Bill for 2011 for fiscal years ending between the 31 December 2011 and 30 December 2013 is extended to FY ending on 30 December 2015.

2. Changes which impact individuals

2.1 Reminder

As a reminder, an extraordinary surtax on High Income (herein after the "**ESHI**") has been introduced by the Amended finance law for 2012.

This extraordinary surtax amounts to:

- 3% if the individual's taxable income exceeds 250k€ (500k€ for married couples)
- 4% if the individual's taxable income exceeds 500k€ (1m€ for married couples)

This extraordinary surtax applies to all type of income

2.2 General amendments made to the structure of Individual Income Taxation (IIT)

- **Increase of the higher marginal tax bracket of IIT**

For income earned during 2012, the higher marginal tax bracket of IIT will be increased to 45%. This rate will apply to the portion of income exceeding €150k per half part. This marginal rate increased by the ESHI, may result in an overall ITT rate of 49%.

- **Creation of a temporary tax on very high professional income**

A temporary tax, intended to apply for income earned during 2012 and 2013, amounting to 18% would apply on the portion of professional income exceeding €1m per beneficiary. This tax will not be applicable on dividends, interest or capital gains and will neither apply to income derived from carried interest units/shares.

This additional taxation added to (i) the 4% ESHI; (ii) the 45% IIT marginal rate and (iii) the 8% social contributions on professional income would result in **an overall taxation of professional income of 75%.**

Limitation of the maximum amount of tax credits

Tax credits resulting from the tax niches (previously capped at 18k€ plus 4% of the individual's taxable income) will, as from 2013, be capped at 10k€. Some specific regimes are still outside the scope of this limitation (Malraux, SOFICA, Scellier acquired before 1st January 2013).

Likewise, the tax benefits resulting from the application of the dependent's allowance will now be capped at €2000.

2.3 Taxation of passive income

- **Application of the progressive scale of tax on passive income (dividends/interest/capital gains)**

✓ **Dividends**

Dividends will now be subject to the progressive scale of tax. However, the 40% rebate will still be available resulting in an effective taxation of only 60% of the dividends received.

The ITT will now be payable in two steps:

- A 21% prepayment will be withheld upfront.
- This prepayment will be offsetable against the ITT payable in respect of the year during which the prepayment was made or refund if the prepayment exceeds the overall ITT

The taxpayers which taxable income is lower than 50k€ (single) or 75k€ (for married couples) may elect not to pay the 21% prepayment and to postpone the capital gain taxation to the actual IIT payment.

✓ **Interest payments**

Interest received will now be subject to the progressive scale of tax.

Likewise dividends, the ITT will now be payable in two steps:

- A 24% prepayment will be withheld upfront. This prepayment will be offsetable against the ITT payable in respect of the year during which the prepayment was made or refund if the prepayment exceeds the overall ITT.
- The taxpayers which taxable income is lower than 25k€ (single) or 50k€ (for married couples) may elect not to pay the 24% prepayment and to postpone the capital gain taxation to the actual IIT payment.

- **Capital gains**

Pursuant to the new previsions, capital gains should now be subject to a taxation at the progressive scale that could result in an overall tax rate of 62% consisting in:

- 45% (marginal ITT rate)
- 15,5% (social contributions)
- 4% (ESHI)

A portion of social contributions being deductible, the overall tax rate would roughly amount to 62%.

Exception: a lump sum taxation of 24% will still apply (overall tax rate of 39,5% and 43,5% including the surtax on high income) to capital gains earned during 2012.

A specific rebate should nevertheless be available depending the holding period of the securities:

- **For shareholders having directors functions in the company.**

The 19% rate is maintained (overall taxation of 34,5% including social contributions) under certain provisions.

- **Carried interest**

Capital gain still benefit from a rebate based on the holding period.

They are not subject to the 18% temporary surtax applicable on professional income.

- **Roll over regime and exemption subject to the reemployment of the capital gain earned**

Those tax regime are maintained subject to the re-use of at least 50% of the gain earned upon disposal of the securities within a 24-month period.

The exemption is available up to the actual reemployment of the gain realized.

- **Stock options and free allocation of shares**

The gain triggered upon vesting of the stock option rights or free gain of shares will now be treated as a salary for ITT purposes.

- The individual has nevertheless the possibility to offset capital losses realized on the disposal of securities has against gains will not earned upon vesting
- The compliance with an additional holding period pursuant to the specific provisions of a stock options/free shares plan does no longer entitle to a reduced ITT rate (cancellation of the 18% and 30% reduced rates previously available). Conversely, the compliance with this additional holding period allows the taxpayer to benefit from the same level of social contributions (25,5%).
- The gain deriving from the stock options/free allocation of shares is subject to the temporary tax on very high professional income (18%)

2.4 Net wealth tax (NWT)

- **A new progressive scale going from 0 to 1,5% will be introduced:**

The triggering event of net wealth tax is, from now on, the ownership, of assets which net asset value amounts to 800k€. A 1m€ rebate is then applicable. The aggregate amount of ITT & NWT should not exceed 75% of the taxable income for NWT purposes – the NWT paid in excess could be refunded.

This article has been submitted by Fabrice Rymarz who is responsible for its content. For more information, contact:

Racine
Fabrice Rymarz, Avocat à la Cour
Mail : frymarz@racine.eu

Country Review: GERMANY

GERMANY : Finance Bill for 2013 and amendment of the German Insurance Tax Act: Multitudinous changes

The German government initiated on 23 May 2012 the Finance Bill for 2013. The senate has proposed a series of mainly tax increasing measures on 6 July 2012. Besides the changes in the EU-administrative assistance the draft bill introduces a series of new tax measures some of which will come to effect immediately. In addition, the German Insurance Tax Act will be amended in order to close loopholes for multinationals groups.

We outline below the most important tax provisions for individuals and businesses.

1. Tax measures for Individuals

- **Income Tax**

The progressive income tax rates up to 42 % (or 45 % above 250.731 euros) are unchanged since 2010. The proposal to slightly reduce the rates for lower income starting 2013 is currently at the conciliation committee.

- **Donation and Inheritance Tax**

The senate proposed to exclude qualified shareholdings in companies having significant cash from the donation and inheritance exemption. This measure would be effective for events after 26 October 2012. However, several court cases are pending whether the donation and inheritance tax is since 2009 constitutional.

2. Tax Measures Affecting Businesses

Insurance tax

Multinational groups could legally avoid German insurance tax for certain risks when the contract was concluded between a non-EU insurance company and a non-German entity in which Germany was only a beneficiary. Based upon draft legislation, insurance tax is applicable from 2013 onwards if the policy refers (in-) directly to a company, permanent establishment or other facility in Germany.

Corporate Income Tax

- **Restriction to the Use of Tax Losses**

The retroactive use of tax losses might be also restricted for mergers of a profit-making entity into an entity with NOLs. However, the provisions for the forfeiture of losses are currently pending at the German Constitutional Court.

- **95 % CIT exemption on portfolio shareholdings**

The European Court of Justice ruled on 20 October 2011 (Case C-284/09) that the withholding tax imposed on German-sourced dividends paid to foreign corporations with portfolio investment below 10 % violated EU law as German corporations had 95 % participation exemption. Instead of applying the WHT exemption going forward, Germany requires right now substance in the foreign EU-corporation. The senate proposed to retroactively abolish the participation exemption for German corporations for fiscal years starting in 2012 leading to a double taxation for CIT purposes. In addition, the short-term trading of investments shall only be qualified as taxable if this is done by banks or financial institutions excluding thereby holding entities.

- **Neutralization of various tax optimization strategies**

Non-German Dividends shall only benefit from the 95 % participation exemption resp. from the 25 % preferred income tax rate for individuals if the payment is not tax deductible at source (anti-avoidance rule regarding of hybrid instruments); this rule shall be adopted if a way can be found how to prove the treatment at source. In addition, the subject-to-tax clauses regarding taxation of foreign income might be amended as well.

- **German Transfer Pricing rules**

For crossborder activities, Germany will follow the updated OECD model tax treaty thereby partnerships as well as permanent establishments are deemed as separate and independent. A double tax treaty might only lead to a lower transfer price adjustment if the taxpayer can prove the taxation in other state.

This article has been submitted by Volker Runtemund who is responsible for its content. For more information, contact:

GGV Grützmacher / Gravert / Viegener
Volker Runtemund, Rechtsanwalt, Steuerberater
Mail : runtemund@gg-v.de

TAG TAX
EUROPEAN REPORT

EU DEVELOPMENTS

French Withholding Tax on Dividend Payments to Foreign Funds is not EU Law Compliant

In a recent decision "Santander and others", the European Court of Justice (ECJ) ruled that the withholding tax imposed on French sourced dividends paid to foreign UCITS (funds) violated EU law (Cases C338/11 to C347/11).

Under current French tax legislation, payment of French- sourced dividends are subject to a withholding tax of 30 % (formerly 25 %) when they are paid to foreign funds, whereas similar dividend payments to French resident funds are tax exempt.

Several foreign funds held this legislation to be discriminatory. The cases were submitted to the French tax court which referred the question for preliminary ruling to the ECJ.

To justify the withholding tax, the French Government first argued that the withholding tax is a mere indirect taxation of the investors as the involvement of the UCITS is tax neutral. According to the French State account must be taken of the situation of the investors and not of the funds.

The ECJ Court pointed out that the tax exemption of French funds was dependent neither on a distribution of the dividends to the investors nor on an effective taxation of those investors on the income distributed to them. The arguments of the French Government did not reveal any objective difference in the situation of French and foreign funds that could justify a different tax treatment.

The French Government also put forward several grounds to justify the different treatment (need to safeguard balanced allocation of power to tax, need to guarantee the effectiveness of fiscal supervision and the preservation of the coherence of the tax system).

None of those grounds was however accepted by the Court which answered to the request for preliminary ruling as follows:

"Articles 63 TFEU and 65 TFEU must be interpreted as precluding the legislation of a Member State which provides for the taxation, by means of withholding tax, of nationally-sourced dividends when they are received by undertakings for collective investments in transferable securities resident in another State, whereas such dividends are exempt from tax when received by undertakings for collective investments in transferable securities resident in the Member State in question".

Foreign funds that have suffered French withholding tax on dividend payments may rely on the ECJ Ruling to claim the refund of any French withholding tax paid since January 1st, 2009. Note that claims are not restricted to funds established in EU member states as, according to the ECJ, third country residents are also protected by the freedom of capital movement.

Note:

The Tax Team of GGV Paris is involved in numerous pending refund claims for several foreign funds claims and acted as adviser in one of the ten cases submitted to the ECJ. Our Tax team may assist you and or your clients in claiming the refund of French withholding tax on dividend payments.

This article has been submitted by Pascal Schultze which is responsible for its content. For more information, contact:

GGV Grützmacher / Gravert / Viegener
Pascal Schultze, Avocat à la Cour
Mail : schultze@gg-v.net

France-Netherlands Hybrid Financing

The concept of Hybrid Financing has been developed to enjoy the positive factors of both equity and debt. In a multinational context, hybrid financing can also become an ideal tax planning tool.

Economic Purpose of Hybrid Financing

If someone is holding shares of a particular company, then it is obvious that the person would enjoy some special rights regarding the cash flow and the assets. At the same time, the shareholder of the company is also entitled to play an important role while making business decisions.

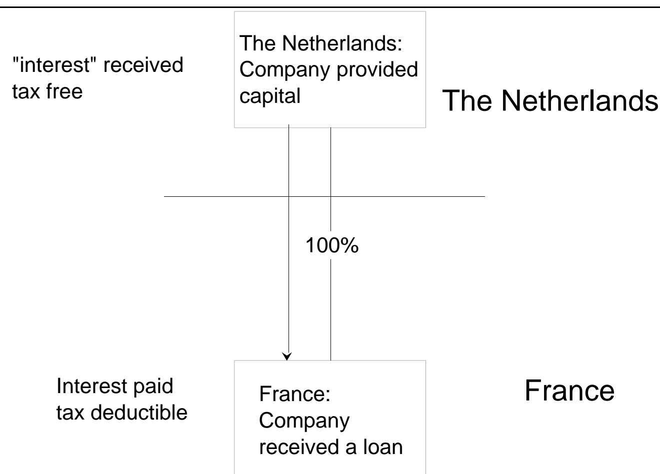
Debt instruments are totally different from equities. These instruments are used by to arrange a kind of loan for the development of the company. The debt instruments do not provide the right to take part in the management of the particular company.

Tax purpose of Hybrid Financing

Tax wise, within the European Union, dividends can be received (almost) tax free under the participation exemption assuming all the conditions are met. On the other hand the company paying out dividends is not entitled to deduct the paid out dividend from its taxable income.

The company paying out the interest on received loans is generally spoken entitled to deduct the paid interest from his taxable income and the company receiving the interest should report this as taxable income.

By combining several aspects of both instruments in combination with (small) distinctions in corporate income tax law in different tax jurisdictions, it is possible to qualify the paid “interest” as tax deductible but on the receiving part to qualify the received amounts as dividend.



By doing this the structure will result in tax deductible interest that can be received tax free by the other party.

Under specified circumstances the loan provided to the French subsidiary will be regarded as a so-called profit-sharing loan. Based on that qualification, every result coming from that loan will be regarded to fall under the scope of the participation exemption. In case the French subsidiary is not able to repay the provided loan, the write-off this loan will also not be tax deductible on the level of the corporation in The Netherlands.

By precisely drafting the loan agreement between The Netherlands and French company the interest paid by the French company is tax deductible in France (only the general limitations set by the French tax code for intercompany loans).

As the described structure is fully legitimate it is possible to obtain upfront from the Dutch tax authorities in writing the exact tax consequences of the structure.

The benefits of this structure are:

- No special off-shore status needed
- Full access to tax treaties
- Upfront approval from Dutch tax authorities possible
- Interest tax deductible
- Interest received not taxed

The preceding article only provides a brief explanation of the possible use of hybrid financing between The Netherlands and France. Before setting up structures like this we strongly recommend contacting your tax adviser.

This article has been submitted by Barry Nijkamp from Van Elderen tax consultants, who is responsible for its content.

For more information, contact:
Barry Nijkamp
Mail : b.nijkamp@vanelderen.nl

The information in this report is for informational purposes only and is intended for use by members of TAGLaw and TIAG only and is not intended to substitute for obtaining accounting, tax or other advice from a qualified professional. Any U.S. federal tax advice contained in this report is not intended to be used for the purpose of avoiding penalties under U.S. federal tax law. Readers are advised not to act on the information in this report without seeking the services of a professional.

Coordinator of this report: GGV Grützmacher / Gravert / Viegener, Paris, M. Pascal Schultze, schultze@gg-v.net