FRANCE STRENGTHENS ANTI-TAX HAVEN ARSENAL

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To Our Clients and Friends:

Following the G20 London Summit in April 2009, a number of countries have adopted rules to combat tax evasion and encourage jurisdictions to adopt the standards of transparency and exchange of information developed by the OECD. As part of the amended finance bill for 2009, the French government announced on November 16, 2009, a series of tax measures which would reinforce France's already strong arsenal of anti-tax haven rules. These new measures, which are to be examined by the French parliament during the coming weeks, would heavily penalize transactions involving "uncooperative States and territories," a new concept in French tax law. It is therefore crucial to understand the scope of these new rules and their potential effects.

INTRODUCTION OF THE NOTION OF "UNCOOPERATIVE STATES AND TERRITORIES" IN THE FRENCH TAX CODE

This notion would be the cornerstone of the new measures. Uncooperative States and territories would be defined as States or territories (i) which are not members of the European Community and (ii) which, amongst those States or territories surveyed by the OECD's Global Forum on Transparency and Exchange of Information (the "OECD's Global Forum"), have not signed an administrative assistance convention allowing the exchange of any information necessary for the enforcement of tax legislation with at least 12 States or territories.

A list of uncooperative States and territories will be drawn up by the Finance Ministry and updated each year, to account for newly signed conventions and assess the compliance of States or territories with the exchange of information procedures. The evaluation of compliance will be based on (i) an assessment made by France of the actual outcome of the implementation of exchange of information procedures and (ii) an assessment by the OECD's Global Forum of the quality of the exchange of information in tax matters.

The list of uncooperative States and territories has not yet been disclosed. It can be expected that this list should generally be similar to the OECD's "gray list" of jurisdictions that have committed to the internationally agreed tax standards but have not yet substantially implemented them. If this is the case, Switzerland, Singapore, the Cayman Islands, Bermuda, the British Virgin Islands, Jersey, Guernsey and the Isle of Man, would not be included in the French government's list, as these jurisdictions have entered into at least 12

tax information exchange agreements based on the model developed by the OECD Global Forum, including one with France. This would, however, need to be confirmed.

INCREASED WITHHOLDING TAX ON FRENCH-SOURCE INCOME

A new withholding tax at the rate of 50% will be introduced on dividends, interest and royalties, as well as on payments in consideration for the provision of services, paid to an account held in an uncooperative State or territory, irrespective of where the beneficiary is located.

Regarding interest payments, the new rules would simplify the existing withholding tax regime on interest, but restrict the scope of available exemptions. Currently, interest payments by a French borrower to a non-French tax resident lender are subject to an 18% withholding tax. Pursuant to a very wide domestic withholding tax exemption, interest paid pursuant to a documented loan agreement or under a bond issue are generally exempt from withholding tax, even when the beneficiary does not benefit from a tax treaty. The new rules would generally exempt French-source interest from withholding tax, except where the interest is paid to a beneficiary or an account in an uncooperative State or territory, in which case a 50% withholding tax would be levied.

AMENDMENT TO THE DOMESTIC PARENT-SUBSIDIARY REGIME

French companies are generally exempt from corporate tax on at least 95% of dividends received from subsidiaries, subject to various conditions including a threshold of 5% ownership and a minimum holding period of two years. This regime, which applies to holdings in French and non-French entities, is not subject to a minimum level of corporate tax imposed on the subsidiary.

Effective January 1, 2011, dividends received from a legal entity situated in an uncooperative State or territory would be excluded from the parent-subsidiary regime. In certain cases, this exclusion would indirectly result in the French interest holder being denied the possibility to benefit from an exemption of 95% of the capital gains on the sale of holdings in a foreign entity.

NON-DEDUCTIBILITY OF CERTAIN EXPENSES

Effective January 1, 2011, certain expenses (interest, royalties, payments for services) paid to entities or individuals in an uncooperative State or territory would not be deductible for tax purposes, unless the taxpayer demonstrates that such payments are being made in connection with a transaction whose main purpose and effect is not to allow the localization of these payments in a uncooperative jurisdiction.

REINFORCEMENT OF EXISTING CFC LEGISLATIONS

Article 209B of the French Tax Code, which applies to French corporations holding 50% or more of a foreign entity which benefits from a privileged tax regime, would be modified in order to tighten safe harbor rules when the entity is in an uncooperative State or territory.

Modifications to Article 123 bis of the French Tax Code, which concerns French individuals holding 10% or more of a foreign tax-privileged entity, would include a presumption that the 10% threshold would be passed when the foreign entity is in an uncooperative State or territory and the creation of a safe harbor rule to exclude EU entities from the scope of this article, except in cases where an artificial arrangement is set up to circumvent French tax law.

Please feel free to contact us with any questions.

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