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CLIENT UPDATE

FIRST SERIES OF TAX INCREASES BY THE NEWLY-ELECTED FRENCH PRESIDENT

July 9, 2012

To Our Clients and Friends:

On July 4, 2012, the new French government unveiled the first part of its tax reforms by including them in the second amending finance bill for 2012. Although most of the major reforms intended by the French government (such as the creation of a 75% tax on individual income exceeding €1 million, increased taxation of financial income of individuals and further limits on interest deductions by companies) will be included in the 2013 budget, to be debated this autumn, the amending finance bill contains several important measures which are summarized below.

Cancellation of the Withholding Tax on Dividends Paid to Foreign Mutual Funds and Creation of a Tax on Dividend Distributions. The withholding tax applicable to dividends paid to non-French mutual funds—which the European Union Court of Justice recently found to be discriminatory—will be abolished as of the enactment date of the law. To compensate for the loss in tax revenue, a tax equal to 3% of distributed dividends will now be applied to companies subject to French corporate taxation. It will not apply to distributions made by investment funds, or to distributions to parent companies holding a minimum 10% shareholding. Small and medium-sized companies will also not be liable for this tax.

Tightening of CFC (Controlled Foreign Corporations) Provisions. French CFC rules are currently applicable to a non-EU subsidiary when such subsidiary benefits from privileged taxation (i.e., when the tax burden of such a subsidiary is less than 50% of the tax burden that would have applied had it been taxable in France) and earns passive income exceeding a certain threshold, unless the French shareholder demonstrates that the subsidiary has a non-tax primary purpose. CFC rules do not apply within the EU, except in cases of artificial arrangements set up to circumvent French tax law. The new rules will shift the burden of proof to the French shareholder of a non-EU subsidiary as of December 31, 2012. Irrespective of the level of passive income of the subsidiary, CFC rules will apply unless the French shareholder establishes that the subsidiary has a non-tax primary purpose (such condition will be deemed to be met where the subsidiary is carrying out an industrial or commercial activity in its territory).

Disallowance of Deduction of Certain Debt Waivers and Subsidies; Taxation of Certain Capital Contributions. Currently, debt waivers or subsidies of a financial nature granted to subsidiaries with a negative net asset position are, under certain conditions, deductible by the parent company for tax purposes. This allowance will be cancelled for fiscal years ending as of July 4, 2012. Similarly, capital contributions to loss-making companies, remunerated with shares having a value lower than the amount of the contribution, will be taxable for the beneficiary.

Restrictions on Tax Loss Carry-Forwards. The conditions under which a company may transfer loss carry-forwards to another company as part of a reorganization (merger or asset contribution) will be narrowed. In particular, the beneficiary of the transfer will now be required to maintain the transferor's lines of business and employment for a minimum of three years. Additionally, tax loss carry-forwards will be denied when a company changes its line of business and reduces its means of production or its employment.

Increase of the Financial Transactions Tax ("FTT"). The FTT was introduced in March 2012 by the first amending finance law for 2012. The FTT will apply, as of August 1, 2012, to the purchase of equity and quasi-equity securities issued by major French listed companies. The rate of the FTT was initially set at 0.1%, but will now be raised to 0.2%.

Creation of an Exceptional Contribution Payable by Certain Financial Institutions. An annual "systemic risk tax" of 0.25% on a bank or financial institution's minimum regulatory capital requirement has been in effect since January 1, 2011. Banks and financial institutions will now be required to pay an exceptional contribution in 2012 of an amount equal to the value of their 2012 systemic risk taxes.

Increase of Taxes on Stock Options and Free Shares. Currently, a 14% contribution is due by employers on the grant of stock options and free shares, and an 8% contribution is due by the beneficiaries at the date of sale of the shares (in addition to taxes on capital gains and social contributions, for a total of up to 55.5%). The tax reform increases the employer contribution to 30% and the employee contribution to 10%. Accordingly, stock options and free share grants, which were already heavily taxed, will likely lose all attractiveness for tax purposes.

Increase of Wealth Tax. A wealth tax is due by individuals (French residents, as well as non-French residents in respect of their French-based assets) whose taxable assets are worth more than €1.3 million. A wealth tax reduction, enacted in 2011, will apply for the first time in 2012. However, an exceptional contribution will be due in respect of wealth in 2012, which will result in a similar wealth tax burden for taxpayers as in the years preceding the 2011 enactments. The constitutionality of this wealth tax increase is already questioned by some authors. The new government intends to reform the wealth tax system as part of the 2013 budget. This new regime will be applicable as from 2013.

Increase in Taxation of Real Estate Profits of Foreign Residents. French real estate income and gains by non-resident individuals are generally subject to personal income tax in France. Unlike for French resident taxpayers, such gains are currently not subject to social contributions. Social contributions, currently totaling 15.5%, will now apply to this income and these gains.

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Please do not hesitate to contact us if you have any questions.

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