COMMENTARY
OCTOBER 2018

Draft French Finance Bill for 2019 Reveals Significant Tax Amendments

IN SHORT

The Situation: The first draft of the French government's finance bill for 2019 contains several significant amendments likely to affect key French tax regimes, as well as past and current transactions.

The Development: The most significant changes relate to the interest deduction limitations, the participation-exemption regimes for dividends and capital gains, the consolidation regime, the favorable rate for IP assets, and the implementation of a general anti-abuse provision.

Looking Ahead: The new provisions should apply to fiscal years open as from January 1, 2019, subject to potential changes during the upcoming parliamentary debates.

Interest Deduction Limitations Revamped

- **New General Limitation**: Tax deduction of "net interest expenses," a term broadly defined in the current draft, would be capped at the higher of €3 million or 30 percent of adjusted EBITDA.
- **Thin-Cap Limitation for Related-Party Debt**: In the case of thin capitalization (i.e., debt-to-equity ratio exceeding 1.5), deduction of global net interest expenses would be capped at the higher of €1 million or 10 percent of adjusted EBITDA.
- **Carryforward**: Nondeductible interest expenses would be carried forward indefinitely, and unused EBITDA would be carried forward for five years.
- **Safe Harbor**: 75 percent of nondeductible interest expenses would be deductible, provided that the equity-to-asset ratio of the taxpayer is at least equal to the same ratio of its consolidated group.
- **Cleanup of Current Limitations**: The Carrez Amendment (for debt incurred to acquire a participation), the *rabot* (25 percent haircut on net interest expenses), and the current thin-cap ratios would be repealed, but the published/market-rate limitations would remain unaffected.

Participation-Exemption Regime Made More Favorable

Subject to certain conditions, the taxable portion would be decreased from 5 to 1 percent for dividends, and from 12 to 5 percent for capital gains.

French Tax Consolidation Regime Made Less Favorable

Certain intragroup transactions would no longer be neutralized.

IP Rights Favorable Rate Narrowed

In accordance with the Organisation for Economic Co-operation and Development's nexus approach, the 15 percent rate would be applicable only where R&D expenses are incurred in France.

Implementation of a General Anti-Avoidance Rule

In accordance with the Anti-Tax Avoidance Directive, the tax authorities would be allowed to disregard any given transaction by demonstrating that: (i) its main purpose or one of its main purposes is to obtain a tax benefit, which is contrary to the intention of the law; and (ii) it has not been implemented for valid commercial reasons which reflect an actual economic goal. This new rule is wider than the current abuse of law theory, which would remain unaffected (including its exclusive test and increased penalties).

Repeal of the Sovereign Credit Default Swap Tax

The specific 0.01 percent tax targeting certain credit default swaps relating to the default of an EU Member State would be repealed.

THREE KEY TAKEAWAYS

1. Key French corporate tax regimes would be significantly affected by the provisions contained in the draft finance bill for 2019, which will be heavily discussed before the Parliament until the end of the year.

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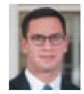
2. The leverage of past and current M&A, leveraged buyout, and real estate transactions should be monitored in order to anticipate any adverse consequences.

3. Going forward, the implementation of a general anti-avoidance rule and the introduction of the nexus approach for IP rights could warrant a heightened level of scrutiny for certain businesses and transactions.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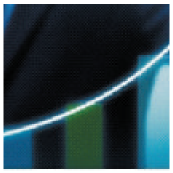
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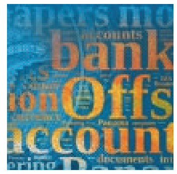

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