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RECENT DEVELOPMENTS IN INTERNATIONAL TAXATION SESSION

FRANCE

Nathalie Sénéchault

nsenechault@jonesday.com

Jones Day
120 rue du Faubourg Saint-Honoré
75008 Paris
France

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1. RECENT LEGISLATIVE DEVELOPMENTS OF INTEREST

1.1 New thin cap rules

1.1.1 The previous regime

Pursuant to Articles 39-1-3° and 212 of the French Tax Code, interest paid by a company to its direct shareholder was tax deductible provided that: (i) the share capital was fully paid up; (ii) the interest rate did not exceed the average floating interest rate on bank loans with a maturity date exceeding two years; and (iii) the amount lent by any shareholder who in law or de facto controls the borrower (or shareholders owning more than 50% of the financial rights or voting rights in the borrower) did not exceed 150% of the share capital of the French subsidiary.

1.1.2 The New regime applicable as from 1 January 2007

New thin capitalization rules were adopted on December 20, 2005 (Article 113 of the Finance Law for 2006, modifying Article 212 of the French Tax Code (the "FTC")). For financial years beginning on or after 1 January 2007, new thin capitalization rules may apply where the lender and the borrower are "related" and regardless of whether the lender is a parent company or may be established in a "friendly" jurisdiction.

Within the meaning of these new provisions, the lender and the borrower are "related" if the borrower controls the lender or the lender controls the borrower or a third person controls both the lender and the borrower. For these purposes, "control" means either the holding of a majority interest in terms of equity or voting rights (*de jure* control) or the exercising of the decision making power in another company (de facto control). Also control may be direct or indirect, through interposed entities. For instance, grandparent or sister companies would be viewed as related parties.

Where a related party situation exits, the following rules apply.

1) First, the maximum rate of interest allowed is the higher of the maximum rate under 39-1-3 of the FTC (the interest rate shall not exceed the annual average market interest rate applied by banking institutions under floating-rate corporate loans having an initial maturity exceeding two years, as published from time to time by the French tax authorities - in 2006) and a “market rate” (i.e., the rate that the borrowing company could have negotiated with an unrelated financial institution bank for a similar borrowing). Interest paid in excess of this rate is disallowed finally (i.e., no carry forward is possible). Disallowed interest is recast into income distributed to the lender (and may be subject to dividend withholding tax).

2) Second, interest paid in accordance with the limit set forth in 1. during a given financial year should be compared to the three following amounts:

(i) *Debt:equity ratio:* The interest computed at the applicable rate by reference to an interest bearing principal amount equal to 1.5 times the amount of the borrower’s net equity (at the borrower’s option, the net equity component may refer to the amount at the opening date or at the closing date of the financial year in question).

(ii) *Interest coverage ratio:* 25% of the borrower’s adjusted operating profits before taxes (AOP –*résultat courant avant impôt*) for the financial year at stake.

The operating profits before taxes should be increased by (x) the amount of interest paid to related parties, (y) the amount of amortization allowances and (z) the fraction of financial lease rentals taken into account for purposes of determining the leased asset's purchase price at termination of the lease.

(iii) *Net interest received from related parties*: the amount of interest received by the borrower in respect of funds lent to related parties.

If any of these limits is not exceeded, the interest paid to the related party is fully allowable.

If all the three limits are exceeded, interest is deductible for the financial year in question only to the extent of the highest limit (or, if higher, €150,000). Any excess interest may be carried forward onto the next financial year and subsequent years (subject to limitations, including the application of a 5% discount every year to the outstanding amount of interest brought forward).

The disallowed fraction of interest paid to non-resident related parties is not deemed distributed income and thus may not be subject to dividend withholding tax.

Several exemptions/ safe harbor provisions may apply. In particular, the rules summarized at 2. above are not applied in respect of sums borrowed by certain persons (e.g., financial institutions) or for the purposes of certain transactions (e.g., cash pooling arrangements, acquisition of assets with a view to leasing them under a financial lease). Similarly, thin capitalization rules do not apply if the borrower proves that its debt-to-equity ratio (including debt from third parties) is lower than the consolidated debt-to-equity ratio of the group to which it belongs.

For purposes of this safe harbor provision, consolidation refers to accounting (vs. tax) consolidation.

Special rules are provided in relation to tax-consolidated groups. In such a group, the aggregate amount of the interest that is disallowed (i.e., the deduction of which is deferred) pursuant to the rules above in a given financial year at the level of the individual group members (a) is transferred to the group parent company (i.e., it may not be carried forward by the individual group members) and (b) may be deducted (in the same year, with a carry-forward possibility to subsequent years, subject to limitations similar to those discussed above) from the group's aggregate taxable income. The amount that may be deducted at group level pursuant to the foregoing is capped at (1) the excess of the aggregate nondeductible interest generated by the individual group members over (2) the difference between (x) the aggregate amount of interest paid by all the tax group members to related parties other than members of the tax group (subject to adjustments for pre-tax grouping deferred interest) and (y) 25% of the aggregate AOPs of all the tax group members (in which each individual group member's AOP is adjusted by the amount of interest paid to related party which are not member of the tax group only), adjusted for intra-tax group dividends.

1.2. The concept of *Fiducie* has been introduced in French law (Law N° 2007-211 of 19 February 2007)

The *Fiducie* is an operation by which one or more persons (*constituants*) transfer assets or rights to one or more persons (*fiduciaries*) who own these assets and rights in a separate patrimony from their own assets and manage these assets or rights according to the provisions of the *fiducie* contract for the benefit of one or more persons (*bénéficiares*). Three limitations apply to the *fiducie*: (i) the *fiducie* may only be constituted by companies subject to corporate income tax (it is not available to individuals); (ii) no donation can be performed by means of a *fiducie*; and (iii) the exercise of the *fiduciaire* functions is reserved to certain financial institutions (credit institutions and insurance companies) that are subject to reporting obligations.

Both *constituant* and *fiduciaire* must be residents of the EC or in a country with which France has concluded an assistance agreement against tax fraud or avoidance.

The *fiducie* is fiscally neutral so that the constituent remains the owner of the assets and rights for tax purposes. The exceptions to the transparency are limited to cases where the tax is imposed on an autonomous activity (VAT and business tax) that is constituted within the assets held in *fiducie*.

Contributions of assets to the *fiducie* do not trigger the taxation of latent capital gains; capital gains are however taxable upon the transfer of the *fiducie* contract by the *constituant* or the disposal of the assets by the *fiduciaire*.

1.3. New official guidelines on the recognition of the transparency principle for foreign partnerships

The French tax administration issued on 29 March 2007 official guidelines in respect of the new approach towards foreign partnerships.

Before these new guidelines, the French tax administration applied the translucency approach to foreign partnerships under which the partnership is the tax subject but the tax is paid by the partners on a proportional basis. For treaty purposes, the French administration first determined whether or not the foreign partnership qualified as a resident for treaty purposes by reference to French domestic law. For this purpose, the foreign entity was compared to French entities by reference to company law criteria (e.g. limited liability of the partners). The foreign entity was then treated for tax purposes similarly to the comparable French entity. For treaty purposes, a company qualifies as a resident only if it is subject to tax without being exempt. Accordingly, to the extent a foreign partnership is a transparent entity for tax purposes in the country of incorporation, France denied the application of the treaty to such partnership.

The guidelines published on 29 March 2007 introduce under certain conditions the recognition of the transparency approach for French source passive income derived by foreign and French resident partners of a foreign partnership. For the purpose of the guidelines, foreign partnerships are defined as foreign entities treated as transparent for tax purposes in the country where they are established. If the transparency approach applies, French source passive income derived by a foreign partner will be subject to the reduced withholding tax rate provided in the treaty between France and the country of residence of the foreign partner. The application of the transparency approach is limited to French source passive income (i.e. dividends, interest and royalties) derived through a foreign partnership.

1.3 Official guidelines on implications of ECJ Denkavit case on French dividend withholding tax published

On May 2007, the French tax administration published guidelines on the implications of the ECJ decision case C-170/05 Denkavit delivered on 14 December 2006 (please see below § 2.5 for a description of the Denkavit case). According to the guidelines, dividends distributed by a French subsidiary to a parent company established in the European economic area will be exempt from French withholding tax from 1 January 2007 provided that (i) the parent company holds at least 5% in the capital of the French subsidiary, (ii) the parent company is unable to set off the French withholding tax because the parent company benefits from a participation exemption regime in its country of residence and (iii) the transaction does not constitute an artificial arrangement.

The French tax administration published a second guideline on 12 July 2007 which lays down the formal aspects pertaining to the exemption from French withholding tax on dividends paid by French companies to Europe Economic Area parent companies. The withholding tax emption applies to companies and other entities registered and effectively managed in the Europe Economic Area (except Liechtenstein) provided they meet the requirements of the French participation exemption set out in Articles 145 and 216 of the FTC (this means that eligible entities must be subject in whole or in part in their country of residence to standard corporate income tax and must hold at least 5% in the capital of the French subsidiary for a 2-year period. The notion of dividends only covers regular distributions of profits and reserves. To benefit from the exemption the EEA parent company must be unable to set off the applicable French withholding tax. Upon request from the French tax administration, French distributing companies must provide a certificate under which the EEA parent company commits to meet all the conditions for the exemption. In addition, the parent company and the distributing company must be able to prove that the transaction does not constitute an artificial arrangement.

1.4. Official guidelines on CFC legislation

On 16 January 2007, the French tax administration published a lengthy Guideline (4H-1-07) on controlled foreign company (CFC) rules.

The French CFC rules set out in Art. 209B of the FTC were substantially amended by Art. 104 of the Finance Law (Law 2004-1484 of 30 December 2004) and by Decree 2006-1309 of 25 October 2006. As from 1 January 2006, the CFC rules apply to resident companies that directly or indirectly hold a participation of more than 50% (previously, 10%) in a foreign legal entity or permanent establishment, which is established or constituted in a country the effective taxation of which is at least 50% lower than that of France. The CFC rules also apply to French permanent establishments of foreign companies to which the participation in the foreign CFC is attributed. Companies subject to CFC legislation are assessed to tax in France on a pro rata amount of the income received, or deemed received, from such entity or permanent establishment. An anti-abuse provision reduces the participation threshold to 5% in situations where more than 50% of the shares in the foreign entity are owned by French companies or by foreign entities directly or indirectly controlled by a French company within the meaning of Art. 57 of the CGI.

According to the Guideline, the participation includes shares in stock companies, interest shares in a partnership or similar entity and financial rights or voting rights held in such entities. To determine the level of participation, the rights held directly and those indirectly must be added together. Voting rights and financial rights must be determined separately for special interests (e.g. usufruct, investment certificate, preference shares).

The determination as to whether a regime is “low tax” is made by reference to the effective corporate tax or business tax applicable to the foreign entity or permanent establishment in the foreign country. The Guideline states that a foreign tax regime providing for a participation exemption regime on capital gains, similar to that of France, may not, by virtue only of this, constitute a low-tax jurisdiction.

The Guideline also clarifies that the new CFC rules do not apply in the following cases:

- within the European Union, unless the structure is purely artificial and its sole purpose is to avoid French tax. According to the Guideline, an « artificial structure » is defined according to the solution provided by the ECJ in the *Cadbury Schweppes* case ; and

- outside the European Union, if the foreign entity or permanent establishment is principally engaged in commercial or industrial activities. However, even if this is the case, the French company must under certain conditions prove that the operations of the foreign structure are not only motivated by tax reasons.

2. RECENT COURT DECISIONS OF INTEREST

2.1 Treaty shopping considered as fraud to the law by the French Administrative Supreme Court (*CE 29 December 2006 n°283314, Sté Bank of Scotland*)

On 29 December 2006, the French supreme court overturned an earlier decision from the court of appeals of Paris dealing with the concept of beneficial ownership under the France-UK tax treaty. The French supreme court concluded that a UK bank, which had acquired dividend coupons under an usufruct agreement with a US company, was not the beneficial owner of the dividends distributed by the French subsidiary of that US company and was therefore not entitled to the reduced treaty rate and transfer of the *avoir fiscal*. The main issue was to determine whether or not a UK bank, which has acquired dividend coupons under a usufruct agreement with a US company was the beneficial owner of the dividends distributed by the French subsidiary of that US company within the meaning of Article 9.6 of the France-UK tax treaty.

The supreme Court examined the usufruct agreement and concluded that the transaction implemented by the contracting parties concealed a loan agreement between the UK bank and the US company which was effectively reimbursed by the French subsidiary to the US company. The supreme court stated that the advantages of the France-UK treaty could only be granted to the effective beneficial owner of the dividends. The Court then ruled that the usufruct agreement was exclusively motivated by tax reasons, with the sole aim at benefiting from the transfer of the *avoir fiscal* which was available under the France-UK treaty and not under the US-France tax treaty. According to the Court, the analysis of the usufruct agreement revealed that the beneficial owner of the dividends was in fact the US parent company which delegated to its French subsidiary the repayment of the loan contracted with the UK bank. As a result the UK bank was not entitled to the refund of the excess withholding tax and the transfer of the *avoir fiscal*.

The Supreme court further denied the claim of the UK bank that it had been deprived from the right to request the opinion of the Consultative Committee for the prevention of Abuse of Law, available under the provisions of Article 64 of the French tax procedure code; Article 64 authorizes the tax administration to disregard structures which are artificial and only motivated by tax considerations. The Court considered that the case did not arise from a tax reassessment procedure but merely from the denial of a claim for withholding tax and *avoir fiscal* refund. In this respect the French tax administration was entitled to recharacterize the transaction as a loan agreement without applying the abuse of law procedure provided by Article 64 of the French tax procedure code.

2.2 Recent courts decisions regarding the abuse of law concept

2.2.1 Supreme administrative court decision on abuse of law in respect of buy-sell transactions (*CE 27 September 2006, n°260050, Janfin*)

Although the Court denied the application of Article 64 of the tax procedure code in the specific case at hand, the Court ruled that in general the tax administration could disregard an act on the basis of the general principle of abuse of law in situations in which the specific provisions of Article 64 could not be applied. This general abuse of law principle "*fraude à la loi*"), which is based on case law, may be applied if the sole purpose of the transaction is to benefit from the literal application of legal provisions against the intentions pursued by their authors in order to avoid or diminish the tax burden of the taxpayer. In order to sustain this general principle, the tax administration must establish the fictitious character of the transaction or the act.

2.2.2 Recharacterization by the Supreme civil court in a direct sale of business on the basis of the abuse of law procedure of a contribution of a business followed by a sale of shares *(Cass. Com 20 March 2007 n°05-20.599, Sté Distribution Casino France)*

The Supreme civil court ruled, contrary to previous decisions, that the contribution of a business followed by the sale of the shares of the beneficiary company can be recharacterized in a direct sale of business on the basis of the abuse of law procedure provided by Article 64 of the French tax procedure code. Pursuant to Article 64 the French tax authorities are entitled to disregard or disqualify a legal transaction on the basis of the abuse of law provided one of the following conditions is met: (i) the said transaction, although formally correct, is fictitious, and (ii) the said transaction is solely motivated by the avoidance or mitigation of the tax liabilities that the taxpayer would otherwise have borne, having regard to his actual situation or activities. In the present case, the court disregarded the contribution followed by the sale which only gave rise to reduced registration duties and characterized the transaction as a sale subject to proportional registration duties on the basis that the sole purpose of the transaction was to avoid the payment of registration duties. This decision confirms a previous decision dated 31 October 2006 (n°1174 F-D, Sté Audit Sud-est) whereby the Court recharacterized the contribution of a property followed by the sale of the shares in the beneficiary company as a direct sale of the property (subject to proportional registration duties) on the basis of the abuse of law procedure.

2.5. French withholding tax on outbound dividends incompatible with EC law (*ECJ, 14 December 2006, C-170/05 Denkavit Internationaal BV*)

On December 14, 2006 the ECJ issued its decision on the Denkavit International case (C170-05). The Court concluded that the French withholding tax rules on outbound dividends infringe upon the EC treaty provisions on the freedom of establishment.

Indeed, the ECJ ruled that domestic legislation that subjects non resident parent companies to withholding tax on dividends is not compatible with the EC principle on freedom of establishment. The ECJ compared a French parent company (which is exempt from dividend taxation) with a non resident parent company and concluded that France must extend the relief granted to its residents to non residents since France exercises its tax jurisdiction over the non residents either unilaterally or by way of a tax treaty. Indeed, by not ensuring that a non resident parent company receiving dividends from French subsidiaries is granted the relief available to a French resident parent company, France infringed the EC principle on freedom of establishment. As a consequence of this case, the French tax authorities issued the statement of practice discussed in .§1.3 above.

2.6. Treaty between France and UK – Rules on agency permanent establishments

The Court of Appeals of Paris ruled on 2 February 2007 that the French company Zimmer SAS , engaged in the distribution of orthopedic products as a commissionaire for the account of Zimmer Ltd, a UK company, constituted a permanent establishment in France for its UK principal. The issue of the case was whether or not the UK company carried out a business through a dependent agent under Article 4.5 of the France-UK tax treaty, so that a portion of profit of the UK company was attributable to a permanent establishment in France and subject to tax therein. The Court noted that under the commissionaire agreement, Zimmer SAS could accept orders, present estimates and documents within the framework of tenders offers and conclude sales contracts for the account of Zimmer Ltd without prior approval. In addition, Zimmer SAS could negotiate prices, grant discounts and payments facilities to existing or new clients without prior approval of Zimmer Ltd. According to the Court, the fact that Zimmer SAS acted in its own name as a result of the commissionaire agreement and thereby could not conclude contracts in the name of Zimmer Ltd, did not have any impact on its capacity to engage Zimmer Ltd in commercial relationships related to Zimmer Ltd's activities. In addition, Zimmer SAS was subject to guidelines from Zimmer Ltd or was under its control with respect to the executions of sales or advertisement. The risks linked to the sales contracts were borne by Zimmer Ltd and Zimmer SAS acted exclusively for the account of Zimmer Ltd. Accordingly, the Court held that Zimmer SAS could not be regarded as an independent agent within the meaning of Article 3 of the treaty and concluded that Zimmer SAS constituted a permanent establishment in France of Zimmer Ltd which justified that the profits realized in France by Zimmer Ltd were taxable in France.

3. RECENT TRANSACTIONS OF INTEREST

The SIIC regime was introduced in French legislation in 2003 to boost interest in real estate segment of the stock-market. This text, adopted as a result of lobbying by the major French quoted real estate investments companies, enabled them to benefit from a “tax transparent” regime similar to the one enjoyed by some of their foreign competitors such as the Americans with their REITs, the Belgians with their SICAFIs, the Dutch with their BIs.

This tax regime allows companies to benefit from a full exemption from corporate income tax on profits generated by letting their real estate assets as well as those derived from gains on the sale of these assets, provided they distribute 85% of profits from letting and 50% of capital gains.

Since the introduction of the new regime, the French real estate sector has significantly out-performed the market, with exceptional results from existing companies and the arrival of new players in the sector. In particular, the SIIC regime has also attracted a number of foreign companies such as Corio (Netherlands), Rodamco Europe and Wereldhave, Hammerson (UK) and Warehouse de Paw (Belgiun). In April 2007, the market capitalization of the SIIC companies reached EUR 52,2 billion. Three French companies (Unibail, Gécina and Klépierre) are listed among the biggest European “REIT” companies. The French SIIC is of particular interest to foreign investors in the absence, for instance, of any transfer tax on the disposal of SIIC shares and of any disclosure requirements with respect to the 3% French annual real estate tax (a tax that may apply, under certain circumstances, to companies holding, directly or indirectly, French real estate).

4. SINGLE MOST SIGNIFICANT TAX DEVELOPMENT

The recent cases whereby the Courts recharacterize a transaction whether or not through the application of the abuse of law procedure provided by Article 64 of the tax procedure code, jeopardize the principle of legal certainty that the French administrative judge accepted to recognize in a recent case (CE 24 March 2006, KPMG) according to which rules imposing charges on the taxpayer must be clear and precise so that such taxpayer may know without ambiguity what his rights and obligations are and may take the appropriate steps accordingly.

5. REAL ESTATE FUNDS AND REIT'S : TAX ISSUES IN THE PRACTITIONERS' COUNTRY

5.1. The French REIT regime

The French "SIIC" regime was introduced in 2003 and has become in a few years a most popular real estate investment vehicle. Since 2003, it has been amended on several occasions. The first changes consisted of improvements and additional tax incentives. Lately, the law adopted at the end of 2006 (the so-called "SIIC 4 package") includes some further improvements but also, for the first time, a number of restrictive measures aimed at closing some tax loopholes and avoiding some forms of foreign investment through a SIIC which were considered abusive by the tax authorities.

The SIIC regime consists in a full corporate income tax exemption with respect to rental income and capital gains from the sale of properties to unrelated persons, subject to compulsory distribution to shareholders of 85% of the net rental income and 50% of capital gains. Election for the regime can be made by any company listed in France with a share capital of 15 M€ at least, whose activity consist mainly in the ownership of real estate as an investment. Non-qualifying activities are allowed within certain limits, in which case the corresponding profits are subject to standard corporate income tax. Subsidiaries held at 95% at least by a listed company that has elected for the regime may elect as well provided that they meet the activity test. Upon election, latent capital gains on the real estate portfolio are taxed at 16.5% (exit tax).

It is interesting to note that, unlike some other REIT regimes, the French SIIC regime does not provide for specific leverage restrictions : although, the new thin-capitalization rules that apply as from 2007 to all French corporate taxpayers and limit under certain conditions the deduction of interest on group loans also apply to companies that have elected for the SIIC regime. However for these companies, the limitation of interest deductions only has an impact on the level of the exempt income that must be distributed to shareholders.

5.2. Recent improvements

5.2.1 Acquisition of real estate by a SIIC

Effective 2005, corporate taxpayers contributing properties in kind to a SIIC in exchange for new shares of the SIIC benefit from a reduced capital gains tax rate (16.5% compared to the ordinary 34% tax rate), provided that the SIIC does not dispose of such property for 5 years. From 2006, the benefit of this reduced rate was extended to sales of properties by a corporate taxpayer to a SIIC, subject to the 5-year holding requirement. As a consequence, the SIICs do benefit from an competitive advantage when bidding to acquire properties and have been in the position to “drive” the real estate market in the last two years. The benefit of that reduced rate of capital gains tax for sellers, which was initially to end at the end of 2007, has been recently extended to December 2008.

5.2.2 Reorganizations within a SIIC group

In the first years of the SIIC regime, reorganizations within the group (moving of assets between the listed SIIC parent and its SIIC subsidiaries or between SIIC subsidiaries themselves, mergers, de-mergers, etc) could not be achieved tax free since any gain recognized on such occasion was not exempt under the SIIC regime due to the fact that seller and purchaser were affiliates. Effective 2005, mergers and similar transactions between SIIC entities benefit from a favourable tax regime which basically provides for tax neutrality provided that the outstanding distribution obligations are transferred with the assets. Effective 2007, straight sales of properties between members of a SIIC group benefit from a tax exemption with roll-over of tax basis. It has also become possible to create joint ventures between two SIIC groups, since a subsidiary may now elect for the regime if its share capital is held at 95% at least by one or more listed SIIC companies. Finally, a SIIC entity may acquire a participation in another listed SIIC and benefit from the dividend exemption provided that its participation reaches at least 5%.

5.2.3 Eligible assets and rights

Initially, the qualifying activity could only consist in the building and leasing of real estate on which the SIIC had full title. In particular, properties held as tenant under a financial lease did not qualify, even if sub-leased. Effective 2005, the sub-leasing of properties that the SIIC is leasing from the owner under a financial lease qualifies as an eligible activity (however financial leases entered into before 2005 still do not qualify). Effective 2007, the SIIC regime is also available with respect to assets on which the company does not have full title but enjoys a usufruct right, or which it leases from the owner under certain long-term leases (*baux emphythéotiques*) or building leases (*baux à construction*).

5.3. New restrictions/Anti-abuse measures

Between 2003 and 2006, the SIIC regime has been extremely successful not only because virtually all existing listed French real estate companies have elected for the regime but also because many new investors, including foreign ones (real estate investment groups, private funds, etc), have created new SIICs. Some of them have purchased existing listed -but dormant- companies and converted them into SIICs that they own in some cases for more than 90% (i.e. the “free float” owned by individual investors is extremely limited). A number of foreign investors have even been able not only to create such a “captive SIIC” but also to benefit from a full and final exemption of the French source real estate income and gains generated in France by the SIIC because (i) dividends received from the SIIC may be, under an applicable double taxation treaty, exempt from French withholding tax while (ii) they benefit from a parent-subsidiary exemption regime in their home and (iii) they are not subject themselves to any distribution obligations. Because it considers that such structures using the SIIC regime are abusive and do not conform with the original purpose of the introduction of the SIIC regime (developing the real estate compartment of the French stock exchange and offer an attractive vehicle to individual investors while shifting the tax liability to the investor, rather than provide for a final exemption of income and gains), the French tax administration has decided to introduce corrective measures effective 2007.

5.3.1 Shareholder Requirements

In order to prevent the formation of “captive” SIICs, the share capital of the listed SIIC may no longer be owned for more than 60% by a single investor or group of investors that are affiliated or acting jointly. SIICs already existing benefit from a 2-year grace period to conform with this new rule, which must be complied at all times. In addition, at the time of the election for the SIIC regime, at least 15% of the share capital of the SIIC must be held by investors who, individually, do not own more than 2%. This second test is aimed at ensuring a minimum level of free float before the company may elect for the SIIC regime.

5.3.2 New 20% Levy

Effective 2007, dividends distributed by a SIIC out of its exempt income and gains to shareholders (French or foreign) -other than individuals- which individually own at least 10% of the share capital and which are either exempt from any income tax on the SIIC dividend or which are subject on such dividend to a low rate of tax (i.e. a rate lower than 11.12%) are subject to a 20% levy which is assessed on and payable by the SIIC. The purpose of this new levy is to ensure that a minimum level of tax will be levied in France or abroad along the chain between the SIIC and the ultimate investors. In particular, SIICs created by foreign corporate investors that benefit in their home jurisdictions from a dividend exemption regime and which are treaty protected against French dividend withholding tax, will be subject to the new 20% levy. As a side effect, a number of French or foreign investment vehicles that are exempt from income tax but whose members or beneficiaries are normally taxable (collective investment funds, pension funds / trusts, etc) will trigger the application of the 20% levy if they own more than 10% of the share capital of a SIIC. Although it is obvious that the new legislation introducing this new 20% levy has been designed to tentatively ensure its compatibility with tax treaties and the EC basic freedoms, it is nevertheless not free from doubt that it does not indeed qualify as a withholding tax on dividends that would be eliminated or reduced under certain French tax treaties.

Nathalie Sénéchault

Jones Day

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