

# TAX UPDATES FROM AROUND THE WORLD

## FRANCE

Michel Collet

**STEP CONFERENCE, Tel Aviv**

*June 19, 2018*





1

# NEW DEVELOPMENTS

# 1. NEW DEVELOPMENTS

## 1.1. Flat tax introduced on financial income (1/2)

### ❖ Until December 31, 2017

Financial income (dividends, interest and capital gains from the sale of shares) derived by individuals were subject to:

- personal income tax (“PIT”) at the progressive rates (up to 45%, with specific allowances applicable to dividends and capital gains)
- exceptional surtax on high income (“ESHI”) at the rate of 3% or 4%;
- social taxes at a cumulative rate of 15.5%.

⇒ **Maximum taxation rate of up to 46.5% for dividends and 64.5% for capital gains / interest.**

⇒ **Not conducive to investment.**

### ❖ New 30% tax on dividends, interest and capital gains on stocks (12.8 % for non residents individuals)

As from January 1<sup>st</sup>, 2018, financial income derived by individuals are subject to a 30% flat tax, broken down as follows:

- PIT at a 12.8% rate (regardless of the amount of financial income derived with respect to a given calendar year);
- ESHI at the rate of 3% or 4%;
- social taxes at a cumulative rate of 17.2%.

→ *Option for progressive tax rate available if lower tax burden*

⇒ **Maximum taxation rate of 34% applicable to financial income derived by French tax residents.**

⇒ **12,8 % rate for non-French residents**

⇒ **Simplified regime – easier to understand for foreign investors**

### ❖ Capital gain tax on stocks

- *Allowances for holding period remain available for capital gains derived from the sale of shares acquired prior January 1<sup>st</sup>, 2018*

Standard allowances	Specific allowances (subject to conditions)
between 2 and 8 years: 50% allowance = <b>22.5% PIT</b>	between 1 and 4 years: 50% allowance = <b>22.5% PIT</b>
more than 8 years: 65% allowance = <b>15.75% PIT</b>	between 4 and 8 years: 65% allowance = <b>15.75% PIT</b>
	more than 8 years: 85% allowance = <b>6.75% PIT</b>

- *Specific €500k allowance available upon retirement*

Capital gains derived by owners retiring upon sale may benefit from a €500k allowance.

- However, such allowance may not be combined with allowances depicted in the above table).

⇒ **In most cases, flat tax turns out to be the best option**

# 1. NEW DEVELOPMENTS

## 1.1. Flat tax introduced on financial income (2/2)

### ❖ Lower flat tax for non-resident individuals

#### ➤ French source dividends:

- Domestic law: **12.8% withholding tax**
- DTT: **15% maximum withholding tax** (5% if >10% corporate shareholder)

⇒ **12.8% WHT on French source dividends**

#### ➤ French source interest:

- Domestic law: **no withholding tax**
- DTT: **10% maximum withholding tax**

⇒ **0% WHT on French source interest**

#### ➤ Capital gains:

- Domestic law: **12.8% withholding tax** if sale of a directly or indirectly held substantial shareholding (>25%)
- France-Israel double tax treaty ("DTT"): **18% maximum withholding tax** if sale of a directly or indirectly held substantial shareholding (>25% of a family company or >10% of another company)

⇒ **12.8% CGT on French stocks (if >25%)**

⇒ **0% WHT if interest below 25% in a French company**

### ➤ Life insurance:

#### - Domestic law:

#### • Premiums paid until September 26, 2018:

- Contracts <4 years: **35% withholding tax**
- Contracts >4 years and <8 years: **15% withholding tax**
- Contracts >8 years: **7.5% withholding tax**

→ *Option for 12.8% flat tax available*

#### • Premiums paid as from September 27, 2018: **12.8% withholding tax**

- DTT: **10% maximum withholding tax** (income derived from life insurance contracts are deemed as interest income under the provisions of the DTT)

⇒ **7.5% or 10% WHT on French profit / life insurance**

# 1. NEW DEVELOPMENTS

## 1.2. Wealth tax

### ❖ Until December 31, 2017

Wealth tax ("ISF") was assessed on all assets provided net wealth was above €1.3m

- Movable and real estate worldwide assets for French tax residents
- Mainly French based real estate and substantial shareholdings for Non-French residents (exemptions available, notably regarding financial assets).

Progressive tax rate ranging from 0,5% to 1,5% (above €10m).

### ❖ From ISF to IFI

As from January 1<sup>st</sup>, 2018, ISF was repealed and replaced by a net wealth tax on real estate ("IFI") assessed only on directly or indirectly owned real estate.

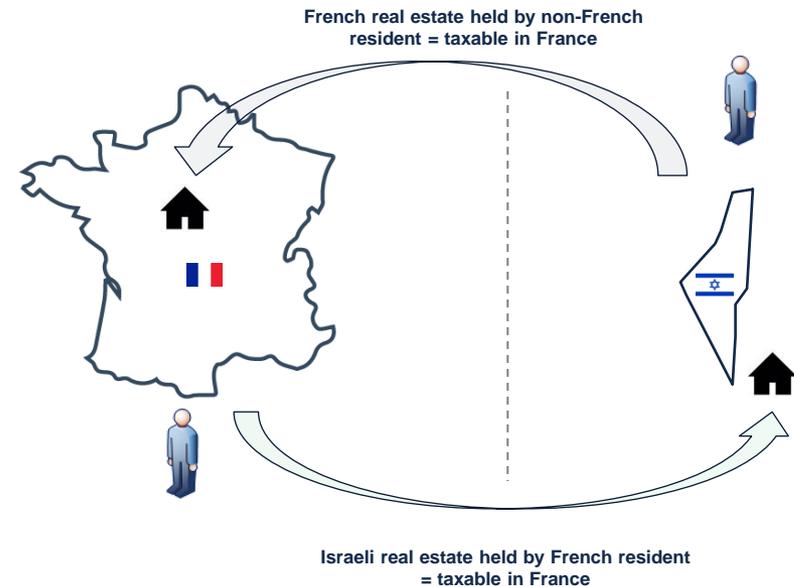
- Movable assets no longer in the scope of the IFI (especially financial assets)
- Exemptions available for professional assets
- 5-year exemption for real estate held outside France by new French residents
- Broader scope (e.g. indirect ownership structures, including investment vehicles)
- Repeal of a well established 75% exemption ("pacte Dutreil")
- Acquisition debt deductible subject to limitations, especially if loaded in acquisition vehicle (overall cap – related party debt)

Progressive tax rate ranging from 0,5% to 1,5% (above €10m).

### French-Israeli DTT

Does not prevent IFI from applying

### Impacts of the wealth tax reform



# 1. NEW DEVELOPMENTS

## 1.3. Others

---

### ❖ Corporate income tax rate drops from 33.33% to 25%

The standard CIT rate is to be reduced progressively down to 25 % until 2020:

- In 2018, a rate of 28% applies to a taxable basis of up to €500k and a rate of 33.33 % to a basis of more than €500k;
- In 2019, a rate of 28% would apply to a taxable basis of up to €500k and a rate of 31% to a basis of more than €500k;
- In 2020, the standard rate would be 28%, in 2021 it would be 26.5% and in 2022 it would be 25%.

### ❖ Repeal of the 3% tax on dividends

Second Amending Finance Bill for 2012: introduction of additional 3% contribution on **distributions declared by companies subject to CIT**.

- Distributions made between tax consolidated companies were however exempt from this tax.
- Distributions falling within the scope of the 3% tax on distributions were mainly distributions received by individuals and foreign resident companies.

Further to a 2016 French Constitutional Court decision: amending Finance Bill for 2016 extended the exemption to distributions made within a French tax group by qualifying companies subject to a CIT equivalent to the French CIT in a EU Member State, **fulfilling the criteria for tax consolidation, had they been located in France**.

Finance Bill for 2018:

- Significant number of tax disputes about the 3% tax on distributions in progress + recent decision rendered by the European Court of Justice held that the 3% distribution tax is contrary to the EU Parent-Subsidiary Directive (tax assessed on dividends distributed by subsidiaries that are residents of other Member States)
- French government decided to repeal the tax in the draft Finance Bill for 2018 issued on September 27, 2017 (a few days later, the French Constitutional Court issued a decision holding that the 3% tax is unconstitutional).

- ⇒ **Taxpayers have until the end of 2018 to file, with the FTA, claims for refund of the 3% tax on distributions paid since the beginning of 2016.**
- ⇒ **Good news for foreign shareholders of French companies, as this tax often resulted in distributions being postponed (except in the case of French listed companies, which had no choice but to distribute dividends to their shareholders) .**
- ⇒ **French government has however decided to finance 50 % of the tax refunds claimed by adopting a new taxes levied on large enterprises.**



2

# MAKING ALIYAH – REPEAL OF FRENCH EXIT TAX

## 2. MAKING ALIYAH – REPEAL OF FRENCH EXIT TAX

### ❖ Current exit tax regime

#### ➤ Who?

French tax residents transferring their domicile in another country who hold substantial shareholdings (i.e. >50% of the share capital or value > €800k)

#### ➤ Tax base?

Latent capital gains as of the date of the departure

#### ➤ Tax rates?

12.8% as from January 1<sup>st</sup>, 2018 (unless election for progressive tax rate)

#### ➤ When is the exit tax due?

Immediately upon leaving, unless deferred subject to financial guarantees provided to the French tax authorities. Tax paid upon disposal within 15 years

### ❖ Possible repeal of the exit tax as from 2019

The French President announced in May 2018 that the exit tax may be repealed starting 2019 with the clear intention of attracting foreign tax residents and investors

➤ 3 times more taxpayers leaving France in 2015 than in 2010 (yearly income >€100k)

➤ Capital gains derived from the transfer of substantial shareholdings (>25%) remain taxable in France at a 12.8% rate

⇒ **To be confirmed in the upcoming months**

⇒ **CGT on substantial shareholdings (>25%) may still be due by Israeli residents**

### ❖ Pre-Aliyah planning for entrepreneurs

**(A)** Contribution of FrenchCo to a holding company: tax deferral

**(B)** Sale of FrenchCo by HoldCo:

- Lower taxation if any at the level of HoldCo
- No claw back of deferral if reinvestment within a 2-year period of at least 50% of the proceeds in professional assets

**(B bis)** or donation of HoldCo's shares

- In principle, contributions of shares by an individual to a company subject to CIT trigger CGT at a 12.8% rate (only if >25% shareholding when non-resident individual).

⇒ **In case of contribution of FrenchCo to HoldCo followed by Aliyah**

1. Tax deferral granted upon contribution.
2. Tax deferral converted into payment deferral upon transfer of residence (subject to financial guarantees provided to the FTA)

PROS	CONS
Donation of the shares received upon contribution triggers full exit tax relief	No automatic exit tax relief after a 15-year period as from the transfer of tax residence Uncertainty regarding the impact of a sale of the contributed shares within a 3-year period as from the contribution

⇒ **Contribution of shares prior to transfer of tax residence should be favored if possible**



**3**

**DISCLOSURE AND  
TRANSPARENCY**

## 3.1. Exchange of information

### ❖ Automatic exchange of information (at large)

- Main tools at the disposal of the French tax authorities (“FTA”)

 Double tax treaties (art. 26 of the OECD tax model convention and article 6 of the MLI): exchange of information necessary for the application of the treaty and domestic law of both countries

#### EU Directives

- ✓ **Common Reporting Standard** (art. 1649 AC of the FTC): covers income attributed by banking institutions to non-resident EU individuals
- ✓ **Ruling Directive** (art. L13 AA of the FTC): covers tax rulings and advanced pricing agreements
- ✓ **CbCR** (art. 223 quinquies C of the FTC): covers profits generated by the group, accounting and tax aggregates or location and activities of the various related entities
- ✓ **Anti-money laundering and financing of terrorism:** covers all information collected within this context: **disclosure of Beneficial owner** and strengthening of duties of lawyers, notaries, etc. with access of the FTA within the frame of automatic exchange (in force as from January 1, 2018)
- ✓ **Automatic exchange of information between Member States** (2018 for France)

#### Other instruments

- ✓ **Multilateral agreement aiming at implementing CRS at a worldwide scale:** bank accounts of non-resident individuals (in force as from 2017 for France and 2018 for Israel) 
- ✓ **Multilateral agreement relating the CbCR** (in force as from 2018 for France and Israel) 

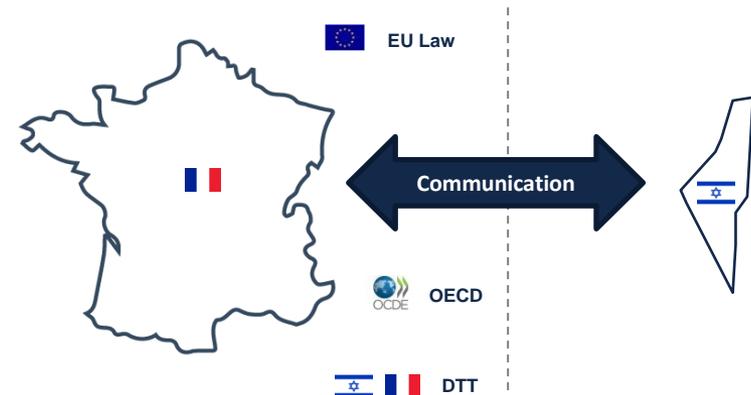
⇒ Considerable intensification of agreements aiming at the exchange of information over the past years and closing the gap between market practice and its knowledge by tax authorities on a multilateral basis.

### ❖ Listed transactions

- published in 2015 on FTA’s website dedicated to tax audits and fight against tax fraud
- Invitation to approach the FTA to restructure (80% penalty / abuse of law)

⇒ Prior attempt to introduce a disclosure obligation for promoters (advisors/service providers) of tax optimization structuring were struck down based on the constitutional principle of freedom of entrepreneurship .

⇒ Attempt to introduce a 5% penalty applicable to promoters of tax fraud and avoidance was also struck down by Constitutional Court.



## 3.2. Disclosure required from advisors / promoters

### ❖ Principle:

- All exchanges with clients are covered by attorney-client privilege

### ❖ French Anti-money laundering provisions

Double obligation concerning attorneys:

- Duty of vigilance (also known as “know your client”)
- Duty of declaration in case of suspicion of an offense, especially if this offence is money laundering.

### ❖ Main liability and filing requirements for advisors

#### ■ ■ Attempts of lawmakers to introduce disclosure obligation and penalties

- **Disclosure obligation** of “tax optimization schemes” applicable to any person who markets a tax optimization scheme for the benefit of a client or develops and implements a “tax optimization scheme” for his own benefit, sanctioned by a
- **Fine of 5% of fees** for tax optimization structure or 5% of the tax benefits for the taxpayer/client.

*The draft did not precisely defined tax optimization structures targeted by the law and thus might have been contrary to the freedom of entrepreneurship (tax advisors may try to optimize the tax situation of their clients without committing tax fraud).*

#### ■ ■ Ongoing discussions before French Parliament

Bill against tax fraud including provisions providing for a **€10k fine** (or **50% of the fees**) applicable to advisors who provided assistance to taxpayers reassessed for tax fraud or abuse of law

- Requires the active participation of the advisor to the structuring
- Such assistance may notably consist of facilitating hiding the identity / the activity of the taxpayer or the wrongful benefit of a tax advantage (tax deduction, tax credit, etc.), as an example

🇪🇺 Directive 2018/822 of 25 May 2018 relating to mandatory automatic exchange of information (cross-border arrangements)

Intermediaries are required to disclose potentially aggressive cross-border arrangements to tax authorities within 30 days of implementation, i.e. arrangements that cumulatively:

- **satisfy the main benefit test:** “the main benefit or one of the main benefits a person may reasonably expect to derive from an arrangement is the obtaining of a tax advantage”
- **contain one or more “hallmarks”**
  - *Generic hallmarks linked to the main benefit test* (e.g. confidentiality which may require not to disclose how the arrangement could secure a tax advantage, or fee fixed by reference to the amount of the tax advantage derived from the arrangement)
  - *Specific hallmarks linked to the main benefit test* (e.g. effect of converting income into capital, gifts or income which are tax at a lower level or tax exempt)
  - *Specific hallmarks related to cross-border transactions* (e.g. deductible cross-border payments made between associated enterprises, deduction for depreciation of assets in several jurisdictions)

If the obligation is not enforceable upon an intermediary due to legal professional privilege = obligation to disclose falls on the taxpayer.

⇒ **Advisor should inform clients of disclosure requirement falling upon them**

#### 🇧🇪 ■ ■ Implementation time table:

- Arrangements implemented between June 25, 2018 and July 1<sup>st</sup>, 2020 will have to be reported by August 31, 2020
- Information is to be exchanged between EU Member States by October 31, 2020.

### 3.3. Ultimate beneficial owners

---

#### ❖ **New obligation to declare ultimate beneficial owner (UBO) of non-listed French corporate entities**

Creation of UBO registers at the seat of the commercial courts where corporate entities are registered in France.

This new disclosing obligation entered into force on August 1<sup>st</sup>, 2017 and applies immediately for entities incorporated in France as from this date. Existing entities had to comply with said obligation at the latest on April 1<sup>st</sup>, 2018.

#### Definition of the UBO

UBOs individuals who, either:

- hold, directly or indirectly more than 25% of the share capital and/or voting rights; or
- exercises, by any other means, the authority to control certain functions including corporate management and governance, or control of executive bodies or shareholders' meeting

⇒ **Entities subject to this rules are required to obtain and keep accurate and up-to-date information on their UBOs.**

⇒ **Individuals (managers, directors, etc.) who do not comply with this filing requirement (or who file inaccurate or incomplete information) may be subject to criminal sanctions (six months prison, €7.5k fine and management ban).**



**4**

**FRENCH GAAR**

## 4. FRENCH GAAR

### ❖ The FTA have the general power to disregard or recast all transactions or legal deed that qualify as an abuse of law.

Under its current definition, the abuse of law must be exclusively tax driven (factual analysis)

- Attempt to change domestic law to enlarge it with **principal purpose test** was struck down as the proposed new test would have given the FTA a significant margin of discretion in the application of the abuse of law procedure.
- Main purpose test is retained in anti-abuse provisions in double tax treaty signed by France and now MLI and some targeted anti-abuse mechanisms.
- “Private ruling on the abuse of law” (no answer after 6-month delay = procedure of abuse of law not applicable)

The principal purpose test (“PPT”) is also retained in more specific provisions.

### ❖ French experience: the Participation exemption on dividends

#### ➤ Main principles (inbound / outbound dividends)

Denial of the exemption if dividends resulting from a planning or a series of plannings which, having been put into place for the principal purpose or one of the principal purposes of obtaining a tax advantage in contradiction with the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances (safe harbor clause available).

#### ➤ PPT

- Factual analysis taking into account the assessment of the tax advantage which would have been obtained in violation of the purpose of the exemption of dividends in proportion of the whole gains or benefits of any kind derived from the arrangement at stake.
- Pursuant to the administrative guidelines, an arrangement may fall within the scope of the GAAR even if it achieves several competing objectives.

#### ➤ Lack of economic reality test

- An arrangement shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.
- The notion of “commercial reason” shall be understood in a broad meaning = any economic justification (e.g. holding structures, financial structures, etc).

#### ➤ Attitude of the FTA

- Challenge of the WHT exemption on French outbound dividends paid by SPVs or holding companies as being abusive since the recipients are not regarded as having the proper substance.
- Factual elements such as economic rationale, functions assumed by the recipient, human and material means, governance, etc. are scrutinized.
- *Conflicting view in a cross border context?*
- *Is BEPS action 6 a relief? No*
  - PP derives from an objective analysis of the fact and circumstances.
  - Reviewing the effects of the transaction should not automatically lead to a PP.
  - However, “where an arrangement can only be reasonably explained by a benefit that arises under the DTT, it may characterize PP.”

5

**NEVER TRUST TRUSTS  
IN FRANCE!**

## 5. NEVER TRUST TRUSTS IN FRANCE! (1/2)

### ❖ French estate law

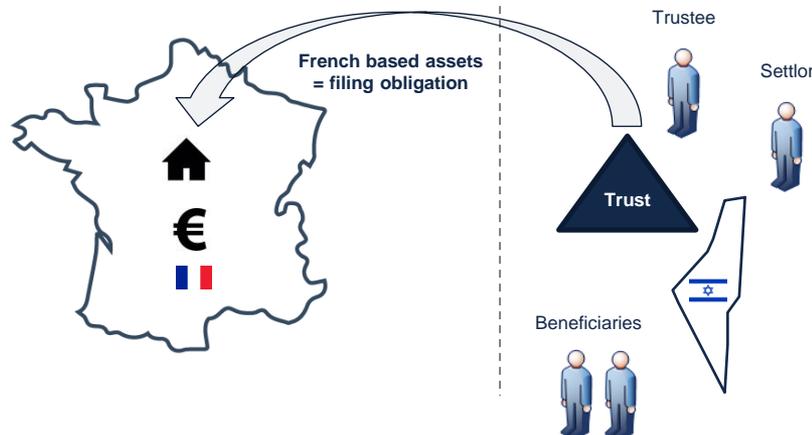
Where French estate law is not applicable, French forced heirship law is excluded.

⇒ **Recently confirmed by French Civil Supreme Court (September 27, 2017)**

### ❖ French nexus = French filing obligations

A French nexus is characterized in the following cases:

- The **settlor** is a French tax resident;
  - One of the **beneficiaries** is a French tax resident;
  - The **trustee** is a French tax resident;
  - One or several **assets** or rights placed into the trust are located in France.
- ⇒ **Characteristics of the trust do not matter (revocable and irrevocable trusts receive same treatment)**



### ❖ Reporting

Where one of the above-mentioned criteria is met:

- **Event-based reporting:** filed by the trustee by the end of the month following a specific event affecting the trust (e.g. setting up, modification or termination of the trust, distribution of assets, etc.);
- **Annual reporting:** detail of assets and rights placed into the trust, along with the worldwide capitalized income.

### ❖ Sanctions

Penalties have undergone significant changes over the past years:

- December 2013: penalties for any omission, initially set at 5% of the fair market value of the assets held in the trust (or €10k if higher), were increased to 12.5% (or €20k if higher)
- March 2017: the French Supreme Constitutional Court ruled that the 12.5% penalty (formerly 5%) was unconstitutional.

⇒ **Failure to comply with these reporting requirement trigger a €20k fine.**

### ❖ Impact of the net wealth tax reform

Trust filing obligations are designed to avoid non-disclosure for wealth tax purposes of French based assets that would be held in a trust.

⇒ **Reduction of the scope of French net wealth tax (now limited to real estate) = reduction of the scope of trust filing obligations?**

## 5. NEVER TRUST TRUSTS IN FRANCE! (2/2)

---

### ❖ Public register of trusts declared unconstitutional

A French public register of trusts was established by decree on 11 May 2016.

➤ Purpose: gather information on trusts having French nexus with trustees subject to the specific annual and event-driven filing requirements.

➤ Matter brought before the French Constitutional Court:

An 89-year American individual, settlor of trusts subject to the French reporting, challenged the implementation of the public access to this register on the basis that the information made available to the public (including journalists and private investigators) led to the disclosure of her testamentary intentions (necessarily confidential and protected)

⇒ Information available to French constitutional Court considered that public access (even limited to individuals who have a French tax identification number) was considered as in breach of her privacy rights guaranteed by the French Constitution.

⇒ Suspension of the public access to this register as from July 22, 2016

⇒ Public register of trusts declared unconstitutional on October 21, 2016 (Constitutional Supreme Court, October 21, 2017, QPC n° 2016-591)

⇒ **Trustees remain subject to annual and event-based reporting requirements in France provided the trust has a French nexus.**

⇒ **Failure to comply with these reporting requirements trigger a €20k fine.**



**A**

# **APPENDIXES**

## Appendix 1: New developments

### ❖ Lower flat tax for non-resident individuals

	French tax regime - Prior to flat tax reform	French tax regime - After flat tax reform
Capital gains	<ul style="list-style-type: none"> <li>- Progressive tax rate (max. 45% + 4%) after allowance for ownership</li> <li>- Social taxes (15.5%)</li> </ul> <b>= max. 64,5% taxation</b>	Flat tax (12.8%) <b>= max. 12.8% taxation</b>
Dividends	<ul style="list-style-type: none"> <li>- Progressive tax rate (max. 45% + 4%) after 40% allowance</li> <li>- Social taxes (15.5%)</li> </ul> <b>= max. 46,5% taxation</b>	Flat tax (12.8%) <b>= max. 12.8% taxation</b>
Interest	No WHT tax in France	
Life insurance	<ul style="list-style-type: none"> <li>- Specific WHT ranging from 7.5% to 35%</li> <li>- Social taxes (15.5%)</li> </ul> <b>= max. 50,5% taxation</b>	Flat tax (12.8%) <b>= max. 12.8% taxation, capped to 10% by DTT provisions</b>

### ❖ From ISF to IFI

	French tax regime - Prior to NWT reform	French tax regime - After NWT reform
Real estate	Subject to ISF if located in France	Subject to IFI
Intangible and movable assets	Subject to ISF if located in France	Out of the scope of IFI
Financial assets	Subject to ISF if located in France (exemptions available)	Out of the scope of IFI, <b>except if underlying real estate assets</b>

## Appendix 2: drop draft of tax planning disclosure for taxpayers and penalty for promoters of tax structures

### ➤ In 2013:

Draft Finance Act for 2014 providing for a disclosure obligation relating to “tax optimization schemes”

- Any person (either companies or individuals) who
  - (i) markets a tax optimization scheme for the benefit of a client or
  - (ii) creates and implements a “tax optimization scheme” for his own benefit,
 was required to declare it to the FTA before its marketing or implementation
- Tax optimization schemes were defined as any combination of legal, tax, accounting and financial procedures and instruments, whose main purpose is to reduce the tax liability of a taxpayer, to defer a tax payment or to obtain its reimbursement.
- Failure to comply with these requirements would be punished by a 5% fine computed on (i) the amount of the remuneration received in consideration for the marketing of a tax optimization scheme or (ii) the amount of the tax benefits obtained by persons developing and implementing tax optimization schemes for their own benefit.

*Basis of the decision :*

- *Tax optimization not precisely defined (too vague);*
- *These new requirements were invalidated by the French Constitutional Court on the grounds that the definition of tax optimization schemes was not precise enough, and that it represented an infringement on the constitutional principle of freedom of entrepreneurship (tax advisors may try to optimize the tax situation of their clients without committing tax fraud).*

### ➤ In 2014 :

Draft Finance Act for 2015 providing for fine applicable to third party facilitating tax fraud and tax avoidance

- Any person (either companies or individuals), with the intent of facilitating a third party avoiding taxes, involved in transactions resulting in tax reassessment based on the procedure of abuse of law was subject to a fine amounting to € 10,000 or 5% of the turnover derived by the third party, if higher.
- Said provisions were designed based on the same spirit as the one invalidated by the French Constitutional Court in 2013.

*These new requirements were invalidated by the French Constitutional Court on the grounds that neither the definition of nature of the tax infraction nor the basis of the fine were sufficiently precise (2014-707 QPC).*

- ➔ **Aforementioned attempts by the government to penalize tax and legal counsels for implementing specific tax schemes badly illustrates the relationship between the government / FTA and the taxpayers and their counsels.**

## Appendix 3: More on French GAAR

### ❖ Applicable provisions

#### ➤ Article 145-6-k) of the FTC:

*“The participation exemption regime is not available to income derived from qualifying shareholdings distributed within the frame of an arrangement or a series of arrangements as defined in article 119-ter 3° of the FTC”.*

#### ➤ Article 119-ter 3° of the FTC:

*“Alinea 1 does not apply to dividends distributed within the frame of an arrangement or a series of arrangements that, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage which defeats the object or purpose of said alinea 1, is not genuine having regard to all relevant facts and circumstances.*

*An arrangement may comprise more than one step or part.*

*For the purposes of paragraph 3, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality”.*

### ❖ Main principles

- The date when the arrangement was put into place is irrelevant, and the anti-abuse clause should apply to distributions carried out as from January 1st, 2016 .
- This new general anti-avoidance rule (“GAAR”) consists of two elements, (i) a subjective test (“**main purpose test**”) and (ii) an objective test (“**lack of economic reality test**”):
  - the arrangement or the series of arrangements is put into place for the main purpose or one of the main purposes of exempting dividend distributions received by a parent company from its subsidiary, against the object of the participation exemption regime; and,
  - the arrangement or the series of arrangements may not be regarded as genuine, which means that it is not supported by an economic justification.

### 1 An arrangement or a series of arrangements

- The law itself indicates that “*an arrangement may comprise more than one step or part*”.
- Administrative guidelines indicate that an arrangement may be composed of several steps or parts, and the GAAR may apply to only one of those steps or parts: the directive indeed only prevents the application of the exemption regime “to the extent” that the arrangement is not implemented for valid commercial reasons.

### 2 “Main” purpose test

- Administrative guidelines indicate that the notion of main purpose is broader than the notion of exclusive tax motivation, as provided for by article L.64 of the French Tax Procedure code.
- In case when an arrangement is implemented for several reasons, the analysis of the main feature of one of the reasons derives from a factual analysis taking into account the assessment of the tax advantage which would be obtained in violation of the purpose of the exemption of dividends in proportion of the whole gains or benefits of any kind derived from the arrangement at stake.

### 3 Lack of economic reality test

- According to the FTA, the notion of “commercial reasons” has to be understood in a broad meaning, i.e., as any economic justification, even if it does not relate to a commercial activity within the meaning of article 34 of the FTC. Hence, may be regarded as being supported by valid reasons holding structures, financial structures or structures serving an organizational purpose.
- However, if an arrangement provides both economic and tax benefits, but economic advantage is negligible compared to the tax advantage, the economic reason may be considered as non valid.

#### Articulation with abuse of law procedure

- ❖ According to the Constitutional court, the anti-abuse clause is an additional requirement for the participation exemption regime to apply, and does not modify the provisions of article L.64 of the French tax procedure code .
- ❖ Administrative guidelines indicate that the FTA may, in a first step, apply the anti-abuse clause, then, apply the penalties for abuse of law, provided the requirements set forth by this article are met, and that procedural warranties are complied with.