

The French Tax System: Promoting Competitiveness and Investment

“France is on the move”: this assertion quoted from an IMF report in 2007 still holds true, particularly as far as taxation is concerned: a large number of recent tax reforms have served to promote business competitiveness, innovation, talent and sustainable development in France.

HIGH INTERNATIONAL RANKINGS

→ With regard to **corporate taxes**, a 2008 study by KPMG¹ based on **effective corporate tax rates** (taking into account different tax bases in different countries, which the Forbes Tax Misery Index fails to do), ranked France:

- **4th for manufacturing operations**, with an effective tax rate of 30.2%, compared with 30.9% for the United Kingdom and 37.8% for Germany;
- **2nd for R&D operations**, with a negative effective tax rate of -25.7%, thanks to the research tax credit, compared with -13.8% for the United Kingdom and 33.5% for Germany (which does not offer tax credits but does grant subsidies).

→ According to the European Private Equity and Venture Capital Association (EVCA) and KPMG², France offers Europe’s **most favorable tax and legal environment for the development of private equity and venture capital**, ahead of Ireland (2nd), Belgium (3rd) and the United Kingdom (4th).

→ According to Ernst & Young’s *Barometer of Tax Competitiveness 2009*, out of 29 major economic powers, France has signed the **most bilateral tax treaties aiming to eliminate double taxation situations**.

THE FRENCH TAX SYSTEM FOSTERS COMPETITIVENESS THROUGH A BROAD RANGE OF REFORMS ENCOURAGING:

PRODUCTIVE INVESTMENT

The local business tax (*taxe professionnelle*) on productive investments has been abolished, generating a **€6.3 billion annual tax cut for businesses**. In 2010, the introductory year of the reform, tax relief will amount to €12.3 billion. In practical terms, **this will lower the cost of productive investments made over 10 years by more than 20%**. A simulator is available at www.economie.gouv.fr/tp-cet to help businesses gauge the benefits of this reform.

Furthermore, France has **one of the most generous depreciation allowance systems among OECD countries**, with accelerated depreciation periods and rates that generate corporate tax savings.

(1) KPMG, *Competitive Alternatives 2008, Guide to International Business Location*: a comparison of business competitiveness in 10 countries (Germany, Australia, Canada, United States, France, Japan, Italy, Mexico, the Netherlands and the United Kingdom) through an examination of business setup and operating costs.

(2) *Benchmarking European Tax and Legal Environments*, November 2008, European Private Equity and Venture Capital Association

INNOVATION

France offers one of Europe's most generous research tax credits:

- **High rate:** covering 50% of R&D spending in the first year, 40% in the second year and 30% in subsequent years, up to €100 million, beyond which 5% of further spending is covered; **the tax credit rate is doubled** for R&D carried out with public-sector bodies; ever since 2008, there has been no upper limit to eligible R&D spending.
- **Covers all R&D spending:** salaries and social security contributions, research partnership expenses, operating costs, depreciation allowances, patent and technology watch expenses, etc.

Appraisal: In 2009, approximately 11,000 companies completed a tax credit return detailing their R&D spending incurred in 2008 (estimated to amount to €15 billion).

Moreover, **income from intellectual property rights** (royalties and gains on transfers of patents, patentable inventions and manufacturing processes) is **subject to a reduced corporate tax rate of 15%** (as of January 1, 2008)³.

Under the **innovative new company** (*jeune entreprise innovante – JEI*) status, created in 2004, companies can claim **tax (corporate tax and local taxes) and social security contribution exemptions**, as well as a **research tax credit rebate in their first year of existence**.

RESEARCH TAX CREDITS

- **The Netherlands:** rate varies from 14% to 60%, primarily applies to employer social security contributions.
- **United Kingdom :** 8.4% of R&D spending, 24% for SMEs.
- **Belgium :** 13.5% of R&D investment costs.
- **Germany :** no tax incentives for R&D, but direct support does exist in the form of subsidies.

FINANCIAL ACTIVITY

The stock exchange tax (*impôt sur les opérations de bourse*) was abolished for all stock market traders on January 1, 2008.

SETTING UP DECISION-MAKING CENTERS

Generous tax incentives make France one of the world's most attractive locations for setting up decision-making centers and holding companies.

- **The 'tax integration' system enables consolidated groups of companies to transfer earnings** between members, thereby reducing their overall tax burden. In addition, under the "parent company system", if a parent company owns at least 5% of a subsidiary, **dividends from that subsidiary – whether it is a French or a foreign subsidiary – are tax-exempt**, and losses can be carried forward indefinitely.
- **The French tax system offers advantages for holding companies**, thanks to tax exemptions on capital gains arising from the sale of stocks, and the tax-deductibility of interest paid on loans. Combined with tax consolidation, these measures make France an especially attractive location for executing leveraged buyouts and setting up holding or parent companies.
- **A special tax break approval system (*agrément fiscal*)** enables corporate headquarters to pass on service costs to other group companies by negotiating a cost-plus margin with the tax authorities which generally ranges from 6 to 8%.

In addition:

- **Legal certainty has been improved** through the implementation of advance tax ruling procedures (*rescrits fiscaux*) in which responses must be issued within three months of requests, and the extension of the advance ruling procedure for social security contributions (*rescrit social*) to all requests relating to exemptions from social security contributions or employment subsidies (*Loi de finances* (French government budget law) 2008; Law to Modernize the Economy - August 4, 2008).

(3) Except for transfers between companies belonging to the same group.

• Simplified tax administration for companies:

- Introduction of a single tax authority point-of-contact: for large businesses a tax department for large businesses (Direction des grandes entreprises – DGE) was created in 2002, and for SMEs regional business tax departments (Services des impôts des entreprises – SIEs) were created in 2006. All companies in France now have a single authority contact point for tax matters.
- Electronic tax return filing and payment procedures have been implemented.

SPOTLIGHT: TAXATION FOR EXPATRIATES

Since 2007, several measures have addressed the income tax liability of expatriates resident in France.

- **Tax rules for expatriates enhanced in 2008: up to half of total remuneration is now exempt from income tax;**
- **Wealth tax reform: sums invested in SMEs or certain funds (FIP, FCPI etc.) are deductible from the wealth tax (ISF), while assets held by expatriates outside France are exempt for five years.**
- **The guaranteed tax ceiling (*bouclier fiscal*) has been lowered to 50% (including social security payments);**
- **Tax exemptions on capital gains arising from the sale of securities which have been held for at least eight years.**

ENVIRONMENTAL AND ENERGY TAXES TO ENCOURAGE SUSTAINABLE GROWTH

More than 40 measures passed into law since 2008 aim to encourage environmental responsibility, specifically by granting tax breaks to companies that contribute to environmental protection and sustainable development in the following areas:

- **Housing:** interest-free loans and loan-interest tax credits for the acquisition of new housing that exceeds thermal energy standards; interest-free “eco-loans” for energy efficient renovation work on existing housing;
- **Vehicles and transport:** system of penalties and rewards (*bonus/malus*) for new vehicle purchases; pay-per-kilometer eco-tax on heavy goods vehicles (LF 2009, art. 153); new tax on company cars and introduction of an “ecological barometer”;
- **Energy:** by encouraging the development of the renewable energy industries: property-tax exemption for buildings equipped with photovoltaic electricity production systems (LF 2008, art. 107); extraordinary write-down over 12 months for renewable energy production equipment (e.g. wind turbines) used by companies (LF 2009, art. 9);
- **Waste:** by promoting recycling and waste prevention: increase in the General Tax on Polluting Activities (TGAP), calculated on the basis of household waste volumes;
- **Biodiversity:** TGAP doubled on extracted materials (LF 2009, art. 29), specifically to encourage the use of renewable materials;
- **Agriculture:** accelerated depreciation of investments made by companies engaged in first-stage wood processing (LF 2009, art. 20); property-tax exemption for undeveloped properties to encourage organic farming (LF 2009, art. 113); gradual increase in taxes on pesticides;
- **Industrial risk:** introduction of a new TGAP tax based on quantities of total airborne particles.

Since January 1, 2007, the General Tax on Polluting Activities has been reduced for manufacturers that comply with certain environmental standards.

Meanwhile, the debate about how the new carbon tax will be implemented is ongoing, after the tax was agreed upon in principle in 2009.

For more information: See the report from the Ministry for Ecology, Energy, Sustainable Development and the Sea (MEEDDM) on new environmental tax measures to promote growth (*Une nouvelle fiscalité environnementale au service de la croissance*)

Link: http://www.developpement-durable.gouv.fr/IMG/pdf/fiscalite_verte__cle14deb7.pdf