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Fundamental Liberties And Principles Of Law: A Necessary Limit To The Powers Of The French Legislator And The French Tax Authorities

By Maryse Naudin

France's structural need for budgetary income, which notably derives from a strong culture for free and accessible public services such as healthcare, education or transportation (in particular within the demographic context of an increasing and aging population), cannot lead the French legislator and the French tax authorities to override the taxpayers' and citizens' fundamental liberties and rights, even with the legitimate aim of fighting tax fraud or tax evasion.

This is even more crucial in the contemporary context of globalisation and proliferation of international transactions which has brought States in general, and France in particular, to implement data gathering mechanisms in relation to domestic and foreign situations that may involve a liability to taxation.

A recent and growing trend shows that several anti-abuse provisions of the French tax legislation, as well as their extensive application by the French tax authorities (FTA), have been challenged and eventually tempered or censored by the French Courts on the grounds of fundamental liberties and principles of Law.

In recent years, the French legislator has strengthened FTA's legal arsenal by implementing new anti-tax avoidance mechanisms, as well as data collection tools granting them a wider access to information.

Logically and in parallel, the FTA have been increasingly targeting tax planning practices or seeking to interfere in the companies' management decisions. However, despite the obviously legitimate aim of these anti-abuse mechanisms, their application turned out to be, in some cases, inappropriate or not proportional to the infringements they sought to sanction.

In this context, taxpayers have been progressively resorting to using fundamental principles of law to challenge these provisions before the Courts and eventually obtain their revocation.

Although the French Constitutional Court has become a predominant recourse for taxpayers, thanks to the possibility offered since 1 March 2010 to appeal to this Court in order to challenge the constitutionality of laws *a posteriori*, a growing jurisprudence from the lower Courts also illustrates this movement.

One major point of contention has concerned laws, or their application in tax and criminal contexts, which introduced or involved presumptions of fraud against taxpayers.

In March 2017, the French Constitutional Court mitigated the application of a French CFC legislation¹ that resulted in an irrefutable presumption of an "artificial scheme" against certain individual taxpay-



ers holding shares in companies located in certain non-EU low tax jurisdictions, on the grounds that it was contrary to the principle of equality of citizens before tax charges (unequal treatment depending on the jurisdiction where the company was located).

This ruling is consistent with another decision recently rendered by the French Criminal Court in the so-called *Wildenstein* case, where some members of a famous art dealer's family were prosecuted on charges of tax fraud for the use of offshore trusts, supposedly to avoid inheritance taxes. In this decision the Criminal Court noted that, contrary to the prosecutor's allegations that the trusts in question were fictitious, this cannot be presumed and neither the tax authorities nor the instructing judges were able to prove it. As a consequence, the defendants

were acquitted (the prosecutor appealed against this decision).

The French legislator's sensitivity to foreign trusts, viewed almost systematically as a potential instrument for tax evasion, led to another striking example of a contentious issue involving fundamental liberties, namely the right for privacy.

The French legislator enacted a law in December 2013² aiming to fight against tax fraud, which provided for the implementation of a trust registry containing information such as the names of the settlors, the beneficiaries, and the trustee of trusts with a French connection. An implementing decree³ provided that the information contained in the registry would be fully accessible to the public.



This public accessibility was held unconstitutional by the French Constitutional Court in a decision of October 2016⁴, on the basis that it would have allowed anyone, in violation to the fundamental right to privacy, to collect information on the estate of settlors and beneficiaries of trusts and their management.

It is also notable to observe that any legislation or regulation of which the application would result in granting disproportionate discretionary powers to the FTA may be successfully challenged before Courts.

In a ruling dated July 2016⁵, the French Administrative Supreme Court put end to the FTA's attempts to interfere in companies' management decisions on the basis of the so-called "undue risk theory". The Court reiterated the strict conditions under which the FTA could disallow the deduction from the corporate income tax basis of certain expenses, when they result from transactions or choices deemed contrary to the company's corporate interest.

In judging so, the Court states that the FTA's powers of appreciation and qualification of a given situation are not discretionary and cannot be applied extensively. A recent decision from the French Constitutional Court dated December 2016⁶ echoes this ruling. A

specific provision of the draft 2017 Finance Bill had introduced the so-called "Google tax", which granted large powers to the FTA to decide under what circumstances profits generated indirectly by certain entities incorporated outside of France would be liable to French corporation tax, when considering that there were reasons to believe that the holding structure was implemented in order to reduce or avoid taxation in France.

The Constitutional court censored this mechanism, on the grounds that the absolute discretion granted to the FTA was in total contradiction with Article 34 of the Constitution which provides that taxation can only result from the law.

Finally, the principle of proportionality of sanctions also gave rise to recent case law. Notably, in two decisions of July 2016⁷ and March 2017⁸, the French Constitutional Court ruled that the proportional penalties sanctioning – respectively – the failure to report foreign bank accounts (up to 5% of the amounts) and foreign trusts (up to 12.5% of the market value of the trusts' assets) were disproportionate.

The rights and means offered to tax payers are far

from being limited to French constitutional principles, and far from being the sole competence of the French Courts.

Without a doubt the recourse to the European Court of Justice (ECJ) has long proven to be very efficient. As an example, two recent ECJ decisions led to tempering the application of domestic provisions introducing additional withholding taxes on cross-border dividend distributions in certain circumstances, on the basis of the freedom of establishment principle ("Groupe Steria" case law⁹) and the EU Parent-Subsidiary Directive ("3% levy" case law¹⁰).

In addition, the possible recourse to the "Mutual Agreement" procedures (generally provided by tax treaties under the OECD Model Convention, Article 25) may also prove to be useful, specifically in the current context where the FTA – encouraged by some recent French courts decisions – are refusing the benefit of the bilateral tax treaties' provisions in the absence of any actual taxation in the other contracting State.

The above illustrates – if it were still necessary – that multiple grounds exist for taxpayers to challenge any regulation, or any application by the FTA of a regula-

tion, which may appear contrary to the fundamental liberties and principles of law.

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1. Article 123 bis of the French tax code

2. Law n° 2013-1117 dated December 6, 2013

3. Decree n° 2016-567 dated May 10, 2016

4. Conseil Constitutionnel, ruling n° 2016-591 QPC, dated October 21, 2016

5. Conseil d'Etat, July 13, 2016, n°375801, "SA Monte Paschi Banque"

6. Conseil Constitutionnel, ruling n° 2016-744 DC, dated December 29, 2016

7. Conseil Constitutionnel, ruling n° 2016-554 QPC, dated July 22, 2016

8. Conseil Constitutionnel, ruling n° 2016-618 QPC, dated March 16, 2017

9. ECJ, case law C-386/14, Groupe Steria SCA, dated September 2, 2015

10. ECJ, case law C-365/16, AFER, dated May 17, 2017