

## TIRARD, NAUDIN International Tax Newsletter

**IMPORTANT NOTE:** Tirard, Naudin has moved. New address: 9, rue Boissy d'Anglas - 75008 Paris

### LEADER

A law dated 4<sup>th</sup> August 2008, the 2009 Finance Bill and the Amended 2008 Finance Bill have introduced new provisions which seem to indicate how the French Government intend to react to the current economic situation. The main approach is to reinforce the attractiveness of France by the adoption of tax incentives for individuals who take up residence in France. Many fiscal measures have also been adopted in order to give more certainty to taxpayers. On the other hand, the international anti-evasion arsenal has also been significantly tightened.

### REINFORCING FRANCE'S TAX ATTRACTIVENESS

#### NEW WEALTH TAX REGIME FOR "IMPATRIATES"

*Wealth tax is an annual tax payable in France by individuals whose private wealth net of debts exceeds a certain amount which is determined on 1<sup>st</sup> January each year (790,000 euros for the tax due on 1<sup>st</sup> January 2009). As a general rule, when a taxpayer is resident in France, he is subject to wealth tax on his worldwide assets, whereas a non-French resident's wealth tax is assessed on his net wealth located only in France.*

The law dated 4<sup>th</sup> August 2008 has created a new favourable regime under which new domiciled can be exempt from French wealth tax on all their property situated outside France for the first five years after they take up domicile in France. This is an extension of a regime which is contained in a certain number of tax treaties negotiated between France and other States like the United-States or Germany. Only individuals who have not been domiciled in France for five years before taking up domicile may benefit from this favourable treatment. Such domicile is determined by reference to French domestic law or by taking into account the provisions of tax treaties. Under the new regime, a taxpayer who is a new domiciled in France will be subject to wealth tax, but only on his property

situated in France. This exemption will apply for five years. Liability to wealth tax is determined on 1<sup>st</sup> January of the year in question. As a result, if a taxpayer becomes domiciled in France in March 2009, the favourable regime will apply from the 1<sup>st</sup> January 2010 to 31<sup>st</sup> December 2014. From 1<sup>st</sup> January 2015, this taxpayer will become liable to wealth tax on his worldwide property.

#### REFORM OF THE FRENCH "TAX SHIELD"

*The 2006 Finance Bill introduced a complex mechanism for capping the level of annual direct taxation for each taxpayer in relation to his income (referred to as the "tax shield"). Under this regime, the maximum amount of direct tax payable in France by each taxpayer in a year may not exceed 50% of his worldwide income for the previous year.*

**Methods of repayment:** As a rule, taxpayers must file an administrative claim in order to be reimbursed of the receivables they are owed by the French tax authorities. From 1<sup>st</sup> January 2009, they are also entitled to deduct, at their own risk, the amount of these receivables of their wealth tax, social contributions and local taxes. In such a case, a special form must be filed to the service in

charge of the recovery of the tax of which the receivables have been deducted from.

**Income received in the first year of French residence.** *Before:* In their first year of residence in France, when calculating their excess tax for the purposes of the tax shield, individuals used to have to take into account any foreign income that they received from 1<sup>st</sup> January of the year of arrival to the date they actually took up residence in France.

*From 1<sup>st</sup> January 2009:* individuals who take up residence in France are allowed not to take into account, for the purposes of calculating the tax shield, any foreign income that they received before taking up residence and which was not taxable in France.

**New treatment for foreign income tax**  
*Before:* foreign income tax paid was not taken into account for the purposes of calculating the tax shield.

*From the 1<sup>st</sup> January 2009:* the amount of income which is taken into consideration in calculating the tax shield is an amount net of tax. When a tax credit is granted in France or when income is tax exempt in France, the amount taken into consideration is the net foreign income reduced by any foreign tax paid.

### DISCOURAGING INTERNATIONAL TAX EVASION

#### UNDISCLOSED TRANSFERS OF FUNDS FROM AND TO THIRD COUNTRIES

Pursuant to article 1649 quater A of the French Tax Code (FTC), transfers of funds by French resident individuals without the intermediary of a financial institution can be made from or to Member States of the European Union on condition that individuals make disclosure to the customs authorities when the amount of the transfer exceeds 10,000 euros. If they do not undertake this formality, this transfer is considered as

taxable income, unless the taxpayer proves that income has already been taxed or was not taxable in France.

From the 1<sup>st</sup> January 2009, the presumption now also applies to transfers of funds from or to a State which is not a member of the European Union.

#### FAILURE TO DECLARE CERTAIN ACCOUNTS OR CONTACTS

Individuals, associations and companies which are not commercial in nature must disclose any accounts opened, used or

closed abroad. If they fail to undertake this formality, they used to have to pay a penalty of 750 euros for each account which was not disclosed.

As from 2009 (for 2008 income tax returns), the penalty has been raised to 1,500 euros. If the account is held in a state or a territory which has not entered into a tax treaty with France that contains an administrative assistance provision allowing access to bank information, the penalty is raised to 10,000 euros for each account which was not disclosed.

#### **TIME BAR ON RIGHT OF REASSESSMENT**

**Undisclosed activity and flagrant tax abuse:** the ability of the FTA to make adjustments with respect to omissions or underassessment can only be exercised within certain legal time limits, on the expiry of which any action is time barred. For income tax, as a general rule, this period expires at the end of the third year following that in respect of which the tax is due. Where there was an undisclosed activity, the time bar period was extended to six years. The same rule applied in the event of flagrant tax abuse.

For time bar periods of six years which had not expired on 1<sup>st</sup> January 2009, the

time bar period is now extended from six to ten years.

**Bank secrecy :** a new exception to the three year period has been created with regard to corporate tax and income tax. It deals with cases of failure to report information in relation to jurisdictions which have not entered into a tax treaty with France that contains an administrative assistance provision allowing access to bank information. In such cases, the time bar period is extended to ten years. It is expected that the FTA will issue a "white list" in order to identify clearly those countries to which this measure actually relates.

The following international anti tax evasion measures relating to individuals are within the scope of this exception:

- obligation to disclose income derived from monetary or financial assets held through intermediary structures set up in foreign jurisdictions benefiting from a preferential tax regime in which they hold, directly or indirectly, a participation of more than 10% (art.123 bis of the FTC),
- obligation to disclose accounts opened, used or closed abroad, (art.1649 A of the FTC),
- obligation to disclose a life insurance policy contracted with entities located abroad (art.1649 AA of the FTC).

**CAVEAT** For the next few months, a voluntary disclosure program is available to French tax residents who want to regularize their situation, particularly in the case of unreported offshore bank accounts. In most circumstances, this will limit the penalties and avoid criminal prosecution. It should also be noted that the repatriation of funds is not compulsory and that it is possible to approach the FTA on a no name basis in order to find out what the cost would be.

### **GIVING TAXPAYERS MORE CERTAINTY**

#### **ABUSE OF LAW**

**New legal definition:** Based on the former article L64 of the Code of Tax Procedure (CTP), the procedure relating to the abuse of law (abus de droit) could only apply to acts which disguised the full scope of a contract or an agreement. The French Courts had broadly extended the scope of this text by identifying two situations where the procedure relating to prevention of the abuse of law would apply: the intention to alter the instrument in order to avoid tax by using a legal structure which appears valid but which does not show the true character of the transactions being carried out ("legal fictitiousness" or sham transactions), and real transactions the only motivation for which is to avoid or reduce the tax which would otherwise be due ("fraud on the law").

The gap between the text of article L64 B of the CTP and its interpretation by the Courts had created a legal uncertainty for taxpayers and the new text clarifies the position. The procedure can now be applied to all taxes, and in matters of both assessment and collection. The French tax authorities are entitled to use the procedure for all of the acts which amount to an abuse of law and not only for acts which disguised the full scope of a contract or an agreement. It is clear that the procedure only applies to transactions entered into exclusively for tax purposes. As a result, transactions entered into "essentially" for tax purposes are outside its scope.

**Penalties:** where an abuse of law was found, the genuine transaction was taxed rather than the simulated one. An automatic 80% fine and interest on late payment were also due. The 80% penalty and the interest on late payment were not due by the author of the abuse of law if he was not a party to the act which constituted the abuse of law. From the 1<sup>st</sup> January 2009, the 80% penalty is now reduced to 40% if it cannot be demonstrated that the taxpayer was the main instigator of the act amounting to an abuse of law or that he was the main beneficiary thereof. However, the taxpayer must pay the 40% or 80% penalty and the interest on late payment even if he is not a party to the act. The new text also creates joint liability for payment between the taxpayer and the parties to the acts constituting an abuse of law.

#### **RULINGS**

*Although France is not a country which generally gives ruling, the Government has extended the scope of existing measures and has introduced a new regime on a trial basis.*

**Abuse of law:** the wording of article L64 B of the CTP has been adapted to the new legal definition of abuse of law. It is now possible to obtain confirmation prior to any act (and not only a contract) that it will not be challenged by the French tax authorities on this ground.

**Position of the FTA:** under article L80 A of the CTP, taxpayers are generally allowed to adopt a position that has been taken by the tax authorities in opposing

tax adjustments. As from 1<sup>st</sup> January 2009, this guarantee is extended to positions relating to tax collection and penalties.

**Request for tax audits:** As a general rule, the ability of the FTA to make adjustments with respect to omissions or underassessments can be exercised until 31<sup>st</sup> December of the third year following that during which the taxable event has been disclosed to the FTA. The Amended 2008 Tax Bill introduced for an experimental period of three years a new procedure under which beneficiaries of a minimum of one third of the net assets declared can request a voluntary tax audit of a return within three months of the registration of the return. Under this procedure, the FTA can challenge the calculation made within a period of one year only. If the FTA make a request for information, the one year period is extended by any period during which the taxpayer's response is delayed by more than 30 days. The one year period is also extended when the FTA require information from foreign authorities. At the end of the one year period, the French tax authorities can no longer increase registration duties.

This procedure does not apply when assets or rights are omitted from the audited return or prior gifts made within six years before the registration have been omitted from the audited return. The FTA can also deny the shortened period when commitments or obligations leading to a favourable tax regime have not been complied with, or when the procedure relating to abuse of law applies.