Bloomberg Tax

Tax Management International Forum

Comparative Tax Law for the International Practitioner

Current Taxation of Income Earned by CFCs

Background

HCo is a limited liability business entity formed under the law of your country and is engaged in a trade or business worldwide through other business entities. HCo wholly owns SubA, which is incorporated under the law of Country A. SubA in turn wholly owns SubB, which is incorporated under the law of Country B. SubB is engaged in a trade or business in Country B. HCo, SubA and SubB are treated as corporations for your country, Country A and Country B income tax purposes.

Questions

In addressing the questions below, can you please highlight in particular any changes that have been made to the relevant rules since this topic was last addressed by the Forum (March 2011).

I. Does your country have a "controlled foreign corporation" (CFC) regime for currently taxing all or some part of the income derived by SubB in the hands of HCo (even though the value of that income is not yet considered distributed to HCo)?

Assuming your country has such a CFC regime:

A. Briefly describe the objectives of the regime.

B. What is the definition of a CFC for purposes of the regime? In particular, what are the definitions of the terms "corporation," "foreign" and controlled"? Could the CFC regime apply if SubA were instead wholly owned by an individual who is a resident of your country or by a trust or partnership?

C. What types of income of SubB are subject to current taxation in your country? Are there any "safe harbor" rules under which income may be exempt from such current taxation? Does it matter whether HCo had any tax avoidance purpose for setting up SubB?

D. Is current taxation of all or some part of SubB's income also triggered in certain other circumstances, for example, where SubB has participated in a boycott, made bribes or made investments in property in your country?

E. What rules are, or may be, used to determine Sub B's includible income for purposes of the CFC regime (for example, Country B financial accounting rules, your country's financial accounting rules, IFRS, Country B's income tax rules, your country's income tax rules, or your country's "earnings & profits" rules)?

F. How would HCo's pro rata share of income subject to current taxation be determined if, instead of the facts assumed, 70 percent of the stock value of SubA was in common stock held by HCo and the remaining 30 percent was in preferred stock held by an unrelated party?

G. How exactly is HCo taxed on the income subject to current taxation: for example, is the value of the income deemed to be paid directly to HCo or is it deemed to flow up through SubA? Are credits given for FC income taxes payable by SubB with respect to the income currently taxed in the hands of HCo? If such credits are given, how is the amount of the credits determined? What are the consequences if Country A has its own CFC regime under which income of SubB is currently taxed in the hands of SubA?

H. What mechanisms are in place to ensure that the value of currently taxed income of SubB is not taxed again by your country when it is considered distributed or the stock of SubB is sold?

I. What would be the consequences if part of HCo's indirect interest in SubB were held through a corporation that did not constitute a CFC for your country's income tax purposes?

J. What is the impact, if any, on your country's CFC regime of any treaties that your country has entered into, for example, bilateral income tax treaties or the European Union "Constitution"?

II. Are there any other regimes in your country's income tax law under which income derived by an entity that is not itself subject to taxation by your country might be currently taxed in the hands of direct or indirect owners of the entity that are residents of your country? Assuming that there is/are such regime(s):

A. Briefly summarize the rules of such regime(s).

B. What is the impact, if any, on such regime(s) of any treaties that your country has entered into?

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FRANCE: CFC Rules

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I. The CFC regime in France generally

A. History and objectives of the French CFC regime

Controlled foreign corporation (CFC) rules were introduced into the French legislation by the 1980 Finance Law in the form of Article 209 B of the French Tax Code (FTC). The rules allow the French Tax Administration (FTA), in certain circumstances, to impose French tax on the results of a French corporation's foreign subsidiary or branch that is subject to a privileged tax regime abroad.

Although, historically inspired by the U.S. rules, the French CFC regime relies on different technical assumptions because of the French territoriality rules. France has a territorial tax system under which corporate tax is payable by corporations only on business executed in France. The income of its foreign branches is in principle ignored in determining a corporation's French taxable basis. In addition, the double taxation of dividends from foreign subsidiaries is eliminated by the exemption of the dividends (only a lump sum 5% of the dividends, which is deemed to correspond to shareholder costs, is taxed) rather than a tax credit (the former tax credit, the *avoir fiscal* has been repealed).

Thus, a French corporation ("FrenchCo") that has branches and controlled subsidiaries abroad is in principle never taxed on the foreign profits realized abroad, even when those profits are repatriated in the form of dividends. This is in contrast to the tax systems of countries like the United States, which tax worldwide profits, use tax credits to avoid the double taxation of dividends received from foreign subsidiaries, and have CFC rules that accelerate the taxation of foreign income that should, in principle, anyway become taxable at some stage, i.e., when (and if) the income is distributed. In short, the CFC regime in the United States is mainly a matter of timing, while in France it is, in principle, purely a matter of tax nexus.

The French CFC rules (Article 209 B of the FTC) allow for the taxation of foreign profits derived by branches and subsidiaries established or incorporated in low-tax countries that are in principle never taxable in France, even if repatriated. However, these provisions include safe harbor rules that can significantly narrow the extent of the situations in which Article 209 B applies. As a result of the restrictive stance historically taken by the FTA, the scope of the safe harbor rules, which are discussed in more detail I.C., below, is open to debate and indeed is regularly the subject of litigation.

After its implementation in 1980, Article 209 B of the FTC was first amended to extend its scope to encompass foreign branches, which were not covered by the regime as initially introduced. After that amendment, no significant changes were made until those introduced by the Law of December 30, 2004, which amended the CFC provisions in response to certain French and European court decisions.

The main 2004 amendment consisted of a change to the characterization of the income taxed in the hands of a FrenchCo consequent on the French *Schneider* case,[1] so as to allow for the taxation of CFC income in a treaty context. In its initial version, Article 209 B of the FTC provided that a FrenchCo was to be taxed on the "profits" derived by its CFC. The French High Court ruled that such taxation was not consistent with the provision in tax treaties under which "business profits" are taxable in the State in which they are derived. The law was then changed to provide that, in the case of a subsidiary, taxation proceeds on the basis that there is a deemed distribution by the CFC to the FrenchCo. According to the FTA, this deemed distribution cannot benefit from the participation exemption, which seems logical with respect to the purpose of the provision, but does not follow from the law, since Article 145.6 only excludes dividends from black-listed "non-cooperative States" (the list of non-cooperative States published by the FTA evolves each year and is, so far, very short even though it was recently extended to include also countries on the EU blacklist[2]). The consequences of this change and the potential impact of tax treaties on the application of the French CFC rules are discussed in more detail in I.G., below.

The other amendments made to the text concerned the definition of the safe harbor rules limiting the scope of the CFC provisions, but these changes were more cosmetic than substantive and did not significantly alter the rules, which included safe harbor rules from the beginning, although the effectiveness of these rules was confirmed only later by case law (see the detailed discussion of the current incarnation of the safe harbor rules in I.C., below).

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The recent BEPS initiatives (Action 3) did not seem to require any change since the existing CFC rules were already BEPS-compliant. The Anti-tax Avoidance Directive (2016/1164) of July 12 2016 (ATAD), Articles 7 and 8 of which include provisions on CFCs that must be implemented and applied by the Member States before January 1 2019, may, however, require some amendments to the current French provision. At the time of writing, the draft bill does not provide for any such amendments, but it remains possible that such amendments may be introduced in the coming weeks or months. The main change may concern the definition of CFC income and the wording of the safe harbor rules (see I.C.4., below).

B. Definition of a CFC for purposes of the regime

FrenchCo will be subject to taxation under Article 209 B of the FTC if it holds, directly or indirectly, more than 50% of the shares, voting rights or financial rights in a legal entity incorporated outside France in a country in which it is subject to a privileged tax regime. Article 209 B also applies to foreign branches established in such countries. A foreign tax system is considered to be a privileged tax regime if, under that regime, the amount of tax borne by the local entity on its income is less than 50 % of the tax that would have been payable in France on the same income computed under French tax rules. This threshold will be reduced to 40% in 2020 The French corporate tax rate is currently 33.33% (plus some additional contributions), but is supposed to be progressively reduced to 25% by 2022. The threshold, which is currently around 17% of the income computed under French rules, should thus go down to 25 x 60% = 15% (thus, for example, potentially leaving Ireland, with its 12.5% rate, within the scope of the CFC rules, subject to the resolution of questions related to the computation of the tax basis).

As regards the minimum holding in the CFC, whether the 50% threshold is reached can be tested by reference to shares, voting rights or financial rights (the financial rights and voting rights are tested separately and are not aggregated for purposes of this test). The percentage of shares, financial rights or voting rights held indirectly through a chain of shareholdings is obtained by multiplying the successive holding percentages by each other. Rights held by related parties with which FrenchCo has a common interest (whether of a personal, financial or economic nature) may also be taken into consideration in computing whether the 50% holding threshold is reached.

The 50% threshold can be reduced to 5% when the holdings have been artificially fragmented. Specifically, the 5% threshold applies when more than 50% of the shares in the CFC are held either by other corporations established in France or by related parties of the French corporation.

C. Types of income subject to the CFC regime — the safe harbor rules

Technically, Article 209 B of the FTC allows any kind of income derived by a foreign branch or CFC to be taxed. However, Article 209 B II and B III provide safe harbor rules that, in essence, prevent the CFC provisions from applying not only when the branch or CFC carries on a genuine activity (i.e., from applying to "active income") but, more generally, when the principal purpose of the implementation of the CFC is not to avoid French tax.

The wording of these safe harbor rules has been amended several times over the past three decades, sometimes creating more questions than those it resolves, and the current wording, which is very close to the initial 1980 wording, has been clarified by both the High Court (*Conseil d'Etat*) and the Constitutional Council (*Conseil Constitutionnel*). The law provides different wording for situations involving CFCs incorporated in EU Member States and those involving CFCs incorporated in non-EU countries, though, as will be seen below, for constitutional reasons, the differences between the two situations are not substantial.

These safe harbor rules, the interpretation of which seemed to be settled, may be changed again in the near future as a result of the implementation of the ATAD (see C.4 below).

1. The activity test for non-EU CFCs

The law allows for the exclusion from the CFC regime of situations in which the principal activity of the CFC concerned (whether a branch or a subsidiary) is located in the country in which it is taxed at a low rate. The wording of the relevant provision has changed over time.

The law initially included a reference to such activity being carried on in the "local market," which the High Court interpreted in 2012[3] as also meaning with "local clients." The High Court consequently held that a private bank in Guernsey or the Bahamas rendering services to international clients could not benefit from this part of the safe harbor rules (but the High Court also held, in the same decisions, that these banks could claim the benefit of the purpose test, for which see below).

The reference to the local market has now been removed from the law and the existence of an activity should be enough, to the extent it is an effective industrial or commercial activity and is carried on in the country concerned: according to the FTA, non-commercial activities such as deriving real estate income or the activities of pure holding companies are excluded from this test. This potentially also excludes situations in which a CFC has no activity in the country in which it is taxed at a low rate, but has an activity in another country.

In situations where the activity test cannot apply, passing another test, the "purpose test," can also allow CFC taxation to be avoided.

2. The purpose test for non-EU CFCs

Under Article 209 B III, CFC taxation should not apply to FrenchCo's CFC income if FrenchCo establishes that the main effect and purpose of the establishment of the foreign CFC concerned is not to allow the localization of profits in a low-tax country.

This element of the safe harbor rule was long ignored by the FTA, which only took into account the "activity test" described in I.C.1., above. In taking this approach, the FTA relied on the reference to the "effect" wording in the law to assert that the establishment of a CFC in a low-tax country in practice always has the effect of reducing the tax burden compared to tax resulting from the application of the French tax rate, thus depriving this part of the law of any significance. The FTA's position was based on the view that the CFC rules were an automatic mechanism, admitting of few exceptions and creating a technical derogation from the normal rules to combat the attractiveness of low-tax countries by subjecting taxpayers investing in such countries to tax treatment of a deterrent nature.

However, a number of court decisions made it possible to draw the conclusion that this comprehensive approach to the CFC rules (relying on a restrictive interpretation of the safe harbor rules) was not in line with the objective of the CFC rules or constitutional principles.

First, in *Sonepar*,[4] the High Court confirmed that Article 209 B of the FTC is an anti-avoidance rule, the effect of which must be limited. As noted above, Article 209 B allows one person to be taxed on another person's income and represents an obvious exception to French territoriality principles. Although the rule potentially contravenes the equal treatment of taxpayers in violation of Article 13 of the *Déclaration des droits de l'Homme et du Citoyen* (the "Declaration of the Rights of Man and of the Citizen"), its purpose is to fight against tax avoidance, which is also an important manifestation of this same principle of equality. In reaching its decision, the High Court observed that the law allows a taxpayer to avoid the application of the CFC rules by establishing that there is no avoidance of French tax and therefore concluded that Article 209 B is not incompatible with the Constitution.

This decision is important because it confirms the importance of the safe harbor rules and the purpose test and insists that it is necessary for these rules to be effective to confer legitimacy on the mechanism as a whole. Concerning other anti-avoidance rules applicable to flows involving black-listed "non-cooperative countries," the Constitutional Council later confirmed, in an AFEP decision,[5] that the absence of safe harbor rules in the law would contravene the principle of equality and concluded that the text of the law should be interpreted as implicitly entailing such safe harbor rules based on a purpose test. The anti-avoidance mechanisms concerned create a simple presumption of avoidance, but must allow that presumption to be contested by the taxpayer.

The other significant contribution of the *Sonepar* decision is that it indicates that the avoidance that must be present for Article 209 B of the FTC to apply must relate to French tax. This is important because it means that the CFC rules should not apply if the income concerned would anyway not have been taxable in France, if a CFC had not been interposed: Article 209 B is a tax measure to combat evasion, not a weapon of economic warfare against countries with a lower tax burden than France.

The principles confirmed by the French High Court in *Sonepar* are, unsurprisingly, consistent with the principles established six years beforehand by the Court of Justice of the European Union (CJEU) in the landmark *Cadbury Schweppes* case[6] (see further below).

The High Court has had occasion to rule on the purpose test in a number of cases concerning subsidiaries of banks located in tax havens such as Guernsey or the Bahamas. Initially, in 2012, the High Court held that the private banking activities carried on locally by the subsidiaries did not qualify under the activity test, because the subsidiaries' clients were not local (see I.C.1., above), but indicated in the *BNP Paribas* 2012 decisions already cited that it was necessary to establish whether the purpose test applied (the application of this test had not been considered by the Court of Appeal).

The cases concerned were remanded to the Court of Appeal, which confirmed that the purpose test applied because the French bank concerned had provided sufficient evidence that the earning of income by its subsidiaries did not involve the avoidance of French tax by the French bank. The FTA again appealed the Court of Appeal's decision to the High Court on the grounds that the bank had not provided evidence that there were no French residents among the clients of the subsidiaries. In a number of decisions handed down in 2015,[7] the High Court confirmed the application of the purpose test, finding that the place where the clients were resident was, in these circumstances, irrelevant. Since, the income realized by the private banks in the countries concerned from these clients would not have been realized in France irrespective of where the clients were resident, there was no avoidance of French tax by the French bank. The questions relating to the taxation of the bank's clients were irrelevant to the application of the CFC rules to the bank.

The purpose test can be applied when the activity test does not apply, for example, where a CFC has no activity in State A where it is located, but carries on an activity in State B using its own staff, even if it is not taxed in State B. If the activity in State B is not taxable in France under French territorial rules because the activity constitutes a permanent establishment (PE) in State B, there is no avoidance of French tax and the purpose test should apply. The result would, of course, be different if, instead of being hired by the CFC, the staff were in fact employed by the French holding company and were in fact performing the activity from France.

Whether there is an activity is, of course, an important question in any consideration of the purpose test, but is not the central question, which remains whether the income concerned would have been taxed in France if the CFC had not been artificially interposed. From this perspective, how these rules should apply to holding activities that involve no commercial operations but whose purpose is not to avoid French taxes is open to debate – all the more so because the scope of France's taxation nexus is narrower than that of most countries because of France's territorial approach and exemption system.

Another example is afforded by the "Trojan horse" scenario, in which a French group gains control of a foreign group that has stakes in CFCs that have been put in place for non-French tax reasons. French law does not provide any specific resolution in these circumstances (unlike the laws of some other countries, for example, the United Kingdom, which grant a delay period to allow the position to be regularized), but the focus should be on the purpose test if the existence of the "Trojan horse" has nothing to do with French taxation.

While the FTA has historically adopted a restrictive position with regard to the interpretation of the purpose test and has not elaborated much on the recent case law in its guidelines, recent discussions appear to indicate that some progress is being made in this respect.

In 2010, the safe harbor rules were amended as regards their application with respect to branches and CFCs located in black-listed "non-cooperative States." The specific rule concerned was later removed from the law, because it added nothing of substance to the general rules for non-EU CFCs and was therefore of no use.

The conclusion that may be drawn is that avoidance is to be combatted to the same extent wherever it takes place and, at the same time, taxpayers' rights to defend themselves are to be preserved.

3. Specific rules for EU CFCs

In its landmark *Cadbury Schweppes* decision,[8] the CJEU held that the UK CFC regime (which was comparable to the regime provided for in Article 209 B of the FTC) constituted an obstacle to the freedom of establishment, which was not permissible except where it could be justified by a compelling reason, i.e., where it was necessary "to prevent conduct involving the creation of wholly artificial arrangements which do not reflect economic reality, with a view to escaping the tax normally due on the profits generated by activities carried out on national territory."

A special provision concerning branches and CFCs located in the European Union was approved in December 2005, some months before (and probably, to some extent, in anticipation of) *Cadbury Schweppes* and has applied since 2006.

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The safe harbor rule provided for in Article 209 B II of the FTC exempts from the scope of the CFC rules situations involving EU CFCs (or branches) that do not constitute "artificial arrangements designed to circumvent the French tax legislation." The definition of an "artificial arrangement" for these purposes mirrors the wording of the *Cadbury Schweppes* decision and is very close to the definition of "abuse of law" (*Cadbury Schweppes* followed and was influenced by another landmark CJEU decision, *Halifax*,[9] which concerned the *fraus legis* concept). In its comments on the provision containing this definition, the FTA has indicated that proof that there is an artificial arrangement may be adduced by any means.

It seems evident that the carrying on of any effective activity in the European Union that corresponds to an establishment in the European Union should qualify for exemption from the application of the CFC rules. The question, however, is whether the safe harbor in an EU context should be available based only on the restrictive "activity test" described in I.C.1., above or whether it should also be based on a broader "purpose test." In other words, can the safe harbor rule for EU CFCs be narrower in scope than the rule for non-EU CFCs? There appear to be grounds for raising this question when one compares the wording of paragraph II of Article 209 B to paragraph III of the same Article. Some grounds for raising it may also be found by some commentators in certain parts of the *Cadbury Schweppes* decision, which insist on the need for substance in the establishment. Except in situations in which a genuine activity exists, the difficulty for FrenchCo is that it bears a negative burden of proof, i.e., it must show that it *did not* create an artificial arrangement to avoid French tax. This seems to move the discussion in the direction of *fraus legis* and it is not certain that the scope of that concept aligns with the scope of the "purpose test" discussed above, which requires a taxpayer to establish that the "effect and purpose of the implementation of the foreign CFC is not to allow the localization of profits in a low-tax country."

Suggesting that the interposition of subsidiaries and branches in the European Union could be treated less favorably than their interposition outside the European Union would, however, appear to make little sense and the conclusion (at least the conclusion reached by this author) is that, for a number of reasons, the same activity and purpose tests should apply in the same way in all situations.

First, the CJEU decision concerned a situation in which the freedom of establishment was at stake and it was logical for the CJEU to refer to situations in which an establishment is not fictitious. A request based on the free movement of capital would not have required such a precaution insisting on substance in the establishment. Second, the French High Court and the Constitutional Council confirmed that an anti-avoidance measure of the kind concerned could not apply without taxpayers being allowed to contest the presumption of avoidance of French taxation. This is consistent with the conclusions in *Cadbury Schweppes* (at paragraph 37), in which the CJEU indicated that "As to freedom of establishment, the Court has already held that the fact that the company was established in a Member State for the purpose of benefiting from more favourable legislation does not in itself suffice to constitute abuse of that freedom". The CJEU also insisted (at paragraph 55) on the fact that the CFC rules justify themselves as combatting wholly artificial arrangements that do not reflect economic reality and are entered into with a view to escaping the tax normally due on the profits generated by activities carried out on national territory (i.e., here, France). Hence, in the author's opinion, the definition of the safe harbour rules applicable to non-EU interpositions (see I.C.1. and 2., above), which is clearer and potentially broader than that which applies to EU interpositions, should in any case also apply to EU situations (see however I.C.4 below).

In 2014, the French High Court[10] had occasion to rule on a situation in which a "1929" holding company located in Luxembourg and controlled by French entities was receiving passive income. The court considered that the holding company did not have enough economic substance to support the existence of a real activity. In the absence of any argument capable of sustaining the proposition that the main purpose of the company was not to avoid French tax, the application of the CFC regime was confirmed.

4. Potential impact of the EU Anti-tax Avoidance Directive

As noted above, the ATAD, Articles 7 and 8 of which include provisions on CFCs that must be implemented and applied by the Member States before January 1, 2019, may require some amendments to the current French provision.

As of the time of writing, the draft bill does not provide for any such amendment and it is difficult to envisage what these amendments (if any) might be, since the Directive allows the Member States to choose between two different methods of defining what CFC income is, either by providing (Article 7.2.a) a limited list of types of income that are deemed to be taxable as CFC income, i.e. mainly passive income, or by referring (Article 7.2.b) to "income arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage."

The election for the second method (Article 7.2.b) would probably not entail significant changes to the current French approach, for the reasons explained above, and it is not certain that, in this case, the text would be modified. Should the Parliament opt for the first method (Article 7.2.a), the safe harbor rule provided by the Directive, which refers to the notion of substance in the entity, rather than, more comprehensively, to the absence of tax avoidance with respect to the French tax nexus, may trigger new and lengthy discussion as to what the objectives of the rule are: to combat tax evasion, or to institute a competition between Member States for tax basis, and to fight against State aids and unfair tax competition, irrespective to the existence of an effective element of tax evasion in France.

D. Rules used to determine CFC income

Under the CFC rules, the income of a foreign branch or CFC is deemed: (1) in the case of a branch, to be derived by; or (2), in the case of a subsidiary, to be distributed to, FrenchCo on the first day of its financial year following the end of the branch's/CFC's accounting period. The income is computed in accordance with the French tax rules and French generally accepted accounting principles (GAAP).

Dividends received by a CFC are exempt from tax in the same way as other dividends received by FrenchCo (i.e., there is a 95% exemption if the CFC owns more than 5% of the capital of the distributing corporation). Dividends received by a CFC from corporations in non-cooperative States do not benefit from the 95% exemption. This exclusion was introduced in 2009, the previous version of the law providing an exemption for dividends received from corporations resident in countries with tax treaties providing for an exchange of tax information with France. Long-term capital gains on the sale of investment stock held by a CFC are also 95% exempt.

Losses incurred by a CFC or a foreign branch cannot be set off against FrenchCo's profits or the profits of another CFC, but

can be carried forward to offset the income of the branch or CFC incurring the loss in subsequent years. Losses incurred by FrenchCo can, by contrast, be set off against profits of its CFCs or branches (which was not possible before 2006).

E. Rules for determining pro rata shares

Obviously, where FrenchCo has a foreign branch or owns directly all of the shares of a CFC, its *pro rata* share in the income of the branch or CFC will be 100%, and it can be taxed on all of that foreign income, except when the safe harbor rules apply to the income.

The situation is slightly more complicated when FrenchCo meets the 50% participation threshold that triggers the application of Article 209 B of the FTC, but part of the 50% (or more) participation is held indirectly:

- First, while voting rights are taken into account in computing whether the 50% threshold is reached, they are ignored in computing the proportion of the CFC income to be included in the taxable income of FrenchCo, as are shares that are held by related parties with which the French corporation has a common interest but that are not owned directly or indirectly by FrenchCo; and
- Second,[11] to avoid double taxation, financial rights held indirectly in the CFC by another, intermediary, French entity that is already subject to tax in France under Article 209 B on the CFC income are ignored. Hence, where there is a chain of holdings, the entity liable to tax under Article 209 B is the entity that is at the tier closest to the CFC.

F. Adjustments to prevent double taxation on actual distributions or the sale of stock

The tax paid locally by a branch or CFC can be credited against the tax payable by FrenchCo on the CFC income, provided such local tax can be "assimilated to" French corporation tax. This requires certain conditions to be fulfilled, i.e., that: the local tax is computed as a percentage of income; the tax is not deductible from income; and payment of the tax is final and without counterparty. In the case of an indirect subsidiary, the tax paid locally can be credited in proportion to the financial rights held, directly or indirectly, in that subsidiary by the FrenchCo subject to Article 209 B of the FTC.

Withholding tax imposed on dividends, interest or royalties received by a branch or CFC and paid in a country with which France has signed a tax treaty can also be credited in accordance with the terms of the treaty concerned (however, taxes paid in non-cooperative States cannot be credited).

Dividends received by FrenchCo from a CFC that have already been taxed as a deemed distribution are exempt from corporate tax including the 5% portion that normally remains taxable under the French participation exemption. Withholding tax imposed on the distribution of such dividends can be set off against the French tax payable on the CFC income.

The law does not provide a specific rule for dealing with double taxation resulting from CFC taxation in France and in another country with similar CFC rules. The FTA has indicated that such situations need to be examined and resolved in light of the tax treaty between France and the other country (if any). In such situations, however, it is likely to be possible to argue for the application of the safe harbor rules on the grounds that the CFC was created for non-French tax reasons (see I.C., above).

No adjustment is made to any gain on the sale of the shares of a CFC, but such a gain can benefit from the participation exemption for long-term gains. Only shares in CFCs located in non-cooperative states are excluded from the exemption (and, in such circumstances, there is clearly a risk of double taxation when the CFC rules apply).

G. Impact of France's Tax Treaties

In contrast to the position in some countries (for example, the United States), the French Constitution provides that a treaty entered into by France automatically takes precedence over domestic law, even law that is enacted after the signing of the treaty.

As noted in I.A., above, the French Supreme Court ruled in *Schneider*[12] that, unless it is expressly authorized by the applicable tax treaty, the taxation of the profits of a foreign branch or CFC is not consistent with the treaty provision under which business profits are taxed in the country in which they are derived.

This case law continues to apply with respect to foreign branches, so that the taxation of the income of such branches under Article 209 B of the FTC depends on whether the applicable tax treaty expressly allows Article 209 B to apply, either by referring to it or by providing for a method of elimination of double taxation by way of a tax credit rather than an exemption method. France's recent treaties generally allow for such taxation, but not all France's treaties have been adapted to that effect.

As regards subsidiaries, the law has been amended so that FrenchCo is not technically taxed on the profits derived by its CFC, but on a distribution deemed to be made by the CFC. The purpose of the change was to provide for a CFC's income to be taxed as "other income" (when the applicable treaty so allows) or as dividend income (which, depending on the definition of dividend income in the applicable treaty, can create an issue when no income is effectively distributed). The new wording of the law has not yet been tested before the High Court.

II. Other anti-evasion regimes

The French tax law has for a long time (since 1925 in relation to registration duties and since 1941 in relation to income tax) a general anti -avoidance rule directed against abuse of law or *fraus legis*. Article L 64 of the French Tax Procedure Code (LPF), which is generally referred to as the "abuse of law" (AOL) rule, allows the FTA to challenge the tax treatment of a transaction when the real nature of that transaction has been disguised or the transaction has been entered into for the sole purpose of avoiding tax. The use of this rule by the administration is subject to a specific procedure and the burden of proof lies with the administration, unlike in the case of the CFC rules under which the burden of proof is shifted to the taxpayer. This specific procedure will not be addressed in any detail here.

In addition, pursuant to the ATAD, all EU Member States have had to introduce a general anti-avoidance rules into their domestic law. The draft finance bill for 2019 consequently reproduces this rule in a new Article 205 A of the FTC. The text of Article 205 A mirrors the text of the ATAD, which provides "1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. 2. For the purposes of paragraph 1, arrangements or a series thereof shall be regarded as non-genuine to the extent

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that they are not put into place for valid commercial reasons which reflect economic reality. 3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law."

This new provision comes on top of the existing anti-abuse provisions of Article L 64. It remains uncertain at this stage how the new rule, which is very far from being clear, will apply.

Apart from these general anti-avoidance provisions, it is also worth mentioning:

- Under Article 238 *bis* O I of the FTC, a French company that transfers assets outside France, whether directly or indirectly, to a person, an organization, a trust or a comparable institution with a view to managing such assets in its own interest or assuming for its own account an existing or future commitment or liability is taxable on the income resulting from the management of those assets. The provisions of Article 238 *bis* O I may apply concurrently with those of Article 209 B. Article 238 *bis* O I applies, in priority, to income defined in that article, with the remaining portion of the CFC income being taxable under Article 209 B, so that the same profits are not taxed twice. Article 238 *bis* O I is, however, seldom invoked by the FTA.
- Article 238 A of the FTC, which provides that interest, royalties and fees for services payable to an entity located in a tax haven are allowed as deductible expenses only if the debtor supplies proof that the expenses correspond to actual operations and that they are priced at arm's length.
- Article 123 *bis* of the FTC, which provides a rule equivalent to Section 209 B that applies to individuals owning more than 10% of an entity located in a tax haven.

NOTES

[1] CE ass. June 28, 2002 n° 232276, *ministre c/ Sté Schneider Electric*. RJF 10/2002n 1080.

[2] The last list published by the Administration in December 2015 identifies the following non-cooperative jurisdictions: Botswana, Brunei, Guatemala, the Marshall Islands, Nauru and Niue. The recent law to combat fraud and tax evasion extended this list to countries on the black list issued by the European Union, which, on October 5, 2018, included: American Samoa, Guam, Namibia, Samoa, Trinidad and Tobago, and the U.S. Virgin Islands. This list is constantly changing (Namibia was removed on November 6, 2018), and is hard to follow for taxpayers wishing to know if they can reasonably engage in business with these jurisdictions.

[3] CE November 28, 2012, n° 338682, n° 341128, n° 341928, n° 342065, *min. c/ Sté BNP Paribas*, CE December 26, 2012 n°349071 and n°350366 *HSBC France*.

[4] CE QPC *Sonepar*, February 2, 2012.

[5] *Conseil Constitutionnel* 2014-437 QPC January 20, 2015, AFEP.

[6] CJEU September 12, 2006 aff. 196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd*.

[7] CE December 30, 2015 n°372522 and 372733 *Set BNP Paribas* and CE March 16 2016 n°372768 *HSBC France*.

[8] CJEU September 12, 2006 aff. 196/04 RJF 2006 n 1644.

[9] CJEU February 21, 2006 aff. 255/02, *Halifax plc*.

[10] CE July 4, 2014 n° 357264 et 359924, *Sté Bolloré*.

[11] FTC, Art. 102 T of annex II.

[12] CE ass. June 28, 2002 n° 232276, *ministre c/ Sté Schneider Electric*. RJF 10/2002n 1080.