FRANCE

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LIST OF ABBREVIATIONS

Agreement	Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments
CGI	*Code Général des Impôts* (French Tax Code)
BOI	*Bulletin Officiel des Impôts* (Official Tax Journal)
Directive	Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payment made between associated companies of different Member States
D. adm.	*Documentation Administrative* (Administrative Documentation)
ECJ	European Court of Justice
LPF	*Livre des Procédures Fiscales* (Tax Procedures Code)
Merger Directive	Council Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States
OECD	Organization for Economic Cooperation and Development
OECD MC	OECD Model Tax Convention 2003
Parent-Subsidiary Directive	Council Directive 90/435/EEC of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
Savings Directive	Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments
SICAV	*Société d'investissements à capital variable* (open-ended investment company)
Parent-Subsidiary Guideline	Guideline 4 J-2-92 of 3 August 1992
RJF	*Revue de Jurisprudence Fiscale* (Revue of Tax Jurisprudence)
UN MC	United Nations Model Tax Convention

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LIST OF LEGAL REFERENCES

Laws

- Law 2003-1312 of 30 December 2003, Journal Officiel de la République Française, 31 December 2003, page 22594.
- Law 91-1323 of 30 December 1991, Journal Officiel de la République Française, 31 December 1991, page 17278.

Decrees

- Decree 2005-26 of 13 January 2005, Journal Officiel de la République Française n° 12 of 15 January 2005, page 661.
- Decree 2004-1017, 22 September 2004, Journal Officiel de la République Française 227 of 29 September 2004, page 16712.

Administrative Guidelines

- Guideline BOI 4 J-2-92 of 3 August 1992.
- Guideline BOI 4 J-3-97 2 December 1997.
- Guideline BOI 14 B-5-04 of 9 July 2004.
- Guideline 4C-7-04 of 27 September 2004.
- Guideline BOI 5 I-3-05 of 12 August 2005.

Administrative documentations

- D. adm, 4 J-1334 of 1 November 1995.
- D. adm. 4 H 1414, No. 41, 1 March 1995.

Case law

- ECJ, C-283/94 *Denkavit International BV v. Bendesamt für Finanzen*, 17 October 1996, European Court Reports 1996 Page I-05063.
- Conseil d'Etat, CE, 4 November 1983, No. 34,516; DF 1984, No. 52, Comm. 2,363, RJF 1/84, No. 19.
- Conseil d'Etat, CE, 11 December 1974, No. 93,653, RJF 2/75, No. 5.
- Conseil d'Etat, CE, 30 December 2003, No. 249047 and No. 233894.
- Conseil d'Etat, CE, 27 April 2004, advise published in Guideline BOI 4C-7-04 of 27 September 2004.

PART I. IMPLEMENTATION OF THE DIRECTIVE

1. INTRODUCTION

1.1. GENERAL INFORMATION ON THE IMPLEMENTATION OF THE DIRECTIVE

Article 27 of the Finance Amendment Law for 2003 implemented the Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payment made between associated companies of different Member States (the "Directive") in France (Law 2003-1312 of 30 December 2003). The provisions of Art. 27 were codified in new Arts. 119 quater and Art. 182B bis of the French Tax Code (*Code général des impôts*, "CGI") and in new article L 208 A of the Tax Procedures Code (*Livre des Procédures Fiscales*, "LPF"). The parliamentary proceedings concerning the implementation of the Directive are contained in a report of the Finance Committee of the French Senate (Report No 112 (2003-2004) of 11 December 2003; (*Rapport n° 112 (2003-2004) de M. Philippe MARINI, fait au nom de la commission des finances, déposé le 11 décembre 2003*).

The French tax authorities have not yet published their guidance on the implementing legislation in a Guideline. The French implementing legislation is similar in many aspects to that of the Parent-Subsidiary Directive. Therefore the published guidance issued by the tax authorities on the implementing legislation of the Parent-Subsidiary Directive (Guideline 3 August 1992, 4 J-2-92 and D. adm, 4 J-1334 of 1 November 1995) will be used to describe the approach of the tax authorities on several aspects common to the Parent-Subsidiary Directive and this Directive. According to informal conversations with the tax authorities, a Guideline commenting on the implementation of the Directive is to be prepared in future.

The enacted provisions concern the abolition of the withholding tax on French-source interest and royalty payments made by a French qualifying company to an associated company resident in another EU Member State. The provisions apply to interest and royalties paid as of 1 January 2004.

The following table depicts the relevant provisions of the French law implementing the Directive:

Articles of the Directive	Relevant sections of national laws
Art.1 (1)	CGI, Art. 119 quater (1)
Art. 1(2)	CGI, Art. 119 quater (1)
Art. 1 (3)	---
Art. 1 (4)	CGI, Art. 119 quater (2)
Art. 1 (5)	
(a)	---
(b)	CGI, Arts. 119 quater (2) and 182 B bis (2)
Art. 1 (6)	---
Art. 1 (7)	CGI, Art. 119 quater (2) (d) and 182 B bis (2)

Articles of the Directive	Relevant sections of national laws
Art. 1 (8)	CGI, Arts. 119 quater (2) (d) and 182 B bis (2)
Art. 1 (9)	---
Art. 1 (10)	CGI, Arts. 119 quater (1) and 182 B bis (2)
Art. 1 (11)	CGI, Annex III, Art. 46 quater–0FB
Art. 1 (12)	---
Art. 1 (13)	CGI, Annex III, Art. 46 quater–0FB
Art. 1 (14)	---
Art. 1 (15)	Art. L 208 LPF/ Art. R 196-1 LPF
Art. 1 (16)	Art. L 208 LPF/ Art. R 196-1 LPF
Art. 2 (a)	CGI, Art. 119 quater (1)
Art. 2 (b)	CGI, Art. 182 B bis (1)
Art. 3 (a)	CGI, Art. 119 quater (2)
Art. 3 (b)	CGI, Art. 119 quater (1)
Art. 3 (c)	---
Art. 4 (1)	CGI, Arts. 109 (I) and 212
Art. 4 (2)	CGI, Art. 119 quater (3)/ Art. 182 B bis (3)
Art.5 (1) and (2)	CGI, Art. 119 quater (3)/ Art. 182 B bis (3)
Art. 7	Finance Amendment Law for 2003

1.2. TAX TREATMENT OF INTEREST AND ROYALTY PAYMENTS UNDER GENERAL TAX LAW

1.2.1. Domestic rules

a. Tax treatment at the level of the paying company

Deduction of interest and royalty payments

Royalties and interest are generally deductible in computing the company's income, provided they are incurred for business purposes and the remuneration applied is not excessive (CE, 4 November 1983, No. 34,516; DF 1984, No. 52, Comm. 2,363; RJF 1/84, No. 19). Subject to certain exceptions, interest on loans used to acquire a participation in another company is deductible even if the dividends received from the participation are (partially) exempt. The deduction of interest paid to related parties may be disallowed under the maximum interest rates rules (the maximum rate amounts to the annual average effective rates charged by credit institutions for variable rate loans to enterprises for an initial duration exceeding 2 years and it is published quarterly), transfer pricing rules and thin capitalisation rules. The deduction of royalty payments may be disallowed under the transfer pricing rules.

In respect of French permanent establishments of foreign companies, the deduction of interest paid to the foreign general enterprise is not allowed because the branch is not a separate legal entity. The tax administration has however considered that the deduction of interest paid on a loan that was contracted under normal commercial conditions is deductible (Ministerial Reply to Mr. Mesmin, Deputy, AN, 19 January 1981, p. 245, No. 31,725; Doc. adm. 4 H-1414, No. 40, 1 March 1995).

Thin capitalisation rules

The deduction of interest paid to shareholders who "in law or in fact" manage the company or own more than 50% of its share capital or voting rights is limited to interest on that amount of debt not exceeding 150% of equity. No deduction is allowed unless the capital is fully paid up. The amount of debt to be taken into consideration is that collectively owed to all such shareholders.

The limitation does not apply to interest paid to a parent company subject to French corporate tax at the standard rate (which includes subsidiaries and permanent establishments of foreign companies provided the participation in the debtor is part of their assets). Non-resident parent companies do not benefit from this safe harbour rule. By virtue of recent case law, the thin capitalization rules do not apply in any situation involving a parent company resident in (i) an EU Member State or (ii) in another state but covered by a treaty containing a non-discrimination clause similar to Art. 24 (5) of the OECD MC (CE, 30 December 2003, No. 249047 and No. 233894). The rules continue to apply to non-EU states without a treaty or with a treaty which does not contain a said clause or which has not been negotiated or renegotiated after 23 July 1992 (the date of adoption of the new OECD commentaries on thin capitalization rules) or which expressly authorizes the application of the rules. Accordingly, the rules remain applicable with respect to about 60 countries, including Japan and the United States. For a non-resident company to be subject to the limitation, however, it has to be represented on the board of the debtor or own more than 50% of its share capital or voting rights. It should be noted that the Finance Bill for 2006 provides for a reform of the thin capitalization rules from 2007. The new rules are intended to be compatible with EU law, and will apply to intra-community transactions.

Please note that thin capitalisation rules do not apply in respect of transactions made with sister companies (CE, 11 December 1974, No. 93,653; RJF 2/75, No. 5).

The Finance Bill for 2006 will introduce new capitalization rules, which will apply from 1 January 2007 to both resident and non-resident companies, and aim to bring the French rules in line with EU law.

b. Tax treatment at the level of the beneficiary company

Interest and royalty payments to a French beneficiary company

Interest income derived by resident companies is subject to corporate income tax in the normal manner. As a general rule, interest paid to resident companies is not subject to withholding tax.

Royalties received are generally treated as ordinary business income. However, although constituting royalty income in the strict sense, proceeds from the licensing of patents, patentable inventions and manufacturing processes associated with such patents or patentable inventions may qualify for the reduced long-term capital gains tax rate of 15%, increased by a 1.5% surcharge to 15.225%. In order to qualify for the reduced rate, the patents must have been held by the company as fixed business assets (thus, excluding traders in patents) for at least 2 years (no time limit applies for patents developed within the company).

Before 1 January 2004, in cases where the licensor (or licensee) directly or indirectly controlled the licensee (or licensor), the licensee could only deduct for French income tax purposes a fraction of the royalties paid, which corresponded to the ratio between the reduced rate and the normal rate. From 1 January 2004, the licensor company may waive the above reduced rate regime in respect of all patent royalties received, in which case the associated licensee may deduct the full amount of the royalties paid to the licensor (Guideline C-2-04 of 14 April 2004).

Cross-border interest and royalty payments

Interest and royalties paid by French companies to legal entities the incorporation or the effective management of which is located outside of France are in general subject to a French withholding tax. However, in practice, the application of the provisions of tax treaties concluded by between France and other EU Member States entails the reduction of the withholding tax or its exemption in cases where the taxation of such income is reserved to the State of residence of the beneficiary.

Tax treatment of outbound interest

French-source income from fixed income securities paid to foreign individuals or companies is generally subject to a 16% prepayment levy (*prélèvement forfaitaire*) under Art. 125 A III CGI. The prepayment levy applies to interest and other income from bonds and similar instruments, receivables, deposits, current accounts and security deposits. Lower rates may apply, however, depending on the type of interest. Significant categories of interest payments are exempt, including interest on loans contracted abroad, bank deposits, state bonds issued on or after 1 October 1984, corporate bonds issued on or after 1 January 1987 and certain negotiable debt instruments that are traded on a regulated market but cannot be quoted on the stock exchange.

In practice, the imposition of a withholding tax on interest is exceptional as an exemption would be available either pursuant to a tax treaty or to the internal law exemption for interest on loans contracted abroad.

Tax treatment of outbound royalties

Under Art. 182B CGI, royalties paid by a debtor exercising an activity in France to a beneficiary (either an individual or a company) that does not have a permanent establishment in France are subject to a 33 1/3% withholding tax on the gross amount of the royalties paid. This withholding tax is not final; it is credited against the corporate income tax assessed under the general rules, but any excess is not refundable.

The following royalties are, amongst others, subject to the withholding tax:

- income from intellectual or industrial property rights, copyright, etc, defined in Art. 92 CGI,
- compensation for non-commercial activities performed in France; and
- remuneration for services of any kind supplied or used in France.

c. Transfer pricing

The arm's length principle applies to transactions between related parties under Art. 57 CGI. Failure to apply the arm's length principle results in readjustment of profits under specific transfer pricing legislation, unless the company making the transfer is able to prove that it did so for sound commercial reasons, such as protecting its market position. The concept of related enterprises is broad and encompasses legal control as well as de facto control.

Adjustments are made by reintegrating the transferred amounts to the taxable base by reference to the data provided by the reassessed company; where no data is available, the tax authorities may reassess the company by reference to comparable market transactions. The transferred amounts are generally treated as hidden profit distributions (see constructive distributions above), which are not deductible for the transferor and are taxable in the hands of the recipient.

Reallocation of income of related companies can be performed as follows:

- application of the constructive distribution rules (see below) under Arts. 109 I (1) and 109 I (2) CGI;
- denial of long-term capital gains treatment on royalties paid to related companies;
- denial of deduction for business expenses not meeting one or more of the established conditions;
- adding back to the taxable income of French companies or branches of foreign companies of profits indirectly transferred to related companies or head offices abroad (Art. 57 CGI). This arm's length rule applies to profits transferred to: "foreign enterprises controlled by the French enterprise, or which control the latter .... or which are controlled by an enterprise or group which has control over the enterprise outside France". The provision is thus broad enough to cover virtually any transfer within a related group of companies or branches.

Transfers of profits are defined as those effected by:

- increased or reduced buying or selling prices;
- excessive royalties for the use of patents, trademarks, technical assistance, etc.;
- interest free loans, or loans at abnormally high or low rates of interest; or
- any other means.

The tax authorities are allowed to request a resident company to provide information regarding transactions with affiliated non-resident companies, information on the transfer pricing method used by the company and details of the activities of the non-resident affiliated companies and the tax regime applicable to them. In order to avoid transfer pricing adjustments, companies may apply, under the bilateral or unilateral advance pricing agreement procedure, for an advance ruling on the compatibility of their transfer pricing methods with the relevant legislation.

d. Constructive distribution rules/ deemed dividend distributions

In the situation where the payments made by a French company or a French permanent establishment of a foreign company to a related non-resident beneficiary are not at arm's length or fall under the thin capitalization rules, the excess payments may be treated as a deemed dividend distribution. The term "constructive distribution" is generic for the purpose of this study and encompasses "distributed income" (*revenus distribués*) by reference to:

(i) Art. 109-1-1 CGI if the taxable year is profitable. This provision defines distributed income as being all profits which are not booked into reserves or incorporated in the corporate capital;

(ii) Arts. 109-1-2 or Art. 111(a) CGI if the taxable year results in a loss and the foreign beneficiary company is an associated company. Article 109-1-2 CGI defines distributed income as all sums or valuable assets made available to shareholders which have not been taken from taxable income; or

(iii) Art. 111 (c) CGI related to hidden profit distributions if the provisions in (i) and (ii) are not applicable.

As a result of these provisions in case of transfer pricing readjustment, the dividend withholding tax is applicable irrespective of whether or not the French undertaking's accounts show a profit as well as irrespective of whether or not the foreign undertaking is a shareholder.

In case of transfer of profits in any form between related companies, France generally considers that the amount paid must be reintegrated into the taxable base of the paying company and treated as a dividend distribution made to the beneficiary (Art. 109- I (1) and Art. 109 I (2) CGI). Interest and royalties may be re-characterized as dividend distribution (a constructive distribution).

The following tax treatment applies to excess interest or royalties:

- the excess interest or royalties are reintegrated into the tax base of the paying company; and
- the excess amounts may also be treated as a profit distribution made to the associated recipient, and thus be subject to the dividend withholding tax.

Tax treatment at the level of the beneficiary company

For non-resident beneficiaries, the re-characterized interest or royalties are subject to a withholding tax at the rate of 25% levied on the gross amount (i.e. 25/75 = 33 1/3% on the net amount when the withholding tax has not been levied initially (Art. 119 bis-2 CGI), as confirmed by a decision of the Conseil d'Etat (CE, 27 April 2004) and by the tax administration in Guideline 4C-7-04 of 27 September 2004). However, the rate may be reduced under the relevant treaty or the drafting of the treaty may prevent France from imposing any dividend withholding tax (essentially where the treaty contains a restrictive definition of dividends and the constructive distribution therefore falls under the "other income" clause).

France does not apply the exemption of the Parent-Subsidiary Directive to deemed dividend distributions. According to the Parent-Subsidiary Guideline, Art. 119 ter (1) CGI on the withholding tax exemption applying to dividends between EU companies covers only

"distributed dividends". It therefore does not cover non-deductible payments, which are reintegrated into the taxable base of the paying companies and constructive distributions (D.adm 4 J-1334 (paras. 50 and 51) of 1 November 1995).

1.2.2. Treaties

Prior to the implementation of the Directive, the tax treatment of interest and royalty flows eligible to a withholding tax exemption under the Directive were covered by the tax treaty between France and the relevant Member State. France has tax treaties with all other EU Member States (see Annex).

a. Interest

Most tax treaties concluded between France and EU Member States provide for a reduction of or an exemption from the above mentioned withholding taxes (see Annex for the rates applicable under each particular treaty).

b. Royalties

In practice, Art. 182B CGI does not apply to payments made between France and other EU Member States by virtue of the provisions of a tax treaty. Tax treaties between France and EU Member States provide, depending on the state of residence of the beneficiary, either for exclusive taxation in the state of residence or a reduced withholding tax ranging from 5 to 15%. Avoidance of double taxation is achieved by a credit amounting to the French withholding tax.

It should be noted that the definition of royalties is not similar in all the tax treaties concluded by France. However, in most tax treaties, the term 'royalties' relates to remunerations of any kind received as a consideration for the use of or the right to use:

- any copyright of literary, artistic or scientific work (including cinematograph films and films or tapes for television or radio broadcasting);
- any patent, trade mark, design or model, plan, secret formula or process; and
- information concerning industrial, commercial or scientific experience.

Some tax treaties, following the OECD MC do not treat remuneration in consideration for the use or the right to use industrial, commercial or scientific equipment as royalty payments falling under Art. 12 OECD MC (e.g., treaties with Austria, Denmark, Luxembourg and Sweden). Such payments fall under Art. 7 OECD MC.

The tax treaties between France and Belgium, Denmark and Luxembourg provide that income from the sale of certain assets and rights mentioned in the royalty article of the treaty shall be treated as royalty. In general, such income fall under the business profits article (Art. 7 OECD MC), or capital gains article (Art. 13 OECD MC) or other income article (Art. 21 OECD MC).

c. Conclusion

Although the definition of interest and royalties under a tax treaty may differ from that combined in domestic law and in the Directive, some tax treaties concluded by France and some other Member States provide for the exclusive taxation of interest or royalty payments in the state of residence. The tax treaties providing for exclusive taxation of interest or royalty income, or both, in the state of residence are those concluded with Austria, Belgium (only in

respect of royalties), Cyprus (only in respect of royalties), Czech Republic (only in respect of interest); Denmark, Finland (only in respect of royalties), Germany, Hungary, Ireland, Luxembourg (only in respect of royalties), Netherlands (only in respect of royalties), Poland (only in respect of interest), Slovak Republic (only in respect of interest), Slovenia, Sweden and the United Kingdom.

2. SCOPE

2.1. PAYMENTS

2.1.1. Concept of interest

a. Definition

The definition of Art. 119 quater (1) CGI encompasses "income from debt claims of every kind with the exception of penalties charges for late payments".

The definition of interest under the implementing provisions of the Directive in France is not a word-by-word transposition of Art. 2 (a) of the Directive. In comparison to the one in the Directive, the French definition does not list the examples of payments to be treated as interest. The definition has not been interpreted yet by the tax administration. According to a report from the Upper House of the Parliament, the definition of interest set out in Art. 119 quater (1) CGI is sufficiently broad to cover efficiently the scope of the definition of Art. 2 (a) of the Directive (Report No 112 (2003-2004) of 11 December 2003). Interest for late payments is expressly excluded from the definition of interest.

This definition is specific to the implementation of the Directive. In Guideline 14 B-5-04 of 9 July 2004 commenting the France-Uzbekistan tax treaty, the tax administration clarified that the definition of Art. 119 quater (1) CGI shall apply only in respect of interest paid between associated companies within the European Union, and not those of third countries, so that the definition of interest under the Directive is independent from that set out in tax treaties concluded by France (paras. 41 and 42 of the Guideline).

b. Exclusion of hybrid financial arrangements (Art. 4(1) b)-d))

The law implementing the Directive did not expressly exclude certain types of interest payments from the application of the withholding tax exemption. It is expected that the issue will be clarified in a tax authorities Guideline.

c. Exclusion of interest reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

Interest the deduction of which is disallowed is treated as a constructive distribution, either under the thin capitalization rules (see Introduction, 1.2.1. *a. Tax treatment at the level of paying company*) or the transfer pricing rules (see Introduction, 1.2.1. *c. Transfer pricing*). Disallowed interest paid to non-resident beneficiaries is re-characterized as a constructive dividend distribution and is subject to withholding tax at the rate of 25/75 = 33 1/3% under Art. 119 bis-2 CGI. However, the rate may be reduced under the relevant treaty or the treaty may prevent France from imposing any dividend withholding tax where the treaty contains a restrictive definition of dividends and the constructive distribution therefore falls under the other income article (Art. 21 OECD MC).

It should be noted that the benefit of the Parent-Subsidiary Directive does not apply to such payments (see Introduction, 1.2.1. *d. Constructive distribution rules/ deemed dividend distributions*).

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2.1.2. Concept of royalties

a. Definition

According to Art. 182 B bis CGI, the concept of royalties includes payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films and software, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; payments for the use of, or the right to use, industrial, commercial or scientific equipment shall be regarded as royalties.

The definition of royalties provided in Art. 182 B bis CGI is identical to that one set out in Art. 2 (b) of the Directive.

This definition is specific to the implementation of the Directive. In Guideline 14 B-5-04 of 9 July 2004 commenting the France-Uzbekistan tax treaty, the tax administration clarified that the definition of Art. 182 B bis CGI shall apply only in respect of royalties paid between associated companies within the EU, and not those of third countries, so that the definition of interest under the Directive is independent from that contained in tax treaties concluded by France (para. 53 of the Guideline).

b. Classification of revenue from leasing and software

The definition of royalties under Art. 182 B bis CGI includes payments for the use or the right to use software. In addition, the definition being the same as that of Art. 2 (b) of the Directive, payments from leasing should generally be covered by Art. 182 B bis CGI. It is expected that this will be clarified in a Guideline on the application of domestic law under Art. 182 B bis CGI.

c. Exclusion of royalties reclassified as profit distribution or conflicting arm's length (Art. 4(1) a) and Art. 4(2))

Excessive royalties that conflict the arm’s length principle fall under the general French transfer pricing rules (see Introduction, 1.2.1. *c. Transfer pricing*). In certain cases excessive royalties may also fall under the provisions of Art. 109 I (1) CGI on constructive distributions (see Introduction, 1.2.1. *d. Constructive distribution rules*).

It should be noted that the benefit of the Parent-Subsidiary Directive does not apply to such payments (see Introduction, 1.2.1. *d. Constructive distribution rules/ deemed dividend distributions*).

2.2. COMPANIES

2.2.1. Types of companies benefiting from implementing provisions (Art. 3(a)(i))

a. Other types of entities

The abolition of the French withholding tax applies to interest and royalties distributed by an associated company which is resident in France and which takes one of the forms listed in Annex to the Directive, point (f). The listed companies are those that take the form of:

- a corporation (*société anonyme*, “SA”),
- a partnership limited by shares (*société en commandite simple*, “SCA”),

- a limited liability company (*société à responsabilité limitée*, “SARL”) and
- industrial and commercial public establishments and undertakings (*établissement à caractère industriel ou commercial ou une entreprise publique*).

In addition to those, Art. 119 quater (1) CGI has added the simplified stock corporation (*société par actions simplifiée*, “SAS”) to the list of French entities eligible for the exemption under the French implementing provisions. As a result, exemption from withholding tax applies to payments made by a SAS to an eligible EU recipient. In reverse situation, when the payment is made by a qualifying associated company resident in another EU Member State to a French SAS, the other EU Member State is not required to apply the same exemption. The same applies to payments made by a permanent establishment of a French SAS in other EU Member States.

In respect of the beneficiary associated company, Art. 119 quater (1) (2) (b) CGI only grants the benefit of the withholding tax exemption to companies listed in the Annex to the Directive.

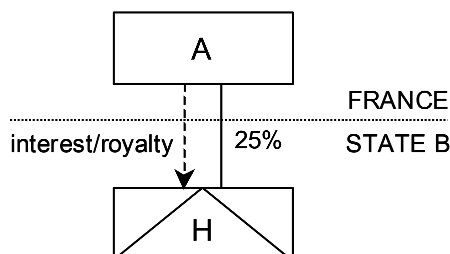
b. Hybrid entities

There is no specific guidance with respect to application of exemption from withholding tax when interest or royalties are paid to or from hybrid entities. Conclusions on the tax treatment of such payments are drawn on the basis of general implementing provisions of the CGI. The issue of tax treatment of payments in situations involving hybrid entities is considered based on three hypothetical situations described below:

- Case 1: a French associated company pays interest and royalties to a hybrid entity H located in Member State B ;
- Case 2: a French hybrid entity H pays interest and royalties to an associated company in Member State A;
- Case 3: a French associated company pays interest and royalties to an associated company through a hybrid entity H, the latter two located in Member State A.

Case 1: Payment to a hybrid entity

A French associated company A pays interest and royalties to a hybrid entity H situated in Member State B. France treats hybrid entity H as a transparent entity.



The implementing rules to the Directive do not expressly address this issue. Art. 119 quater (2) CGI requires that the receiving EU associated company must fulfil the following requirements:

(i) have its effective management in one of the EU Member States;
(ii) have one of the legal forms listed in the Annex to the Directive; and

(iii) be liable to corporate income tax, also in respect of its income in the Member State where its effective management is located, without being exempt.

In addition, Art. 119 quater (1) CGI provides that the participation in the associated company must be direct. This requirement is identical to the one set forth in Art. 119 ter CGI in respect of the Parent-Subsidiary Directive (Law 91-1323 of 30 December 1991).

In accordance with the requirements cited above, the benefit of the withholding tax exemption on interest and royalty income paid by the French associated company will not be granted if company H is not subject to corporate tax on its income. In this situation, such income is taxed at the level of the members, and not at the level of the hybrid entity. The requirement of being liable to corporate income tax is not met.

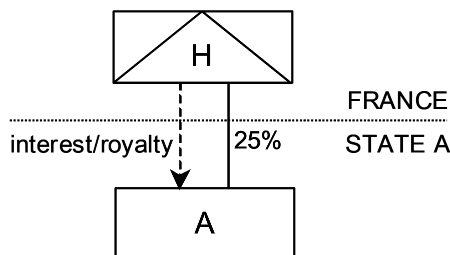
In the case at hand it is also not clear whether the participation of the hybrid entity H in French company A would be treated as "direct participation" by the French tax authorities, since the participation can be regarded as being held by the members of the hybrid entity H. In their commentary on the direct shareholding requirement under the Parent-Subsidiary Directive (Guideline 4 J-3-97 2 December 1997, paras. 20 et 21; D.adm. 4 J-1334, 1 November 1995, para. 40 et 41), the tax administration considered that the requirement of direct participation excludes the interposition of a partnership or a transparent entity. It is expected that the tax authorities will uphold the same interpretation with respect to the Directive.

For these reasons, the withholding tax exemption under the Directive is most likely to be denied in situations where the payment is made to a hybrid entity.

Note that in respect of companies listed in the Annex to the Directive, the case of e.g., Italian Czech or Slovak companies may trigger potential issues. Under certain conditions, Italian limited liability companies (*societa a responsabilita limitata*) and partnerships limited by shares (*societa in accomandita per azioni*) listed in the Annex to the Directive may opt to be treated as flow-through entities. In these cases, the income of the Italian entity is attributed directly to the members. The income of Czech or Slovak general partnerships (e.g., the Czech *veejna obchodni spolecnost*) listed in the Annex to the Directive is subject to tax at the level of partners. It is not clear whether the French tax administration would consider the participation to be direct, as the income of the entity is directly attributed to the members. In this latter case, the tax administration may deny the application of the withholding tax exemption because participation is considered to be indirect and because of the failure to meet the subject to tax test. It is expected that the issue will be clarified in a Guideline on the application of implementing provisions of the Directive.

Case 2: Payment from a hybrid entity:

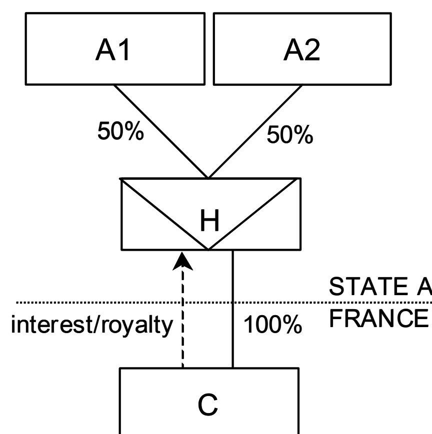
A hybrid entity H in France pays interest or royalties to an associated company A in Member State A.



Payments from French hybrid entities do not benefit from the withholding tax exemption in France. Such entities are not listed as eligible companies under Art. 119 quater (1) CGI (see 2.2.1. *a. Other types of entities*, above).

Case 3: Payment through a hybrid entity

Companies A1 and A2 are the members of the hybrid entity H, all located in Member State A. The hybrid entity H holds all the shares in company C, located in France. France treats hybrid entity H as a transparent entity. Company A1 grants a loan to the hybrid entity H and the hybrid entity H grants a loan to the company C. Interest flows from the company C to a member A1 through the hybrid entity H.



In the case at hand, there is no direct participation, as the payment is made through a hybrid entity H in State A. As already mentioned above in respect of Case 1, in their commentary on the direct shareholding requirement under the Parent-Subsidiary Directive, the tax administration considered that the requirement of direct participation excludes the interposition of a partnership or a transparent entity. It is expected that the tax authorities will have the same approach to the interpretation of the direct participation requirement under the implementing provisions of the Interest and Royalties Directive and the withholding tax exemption under the Directive is most likely to be denied.

2.2.2. Residence requirement (Art. 3(a)(ii))

a. Implementation of the requirement

Under Art. 119 quater 2 (a) and (c) CGI, the receiving EU associated company must
- (i) have its effective management in one of the EU Member States; and
- (ii) be liable to corporate income tax, also in respect of its income in the Member State where its effective management is located, without being exempt.

The provision refers to the place of effective management as the factor to determine the residence of the associated company. This reference stems from French domestic legislation and not from the Directive. In addition, the company must be subject to tax without being exempt in the state where its effective management is located.

The exemption from French withholding tax applies only if the company is a French company as described above (see 2.2.1. *a. Other types of entities*), which is subject to French corporate tax, without being exempt. It is not clear whether a payment from a French company, having an eligible form under Art. 119 quater (1) CGI but having its effective management in another Member State would benefit from the French withholding tax exemption under Art. 119 quater (1) CGI. This issue is discussed below.

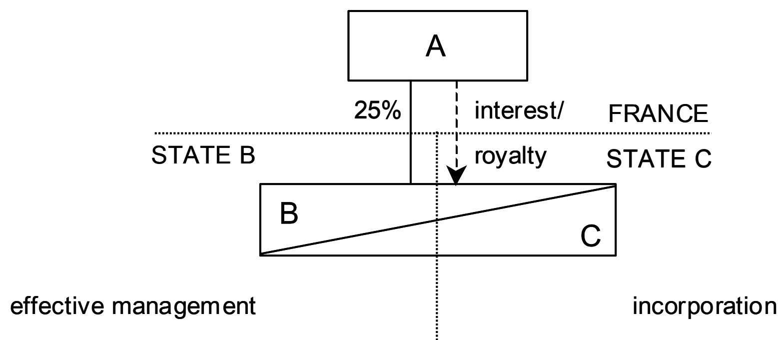
b. Application of the requirement in dual residence cases

There is no specific guidance with respect to application of exemption from withholding tax when interest or royalties are paid to or from dual resident companies. The conclusions on the tax treatment of such payments are drawn on the basis of general implementing provisions of the CGI. The issue of tax treatment of payments in situations involving dual residency is considered based on three situations described below:

- Case 1: a French associated company A makes an interest or royalty payment to a dual resident company BC incorporated in Member State C but with its effective management in State B;
- Case 2: a dual resident company BC incorporated in Member State C but with its effective management in France makes an interest or royalty payment to an associated company A resident in Member State A;
- Case 3: a dual resident company BC incorporated in France but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.

Case 1: Payment to a dual resident

A French associated company A makes an interest or royalty payment to a dual resident company BC incorporated in Member State C but with its effective management in Member State B.



French law requires the receiving EU associated company to meet, inter alia, the following conditions (Art. 119 quater (2) CGI):

(i) have its effective management in one of the EU Member States;
(ii) have one of the legal forms listed in the Annex to the Directive; and
(iii) be liable to corporate income tax, also in respect of its income in the Member State where its effective management is located, without being exempt.

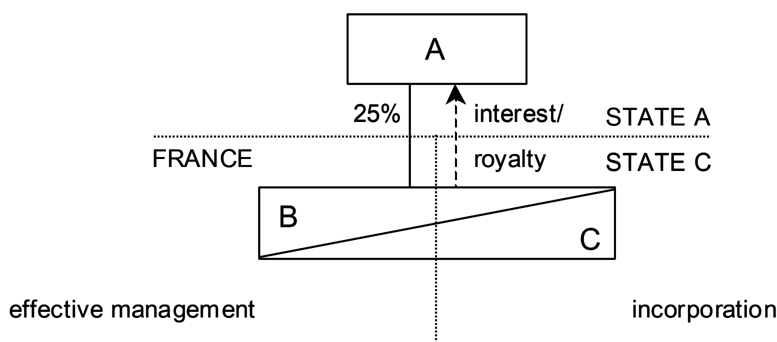
In the case at hand, the company BC meets requirements (i) and (ii) cited above: it has its effective management in Member State B and takes the legal form of a company of Member State C listed in the Annex to the Directive. In respect of (iii), generally, the company BC will

be subject to corporate income tax in Member State B and Member State C under the domestic tax law of Member State B and Member State C, respectively. The issue of dual residence of the recipient dual company will be solved under the provisions of the tax treaty between Member States B and C.

Assuming that the tax treaty between Member State B and Member State C is identical to the OECD MC, the company BC will be considered resident for treaty purposes in Member State B where its effective management is located (Art. 4 (3) of the OECD MC). Consequently, the requirement in (iii) will be met.
In this situation, France will grant the withholding tax exemption in respect of the payment made to the dual resident company BC. The tax authorities have confirmed this approach in respect of the application of the Parent-Subsidiary Directive. In this context, the tax administration accepts that a parent company, which is deemed to be a dual resident company under a tax treaty between two EU Member States, qualifies for the benefit of the Directive (the Parent-Subsidiary Guideline).

Case 2: Payment by a dual resident with the place of management in France

A dual resident company BC incorporated in Member State C but with its effective management in France makes an interest or royalty payment to an associated company A resident in Member State A.



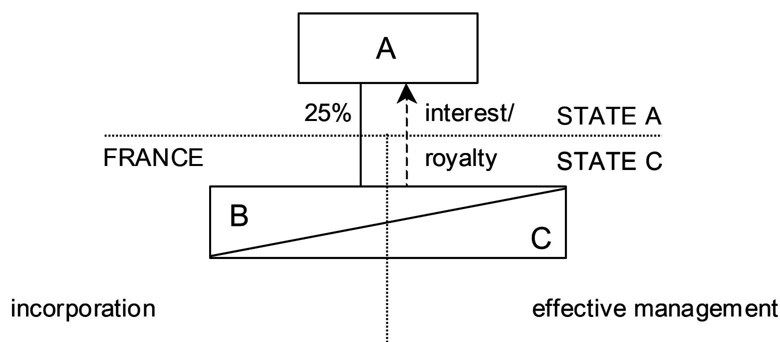
Under the French implementing provisions, France restricts the application of the Directive to payments made by French companies listed in the Annex to the Directive and SAS's, and to French permanent establishment of EU listed associated companies (Art. 119 quater (1) CGI). It is therefore not clear whether France would restrict itself from levying a withholding tax under the Directive, in case company BC is incorporated in State C. One would argue that France would apply the Directive to any company having a legal form listed in the Directive and not only to the French legal forms listed therein. The tax administration has not published any guideline on this issue.

Assuming that the tax treaty between France and Member State C follows the OECD MC, the tie-breaker rule under Art. 4 (3) of the tax treaty between France and Member State C will designate France, where the effective management is located, as the country of residence for tax treaty purposes. The interest or royalty payment will be generally deemed to arise in France. The network of tax treaties between all the countries involved may not to resolve the issue of double source of the payment where the deduction is borne by a permanent establishment in Member State C.

It follows that France will be prevented from applying a withholding tax where the tax treaty between France and Member State A provides for an exclusive taxation of the interest or royalty payments in the state of residence (Member State A). In other cases, France may levy a withholding tax albeit only at the reduced France-State A treaty rate.

Case 3: Payment by a dual resident with the place of incorporation in France

A dual resident company BC incorporated in France but with its effective management in State C makes an interest or royalty payment to an associated company A located in Member State A.



Under Art. 119 quater 1 CGI, France grants a withholding tax exemption to interest and royalties paid by a French company listed in the Annex to the Directive and SAS's (see 2.2.1. *a. Other types of entities*), provided that the company is liable to French corporate tax without being exempt. To determine whether or not the French company is liable to French corporate income tax, it is necessary to determine the situation of company BC for France-State C tax treaty purposes in respect of the residence of the French incorporated company.

Assuming that the tax treaty between France and Member State C follows the OECD MC, the tie-breaker rule under Art. 4 (3) of the tax treaty between France and Member State C will designate Member State C, where the effective management is located, as the country of residence for tax treaty purposes. The interest or royalty payment will be deemed to arise in Member State C, so that France will be prevented from applying a withholding tax, unless the interest deduction is attributable to a permanent establishment in France under Art. 7 of the treaty.

Where the interest payment is attributable to a permanent establishment in France, France will have to apply the withholding tax exemption under the French rules implementing the Directive (Arts. 119 quater and 182 B bis CGI) in respect of the interest and royalties paid by the French permanent establishment to an associated company A in Member State A.

2.2.3. Subject-to-tax requirement (Art. 3(a)(iii))

a. General

According to the wording of Art. 119 quater (2) CGI, the associated beneficiary company must be "subject to corporate tax *on its income* where its effective place of management is located without the possibility of being exempt". The wording of Art. 119 quater (2) (d) CGI further requires that the recipient has to be taxed in relation to the relevant income (i.e. interest or

royalties received) and not simply be taxable. It therefore appears that the French legislator adopted an objective subject-to-tax requirement. However, no further guidance as to the interpretation of the subject-to-tax requirement has been provided by the tax administration.

In addition, the wording of the implementing provision requires the French paying associated company or the French permanent establishment of an EU associated company to be subject to tax without being exempt. The tax authorities have not yet commented on this. It is most likely that the tax administration will follow, in respect of the implementation of the Interest and Royalties Directive, the same approach adopted for the purposes of implementing the Parent-Subsidiary Directive (the Parent-Subsidiary Guideline, paras. 9 to 12). In that case, the tax authorities considered the following:

- entities mentioned in Arts. 207 and 208B CGI (i.e. cooperatives, SICAVs and other investment companies) which benefit from a full exemption from corporate tax do not qualify;
- for companies which benefit from a partial exemption from corporate tax, the exemption from withholding tax applies only to income attributable to the taxable segment; and
- for companies which benefit from a temporary exemption from corporate tax, the withholding tax exemption does not apply. If, however, the temporary exemption applies partially (i.e. to certain types of income only), the exemption from withholding tax applies only to income attributed to the taxable segment.

b. Proof to demonstrate compliance with the subject-to tax requirement

To prove that the subject-to-tax requirement is met, an attestation must be submitted by the beneficiary to both the payer of the income and to the tax authorities having jurisdiction over the non-resident company before the actual payment is effected (Annex III, Art. 46 quater-0 FB CGI, see 3.2 Attestation (Art. 1 (11) and 1 (13), below). This attestation must include proof that the payer and the recipient of the income have been associated companies for an uninterrupted period of 2 years, or that the beneficiary commits to hold the shares in the paying entity for at least 2 years. A fiscal representative must be appointed and named in the attestation. The latter is responsible for the payment of the tax in case the commitment is not respected.

A model attestation is available in respect of the withholding tax exemption under the Parent-Subsidiary Directive (Guideline 4 J-3-97 2 December 1997, Annex; D.adm. 4 J-1334, annex VI, 1 November 1995). It is likely that the tax administration will publish a similar model for application of exemption from the withholding tax on interest and royalty income.

In addition to the attestation, the recipient must provide an attestation of residence delivered by the tax administration of the Member State where the recipient has its effective management. These documents must be addressed to the paying agent and the tax authorities each year, and no later than the date of the first income payment (The Parent-Subsidiary Guideline, para. 63; and D. adm, 4 J-1334 of 1 November 1995, para. 83).

c. Application of the requirement to hybrid entities

The application of the subject-to-tax requirement to hybrid entities is unclear. As discussed above (see 2.2.1. b. Hybrid entities), the subject-to-tax criterion is probably not applicable, as the benefits of the withholding tax exemption may be denied if payment is made by the French company to or through a hybrid entity located in another Member State. Please, note that this issue has not been clarified by the tax administration in respect to the application of the Directive.

2.2.4. Associated company (Art. 3(b))

France does not apply a lower ownership threshold than the one in the Directive. There is no extension to situations of indirect holdings.

Under Arts. 119 quater (1) and 182B bis CGI, two companies are "associated companies" if:
(i) one of them has a direct minimum holding of 25% in the capital of the other or
(ii) a third EU company has a direct minimum holding of 25% in the capital of the two companies.

The shares must be in registered form; otherwise they must be deposited with an approved financial institution (Guideline 4 J-3-97 2 December 1997).

It is not clear how the tax administration will interpret the definition of “capital”. The awaited Guideline is expected to clarify this definition, by most likely adopting the same approach as that of the implementation of the Parent- Subsidiary Directive. In this respect, France requires a holding in both capital and voting rights.

For purposes of determining the minimum holding requirement under the Parent-Subsidiary Directive, shares without voting rights (preferred shares, investment certificates, etc.) do not qualify. In addition, shares borrowed or lent in the context of a securities lending transaction may not be taken into account either by the lender or the borrower. The rationale of this restriction is that under French law, the lending of securities results in a transfer of ownership. For this reason, the lender, who is no longer the legal owner of the securities, may not take them into account. The borrower, while the legal owner of the securities during the agreed lending period, may not take the securities borrowed into account since the undertaking or the commitment to hold the participation for at least 2 years would not be satisfied as generally, the transactions are entered into for shorter periods of time.

2.2.5. Beneficial ownership (Art. 1(4))

Art. 119 quater (2) CGI provides that the beneficiary company (*bénéficiaire effectif*) must demonstrate to the paying company or the paying agent that it is the beneficial owner of the income.

The definition of Art. 1 (4) of the Directive has not been transposed into French law. There also is little guidance in respect of the concept of beneficial ownership. The concept of beneficial owner under the Directive has not been clarified by the tax administration. For the purpose of the Savings Directive, for instance, the tax administration considers that individuals or certain legal transparent entities that receive interest for their own account are regarded as beneficial owners (CGI, Annex III, Art. 49 I (2) (1)). According to Guideline 5 I-3-05 of 12 August 2005 on the implementation of the Savings Directive, the tax authorities will take into account only the "final" recipient of interest and not the various intermediaries in a chain of payments. The awaited Guideline from the tax administration is expected clarify the concept of beneficial owner under the Directive.

As there is no definition of beneficial owner for the purposes of the Directive in the French tax law, it does not link the concept to the subject-to tax requirement. The beneficial owner, however, must demonstrate that it:
(i) has its effective management in one EU Member State,
(ii) has one of the legal forms listed in the Annex to the Directive, and
(iii) is liable to corporate income tax, also in respect of its income in the Member State where its effective management is located, without being exempt (Art. 119 quater (2) CGI).

It follows that although the French law does not link the beneficial ownership requirement to the subject-to tax requirement directly, the beneficiary company must nevertheless demonstrate that it has complied with the subject-to-tax requirement under the French implementing provisions of the Directive.

2.3. PERMANENT ESTABLISHMENTS

2.3.1. Definition (Art. 3(c))

There is no definition of permanent establishment in the law implementing the Directive. It is also not clear whether or not the general concept of permanent establishment under French domestic law, the concept of permanent establishment in each individual tax treaty between France and a particular Member State or a specific concept to be developed for the purposes of application of the exemption under the Directive applies.

With regard to domestic concept of permanent establishment, French domestic tax law does not define the concept of permanent establishment. The latter has been determined by case law. A permanent establishment is generally defined as an autonomous place of business through which business activities of a profit-making nature are carried on. A permanent establishment is, in principle, any industrial or commercial organization established on a permanent and autonomous basis. This includes, generally speaking, branches, factories, buying offices, warehouses, shops and other places where profit-making operations are conducted. This very broad definition includes permanent establishments that are commonly granted exempt status under tax treaties.

In a decision of 20 June 2003 (*Sté Interhome AG*, CE 20 June 2003), the Conseil d'Etat held that a subsidiary formed under French law may constitute a permanent establishment of a foreign (Swiss) parent company for the application of Art. 5 of the France-Switzerland treaty and, more specifically, Art. 5 (4) corresponding to Art. 5 (5) of the OECD MC. However, a French subsidiary may constitute a French permanent establishment of its parent only if (i) the French subsidiary cannot be regarded as an independent agent of the parent and (ii) it habitually exercises an authority to bind the parent in commercial activities, which are related to those of the parent. The Conseil d'Etat also added that "the exercise of the authority to bind the Swiss parent" should be determined not only by reference to a legal mandate, but also by reference to the actual circumstances.

In respect to the concept of permanent establishments under tax treaties, it is not clear whether the definitions of a permanent establishment in each particular treaty concluded by France and another Member State of the EU could also apply in this case. The definition of a permanent establishment in most recent French tax treaties follows the OECD MC. Nevertheless, certain conventions, in particular with developing countries, are (partly) based on the UN MC.

The expected Guideline on the implementation of the Directive will most likely clarify the concept of permanent establishment that applies for the purpose of the withholding tax exemption under the Directive.

2.3.2. Application of source rules (Art. 1(2))

At this stage, we are not aware of any instances where the source state would have interpreted Art. 3 (c) of the Directive more narrowly than Art. 5 of the OECD MC and as a consequence would have imposed withholding tax on interest or royalty payments from its sources to an associated company in another Member State.

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2.3.3. 'Tax-deductible expense' requirement (Art. 1(3))

Art. 1 (3) of the Directive in respect to the 'tax-deductible expense' requirement has not been implemented under French law. Currently, the French law does not require interest or royalty payment to be deductible for tax purposes in order to qualify for an exemption.

The expected Guideline on the implementation of the Directive will most likely clarify the situation.

2.3.4. Beneficial ownership (Art. 1(5))

Art. 119 quater (2) CGI provides that if the beneficiary is a permanent establishment, the latter must demonstrate to the debtor or the paying agent that it is the beneficial owner of the income. For this purpose, it must be demonstrated that:

(i) income derived by the permanent establishment is subject to corporate income tax or to any equivalent tax in the Member State of the permanent establishment; and

(ii) the associated company the permanent establishment of which is the beneficiary meets the requirements of associated companies within the meaning of Art. 119 quater (2) CGI.

The French law does not set forth the requirement of the debt claim and rights in respect of which interest or royalty payments to be effectively connected with the permanent establishment of an associated company in another EU Member State (Art. 1(5)a. of the Directive). Neither it provides for the requirement for interest or royalties income to represent income subject to one of the taxes listed in the Directive. Article 119 quater (2) CGI only provides that the permanent establishment must demonstrate that it is the beneficial owner of the income. The expected Guideline from the tax administration will most likely clarify what the exact requirements are.

In addition, the permanent establishment must be subject to tax on the interest and royalty income. It is therefore an objective 'subject-to-tax' requirement.

2.3.5. Permanent establishment in a third country (Art. 1(8))

In France, the exemption from tax under the Directive does not apply to permanent establishments located in non-EU states. One of the conditions laid down under Art. 119 quater (2) CGI for application of the withholding tax exemption is that the income derived by the permanent establishment must be subject to corporate income tax or to any equivalent tax in the Member State of the permanent establishment. This requirement excludes payment to a permanent establishment in a third state from the scope of application of implementing provisions.

3. PROCEDURE

To benefit from the withholding tax exemption at source, the recipient must submit an attestation to both the paying agent and the tax authorities having jurisdiction over the non-resident before the actual payment is effected. The attestation must demonstrate that the payer and recipient of the interest and royalties have been associated for an uninterrupted period of at least 2 years or provide for a commitment to hold the shares in the paying company for at least 2 years (see 3.1. Minimum holding period, below). In the case the receiving company does not submit the attestation, the latter is not entitled to the withholding tax exemption at the time of the income payment. However, the receiving company may submit a claim (*réclamation contentieuse*) at the end of the 2-year period in order to obtain a refund of the withholding tax levied at source (see 3.4 Application for refund, below).

3.1. MINIMUM HOLDING PERIOD (ART. 1(10))

3.1.1. General

The French legislator implemented the minimum 2-year holding period by following the solution rendered by the European Court of Justice in the *Denkavit* decision (ECJ, C-283/94 *Denkavit International BV v. Bendesamt für Finanzen*, 17 October 1996). Accordingly, the participation must either:

(i) have been held for an uninterrupted a period of at least 2 years on the date of payment; or

(ii) be subject to a commitment from the shareholder that the participation will be held for an uninterrupted period of 2 years.

In respect of (ii), in case the associated company does not have its effective management in France, it must appoint a fiscal representative who will be held responsible for the payment of the withholding tax if the commitment is not satisfied.

The minimum 2-year holding commitment provided for in Art. 119 quater (1) CGI starts from the date of registration of the shares in account, unless it is established that the acquisition date is different (CGI, Annex III, Art. 46 quater-0 FD). These provisions apply also to the withholding tax exemption on royalty payments set out in Art. 182 B bis CGI.

3.1.2. Relief before the holding period requirement is satisfied

See 3.1.1. General, above.

3.1.3. Appeals

French law does not require the 2-year period to have been fulfilled prior to the date of payment, provided that the receiving company commits to hold the shares for at least 2 years (see 3.1.1 General, above).

In the case the receiving company does not fulfil the conditions laid down in 3.1.1, the latter is not entitled to the withholding tax exemption at the time of the income payment. However, the receiving company may submit a claim (*réclamation contentieuse*) at the end of the 2-year period in order to obtain a refund of withholding tax (see 3.4 Application for refund, below).

3.2. ATTESTATION (ART. 1(11) AND 1(13))

3.2.1. General

The French law implementing the Directive provides that to benefit from the withholding tax exemption, the beneficiary company must submit an attestation before the interest and royalty payment is made. Such attestation must be submitted by the beneficiary to both the payer of the income and to the tax authorities having jurisdiction over the non-resident company (Non-Resident Tax Center, 9, rue d'Uzès, 74094 Parix Cedex 02) before the actual payment is effected. The formalities are the same as those set out under the implementing provisions of the Parent-Subsidiary Directive. Articles 46 quater-0 FB, 0 FC and 0 FD of Annex III CGI govern the conditions relating to the attestation.

The attestation must include the following information (CGI, Annex III, Art. 46 quater-0 FB):

- the 2-year holding commitment provided for in Art. 119 quater (1) CGI (for interest payment) and Art. 182 B bis (2) CGI (for royalty payments);
- the number and the type of shares composing the capital of the paying company;
- the number and the type of shares held by the beneficiary company in the paying company;
- the percentage of voting rights and shares in capital held by the beneficiary company in the paying company;
- the account number of the beneficiary company under which the shares are registered, held by the paying company or the paying agent;
- the date of acquisition of the shares and, if different, the date of registration in account;
- the name and the address of the paying agent; and
- the name and the address of the person designated as representative of the beneficiary company.

Under Art. 46 quater-0 FC CGI, the attestation must be accompanied with the commitment of the representative designated by the beneficiary company that he will be responsible for the payment of the withholding tax, as well as the penalty payment if any, set out on Art.1765 bis CGI, in the case the 2-year holding requirement is not met.

In addition to the attestation, the recipient must provide a certificate of residence delivered by the tax administration of the Member State where the recipient has its effective management. These documents must be addressed each year to the paying agent, and no later than the first payment of the income (the Parent-Subsidiary Guideline, para. 63; D. adm, 4 J-1334 of 1 November 1995, para. 83).

3.2.2. Appeals

In the case the receiving company does not fulfil the conditions described in 3.1.1, the latter is not entitled to the withholding tax exemption at the time of the income payment. However, the receiving company may submit a claim (*réclamation contentieuse*) at the end of the 2-year period in order to obtain a refund of withholding tax (see 3.4 Application for refund, below).

3.3. DECISION ON APPLICATION OF THE RELIEF (ART. 1(12))

France does not require a decision on the application of the relief.

3.4. APPLICATION FOR REFUND (ART. 1(15) AND 1(16))

France applies the system of exemption at source. There are no specified application forms for refund procedures. However, in the case the withholding tax has been unduly levied at source, France provides for a refund procedure. Such withholding tax refund may take place in the situation where the withholding tax exemption was not immediately applied, because the 2-year holding period was not fulfilled, and the conditions described above in 3.1.1 General were not met.

3.4.1. General

In case the withholding tax was unduly levied at source, companies may submit a refund claim with the tax administration. In case the withholding tax is refunded more than one year after the request, it entails the payment of interest for late payments (Art. L 208A LPF). This is a strict application of Art. 1 (16) of the Directive. Decree 2005-26 of 13 January 2005 provides for the conditions under which the claim for a refund shall be submitted. These requirements are codified in Art. R. 208 A-1 LPF.

The claim for a refund must be submitted to the French tax administration within the following time-period (Art. R 196-1 LPF):

(i) by 31 December of the second year following that of which the withholding tax was paid (Art. R 196-1 al.1 (b) LPF); or

(ii) by 31 December of the year following that in which the withholding tax was levied (date of interest or royalty payments) in respect of the beneficiary company that bears the withholding tax (Art. R 196-1 al.2 (b) LPF).

The claim must contain the requirements set out in Art. R 197-3 LPF, as follows:

- mention of the contested taxation;
- contain a brief explanation of the facts, means and conclusion;
- contain the written signature of the author of the request; and
- a document justifying that the withholding tax was paid.

In addition, the request for a refund must include all the justifications required to determine whether all the conditions for the exemption are met. These conditions are the same as those mentioned for the attestation (see 3.2.1 General, above).

The tax administration must answer the request within one year from its receipt, or from the receipt of the missing documents that the tax administration may require from the company within 6 months from the date of receipt of the claim.

Normally, provided that the requirements of the attestation (see 3.1.1 General, above) are met, the withholding tax exemption applies immediately. If such requirements are not met, a claim for a refund shall be submitted within the time-period set by law (see above). Art. 208 A LPF provides that where the withholding tax is refunded more than one year after the request, it entails the payment of interest for late payment. We do not have clear information in respect of the average time-period within which refunds are made by the tax administration.

In 2005, the legal interest rate payable by the tax authorities in case of refund is fixed at 2.05% per year, whereas the rate of interest for late payment due by the taxpayer amounts to 9% per year (Art. 1727 CGI). According to the Finance Bill for 2006, interest payable by both the tax administration and the taxpayer will amount from 1 January 2006 to the same rate of 0.40% per month, amounting to 4.80% per year.

3.4.2. Appeals

In case the tax administration did not answer within the deadlines mentioned above (see 3.4.1. General), the taxpayer may bring its case to the Lower Administrative Court.

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4. FRAUD AND ABUSE (Art. 5)

4.1. MEASURES UNDER ART. 5(1) OF THE DIRECTIVE

4.1.1. Domestic

In addition to the domestic transfer pricing rules (see Introduction, *c. Transfer pricing*), the French tax administration can defeat abusive constructions by applying the abuse of law (*fraus legis*) provisions of Art. L 64 LPF. Under this provision, the tax authorities may disregard constructions which, although apparently legal, have been set up primarily to avoid taxation or to minimize the tax liability which would have otherwise been due.

If the tax authorities resort to the abuse of law theory to defeat a given construction, the case may be referred to a Consultative Committee for the Prevention of Abuse of Law. Referral of the case is made by the tax authorities either on their own initiative or, if so requested, on that of the taxpayer. The burden of proof in any subsequent judicial litigation rests on the party which received the negative opinion of the Committee, or, if the case was not referred to the Committee, on the tax authorities. According to case law, there is an abuse of law if the transaction is fictitious or entered into for tax reasons only.

4.1.2. Agreement-based

Certain tax treaties concluded between France and certain Member States contain anti-abuse provisions. It is not clear whether the tax authorities will apply such anti-abuse provisions for transactions covered by the Directive. The expected Guideline from the tax administration might probably clarify whether or not anti-abuse provisions contained in the tax treaties between France and the Member States apply in the context of transactions covered by the Directive.

4.2. MEASURES UNDER ART. 5(2) OF THE DIRECTIVE

Articles 119 quater (3) and 182 B bis (3) CGI contain an anti-abuse provision that is strictly identical to that introduced in respect of the Parent-Subsidiary Directive. This specific anti-abuse provision denies the application of the withholding tax exemption to a legal entity or permanent establishment of a legal entity which, even if it is the beneficial owner of the interest or royalty payments, is directly or indirectly controlled by one or more non EC-residents, unless it can prove to the tax authorities that the principal purpose, or one of the principal purposes, of the chain of participation is not to benefit from the withholding tax relief.

The implementation of this specific anti-abuse provision being strictly identical to that of the Parent-Subsidiary Directive, it is most likely that the French tax administration will adopt the same principles as those provided for in the Parent-Subsidiary Guideline. In this respect, the tax administration considers that where the parent company is directly or indirectly controlled by one or more non-EC residents, it may benefit from the withholding tax relief only if it proves that the principal purpose, or none of the principal purposes, of the chain participation is not to benefit from the withholding tax relief. As a general rule, this proof is deemed to have been provided if:

- the ownership structure was in place prior to the adoption of the Directive and continues to function under similar conditions; or

- the aggregate amount of withholding tax levied at each stage of the distribution, including those levied by all intermediary states, is at least equal to the withholding tax which would have been levied in France if the distribution had been made directly by the French company to the controlling non –EC resident shareholder.

4.3. COMPARISON WITH SIMILAR MEASURES UNDER PARENT-SUBSIDIARY AND MERGER DIRECTIVES

The French legislator has implemented an anti-abuse provision that is strictly identical to that introduced in respect of the Parent-Subsidiary Directive. In contrast, with respect to the Merger Directive, Arts. 210 B and 210 C CGI provides that an advance ruling may be granted by the tax authorities which is aimed at verifying whether or not the principal purpose (or one of the principal purposes) of the operation is fraud or tax evasion.

5. SUMMARY

France generally implemented the provisions of the Directive. The Guideline to be published by the tax administration is expected to confirm the approach previously used by France in respect of the withholding tax exemption under the Parent-Subsidiary Directive. According to informal conversations with the tax administration, such approach will also be adopted in the context of the withholding tax exemption under the Interest and Royalties Directive.

Objective scope

In general, France implemented the definition of interest and royalty income set out in Art. 2 of the Directive. Both interest and royalty payments are subject to the French transfer pricing and constructive distributions rules.

Subjective scope

France generally implemented the provisions laid down in Art. 3 (a) (i) of the Directive. France requires a direct shareholding as mentioned in Art. 3 (b) of the Directive. This strict interpretation of the Directive does not allow payments through or to a hybrid entity to benefit from the withholding tax exemption. The tax administration may deny the application of the withholding tax exemption on the basis of (i) the indirect character of the participation and (ii) the failure to meet the subject-to-tax test provided for in Art. 3 (a) (iii) of the Directive.

France grants a withholding tax exemption only to payments made by French eligible companies or by French permanent establishment of EU listed companies. In this respect, issues may arise as to whether the withholding tax exemption applies where payments are made by dual resident companies the effective management of which is attributed to France under a tax treaty.

France seems to require that the receiving company be subject to corporate tax on the income received (objective tax requirement). Further clarification is expected to be included in the Guideline to be published by the tax administration. In addition, Art. 3 (b) of the Directive on the ownership threshold has been strictly implemented under French law. It is not clear whether for the purpose of determining the ownership threshold, France will require a holding in both capital and voting rights, as it is required for determining the minimum holding requirement under the Parent-Subsidiary Directive.

The definitions of “permanent establishment” and “beneficial owner” have not been formally implemented. The approach that will be used by the tax administration to define such concepts for the purpose of applying the withholding tax exemption remains uncertain. France adopted an objective subject-to-tax requirement for permanent establishments.

Procedure

France adopted the system of withholding tax exemption at source, by means of an attestation. The requirements under French law generally follow the provisions of the Directive. The beneficiary of the payment may benefit from the withholding tax exemption before the completion of the 2-year uninterrupted holding period provided that certain requirements are met. In addition, French law provides for a refund procedure in case the withholding tax was unduly levied.

Fraud and abuse

France will most certainly apply its domestic and agreement-based anti-abuse provisions, but this approach requires further clarifications from the tax authorities. France adopted the same anti-abuse provision to that introduced in respect of the Parent-Subsidiary Directive. In substance, this specific anti-abuse provision denies the application of the withholding tax exemption to a legal entity or a permanent establishment of a legal entity, which is directly or indirectly controlled by one or more non EU residents, unless it can prove to the tax authorities that the principal purpose of the chain participation is not to benefit from the withholding tax exemption.

PART II. THE AGREEMENT

There has been to date no legislative or other regulatory measures concerning the ratification or interpretation of Agreement between the European Community and the Swiss Confederation providing for measures equivalent to those laid down in Council Directive 2003/48/EC on taxation of savings income in the form of interest payments (the "Agreement") or its Memorandum of Understanding in France.

The French tax administration (Direction Générale des Impôts, Sous-direction E- Bureau E2) gave some informal indications in respect to the transposition of the Agreement. In a written response to the IBFD inquiry on the application of the Art. 15 (2) of the Agreement (letter of 9 January 2006), the French tax administration indicated the following:

(i) the Agreements concluded by the European Community with third countries (more specifically Switzerland, Monaco, Andorra, Liechtenstein and San Marino) that provide for equivalent measures as those of Directive 2003/48/EC of 3 June 2003 are of the competence of the European Community. In this respect, such agreements are approved at the European level, and it is not necessary that the Member States examine their compatibility with their national constitutional order; and

(ii) the provisions of the above-mentioned Agreements are directly applicable in France. This excludes the necessity of an implementation into French law. Certain practical modalities could possibly be indicated by way of a Guideline issued by the tax administration in case some difficulties are expressed by the taxpayers or agents of the tax administration.

Under the France- Switzerland tax treaty and protocol of 9 September 1966, as amended by the protocols of 3 December 1969 and 22 July 1997, interest is taxable only in the state of residence (there is no withholding tax (Art. 12(1)), and royalties are subject to 5% withholding tax (Art. 13(2)). In addition, if the patent royalties, dividends or interest are derived through a permanent establishment which the Swiss company maintains in France, the income is included in the taxable profits of the permanent establishment and is subject to corporate income tax under the standard rules (Arts. 13(4) and 12(3)). There is no branch remittance tax (Art. 11(7)). In addition, the treaty contains detailed anti-treaty shopping provisions concerning dividend, interest and royalty payments in Art. 14.

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ANNEX

Table of the maximum withholding tax rates on interest and royalty payments under the tax treaties between France and the EU Member States.

EU Member State	Interest (%)	Royalties (%)
Austria	0	0
Belgium	15	0
Cyprus	10	0
Czech Republic New treaty<2>	0 0	0/5<1> 0/5/10<3>
Denmark	0	0
Estonia	10	5/10 <4>
Finland	0/10<5>	0
Germany	0	0
Greece	0	5
Hungary	0	0
Ireland	0	0
Italy	10	5
Latvia	10	5/10 <4>
Lithuania	10	5/10 <4>
Luxembourg	0	0
Malta	10	0/10 <1>
Netherlands	10	0
Poland	0	0/10 <1>
Portugal	12	5
Slovak Republic	0	0/5 <1>
Slovenia<7>	0	0
Spain	10	0/5 <6>
Sweden	0	0
United Kingdom	0	0

<1> The lower rate applies to copyright royalties, including films, etc.
<2> Effective from 1 January 2006.

<3> The zero rate applies to copyright royalties, excluding computer software, but including films, etc. The 5% rate applies to equipment rentals. The 10% rate applies to patents, trademarks and know-how.
<4> The lower rate applies to royalties paid for equipment rentals.
<5> The lower rate applies, inter alia, to interest on bank loans.
<6> The lower rate applies to copyright royalties, excluding films, etc.
<7> The domestic rate applies; there is no reduction under the treaty.