SULLIVAN & CROMWELL LLP

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France – New "Inpatriates" Tax Incentives

French Prime Minister Announced on July 6, 2016 a Package of Tax Measures to Improve the Attractiveness of Paris as a Financial Center, in Relation With the Recent Referendum on Brexit. This Package Is Focused on Tax Incentives for Employees and Employers in the Financial Services Industry.

SUMMARY

The French inpatriates tax regime currently includes a reduction of the personal income tax basis up to 50% (or higher in certain situations) on both employment income and passive income. In addition, wealth tax is applicable in respect of French assets only, and not on a worldwide basis. The inpatriates regime is applicable during the first five years of French tax residence. No specific regime is currently applicable in respect of salary taxes paid by the employer.

The new package would include (i) an extension of the inpatriates regime from five to eight years; (ii) an exemption benefiting to financial institution employers in respect of the 20% salary tax currently applicable on compensation paid to employees; and (iii) various measures such as the reduction of corporate income tax from 33% to 28%.

EXISTING INPATRIATES TAX REGIME

1. Income tax

The inpatriates tax regime is applicable to employees who:

- are transferred by a company established abroad to work at an affiliated company in France (intragroup mobility), or hired outside of France directly by a company established in France;
- become French tax residents upon taking up their new position in France; and
- have not been tax residents in France in the five years preceding the year they take up their position in France.

The tax advantages currently available to inpatriates are as follows:

- **Exemption of the "inpatriation bonus"**: the inpatriation bonus is defined as the additional remuneration directly associated with the exercise of a professional activity in France. The exemption is subject to the condition that the inpatriate's compensation, excluding the inpatriation bonus, is at least equal to the compensation received by other employees in respect of equivalent positions in the same company or in similar companies established in France. In practice, the amount of the inpatriation bonus is computed as the difference between (i) the compensation received after the transfer to France, and (ii) either the compensation of the relevant employee before the transfer to France, or the compensation paid to other employees in respect of equivalent positions. Employees hired directly by a French company may also elect to have a flat 30% of their net remuneration treated as an inpatriation bonus, and thus exempted from income tax.
- **Exemption of the portion of remuneration corresponding to work carried out abroad**: in addition to the exemption of the inpatriation bonus, the employee benefits from an exemption for the portion of his or her compensation that corresponds to work carried out outside of France.
- The total income tax basis reduction resulting from both exemptions is **capped at 50% of total compensation**. Alternatively, if the inpatriation bonus exceeds 30% of compensation, the employee is entitled to deduct a maximum of 20% in respect of the portion of compensation corresponding to work carried out outside of France.
- **Exemption of certain passive income from non-French sources**: inpatriates benefit, under certain conditions, from a 50% exemption with respect to capital gains on the sale of shares and other investment income. This is subject to the condition that such passive income arises outside of France, and in a country that has concluded a tax treaty with France including an administrative assistance clause.

These exemptions are applicable until December 31 of the fifth calendar year following the inpatriate's taking up his or her position in France, but do not apply to social security taxes that are due in France by both the employee and the employer.

2. Wealth tax

Individuals who transfer their tax residence to France are exempted from wealth tax on assets located outside of France, provided that they have not been tax resident in France over the past five years. For wealth tax purposes, assets are deemed to be located in France if they have either a material link with France (*e.g.*, real estate, movable property located in France, etc.) or a legal link with France (*e.g.*, accounts receivable on French debtors, shares issued by a French company, etc.).

Such exemption applies until December 31 of the fifth calendar year following the beneficiary's transferring its tax residence in France.

PROPOSED AMENDMENTS TO THE INPATRIATES TAX REGIME

The French Prime Minister announced that the duration of the foregoing inpatriates tax benefits would be extended from five to eight years.

In addition, a new exemption would be applicable in respect of the salary tax (*taxe sur les salaires*), which is payable by employers that are not subject to VAT on at least 90% of their turnover. In practice, the salary tax is mainly borne by financial institutions at a rate between 4.25% and 20% (the 20% rate being applicable in respect of compensation exceeding €152,122/year per employee). The new exemption would mean that such tax would not apply to the inpatriation bonus, although it is not clear at this stage whether the portion of compensation corresponding to work carried out outside of France would also be exempted from salary tax.

OTHER MEASURES

The French Prime Minister indicated that the French corporate tax rate would be reduced from 33.33% to 28% by 2020**,** subject to the outcome of the May 2017 French presidential elections.

He also announced the creation of an **information desk** to facilitate inpatriation in France by advising inpatriates on issues such as tax regimes, housing, and residence permits in France in their native language.

The French Prime Minister also indicated that discussions would be initiated with local authorities in order to provide for a temporary decrease in French local taxation on companies and commercial premises.

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CONTACTS

Paris

Gauthier Blanluet	+33-1-7304-6810	blanluetg@sullcrom.com
Nicolas de Boynes	+33-1-7304-6806	deboynesn@sullcrom.com
Alexis Madec	+33-1-7304-5834	madeca@sullcrom.com