Proposed Legislation on French Bonus Tax

French Payroll Tax on Certain Bonuses Paid by Financial Institutions

SUMMARY
Following an announcement made on 16 December 2009 (see our publication of 18 December 2009), proposed legislation1 on the Bonus Tax was released by the French Ministry of Finance on 20 January 2010 and will be considered by the French Parliament in the coming weeks in connection with the Revised 2010 Finance Bill. The draft bonus legislation provides for a 50% tax on performance-related compensation in excess of €27,500 when granted with respect to tax year 2009 by certain financial institutions operating in France. The Bonus Tax would be borne by employers and applicable to bonuses paid in cash or in shares (or stock options) to a broad class of “financial markets professionals”, defined as “professionals of the financial markets whose activities are likely to have a significant impact on the risk exposure of the relevant entity”.2 Since these terms are not further defined, the scope of the Bonus Tax is highly uncertain and may be refined in the course of parliamentary debates.

DISCUSSION
1. 2009 Bonuses
The Bonus Tax is assessed on 2009 bonuses, i.e., variable compensation granted with respect to tax year 2009, in excess of €27,500 per employee. Variable compensation is defined for these purposes as the compensation granted to employees in consideration for their individual or collective performance, excluding amounts resulting from the mandatory profit-sharing mechanisms (participation and intéressement).

If the taxable bonus consists of stock options, restricted stock or any other incentive instruments granted by the employer or an affiliate of the employer, the taxable basis would be equal to the fair market value of such instruments on the grant date as assessed under IFRS accounting rules.
The triggering event for the Bonus Tax would be the grant of the bonus, as opposed to the payment or the vesting. Therefore, the Bonus Tax would be applicable to any bonus granted to employees with respect to tax year 2009, irrespective of any vesting conditions imposed by the employer. In addition, in the event that the amount of the bonus would be reduced after the triggering event (for instance, because all or part of the bonus does not vest), the Bonus Tax would not be refunded.

2. Bonuses Granted to Financial Markets Professionals

The tax would apply to bonuses granted to “financial markets professionals”, consistent with the scope of the Decree dated 3 November 2009 related to the rules and principles governing variable compensation in the banking sector (see our publication of 4 December 2009).

The concept of “financial markets professionals” is unclear. The condition that the activities of such professionals must be “likely to have a significant impact on the risk exposure of the relevant entity” is also particularly uncertain. According to the regulations issued by the French Banking Association (Fédération Française des Banques) on 5 November 2009, “financial markets professionals” are defined as professionals whose performance, hence their compensation, are related to market instruments. However, in the working group report attached to such regulations, professionals of the financial markets are more broadly defined as those involved in financial market activities or investment banking activities. In any event, it seems that the scope of the tax would not only include traders, who are primarily targeted by the proposed legislation, but may also encompass other employees involved in market activities in front-office, middle-office or back-office, as well as support and control functions. However, the Ministry of Finance indicated in a press interview that only 2,500 individuals would be affected by the Bonus Tax, which implies a narrow interpretation of the definition of “financial markets professionals” (Le Figaro, 12 January 2009).

The draft legislation does not provide for any territorial limitation to the Bonus Tax. In particular, the proposed legislation does not specify that targeted employees are those who performed their duties in France. As currently drafted, the proposed legislation may apply to bonuses paid to French and foreign-based employees of French banks and financial institutions. Furthermore, it could in theory apply to non-French banks and financial institutions having a branch in France for all bonuses paid to any relevant employee worldwide. It is expected that the draft bill will be amended to limit the territorial scope of the tax, for instance by reference to the principles applicable to the general payroll tax paid by entities that are not fully subject to French VAT, which would exclude foreign-based employees from the scope of the Bonus Tax.

3. Who Pays the Bonus Tax?

The Bonus Tax would not be a tax on employees, who would remain subject to normal income and social security taxes. Rather, the Bonus Tax would be imposed on the employers in addition to employers' social security taxes (imposed at a marginal rate of approximately 25%) and the payroll tax (taxe sur les
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ENDNOTES

1 Article 1er du Projet de loi de finances rectificative pour 2010.

2 "Professionnels des marchés financiers dont les activités sont susceptibles d'avoir une incidence significative sur l'exposition aux risques de l'entreprise".
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