March 10, 2010

French Bonus Tax

Enactment of the French Payroll Tax on Certain Bonuses Paid by Financial Institutions

SUMMARY
This memorandum follows our publication of January 25, 2010 entitled “Proposed Legislation on French Bonus Tax” regarding the 50% tax on bonuses granted with respect to tax year 2009 by certain financial institutions operating in France. The proposed legislation was enacted on March 9, 2010. An amendment voted by the French Parliament resulted in the extension of the scope of the tax to heads of trading floor and trading desk operations (“directeur de salles de marchés” and “responsables de desks”). Various uncertainties remain as to the territorial scope of the tax and the activities that are subject to the tax.

BONUSES PAID WITH RESPECT TO 2009
The Bonus Tax is assessed on variable compensation in excess of €27,500 per employee. Variable compensation is defined for this purpose as the compensation granted to employees in consideration of their individual or collective performance, excluding amounts resulting from mandatory profit-sharing mechanisms (“participation” and “intéressement”). The taxable basis is equal to the gross amount of such compensation, including payroll withholdings for employee social contributions.

If the bonus consists of stock options, restricted stock or any other incentive instruments granted by the employer or an affiliate of the employer, the Bonus Tax shall be due on the fair market value of such instruments on the grant date, as assessed under IFRS accounting rules (i.e., ignoring certain vesting conditions but taking into account transfer restrictions such as lock-up requirements).

Reports prepared by the French parliamentary commissions (the “Reports”) provide some guidance on the interpretation of the law. Although such Reports do not have binding authority, they may be taken into
account by French courts in the interpretation of the law. In addition, statements of the Government that are quoted in the Reports are deemed to reflect the position of the French tax authorities.

The tax basis is restricted to bonuses “paid with respect to tax year 2009”. The Reports indicate that 2009 bonuses are those that are based on financial results and performance reported with respect to market transactions realized and closed in 2009. The Reports further include a statement of the Government under which “the link with 2009 can be established based on the characteristics of the compensation and the past practice of the company, for instance the label of the compensation (“Bonus 2009”…), the conditions and causes of the decision to grant such compensation, the computation of the bonus, the date of grant or payment, etc…”.

The triggering event for the Bonus Tax is the grant of the bonus, as opposed to payment or vesting. Therefore, the Bonus Tax is applicable even if the bonus is subject to vesting conditions. The Bonus Tax would not be refunded in the event the amount of the bonus would be reduced after the date of grant, for instance because of a clawback provision.

**BONUSES GRANTED TO CERTAIN FINANCIAL MARKET PROFESSIONALS**

The tax will apply to bonuses granted to “financial market professionals whose activities are likely to have a significant impact on the risk exposure of the relevant entity”. This definition is consistent with the scope of the Decree dated November 3, 2009 regarding the rules and principles governing variable compensation in the banking sector (see our publication of December 4, 2009).

An amendment voted by the French Parliament extended the tax to bonuses paid to professionals that supervise employees whose activities are likely to have a significant impact on the risk exposure of the relevant entity. According to the explanatory notes on this amendment, this extension targets heads of trading floor and trading desk operations (“directeur de salles de marchés” and “responsables de desks”), but not corporate officers.

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 unclear. The Reports indicate that this condition was added to limit the scope of the tax to employees engaged in “trading for the bank’s account”, i.e., proprietary trading. The Reports also state that the tax would apply to “traders working in the Investment Banking divisions” and not to (i) brokerage firms (“sociétés de bourse”), (ii) asset managers that are exclusively involved in the management of assets held by third parties through mutual funds, LBO funds, hedge funds or funds of funds and (iii) investment bankers involved in mergers and acquisitions. The back-office and middle-office departments would also not fall within the scope of the Bonus Tax, which is more favorable than the bonus tax in the UK.

However, the Reports further include a statement by the French Government which tends to depart from the distinction that should be drawn between proprietary trading and other banking activities. According
to this statement, professionals affected by the Bonus Tax are “employees that are engaged in various services and market activities for the account of their employer (execution of buy/sell instructions given by clients, proprietary trading, underwriting, placement with underwriting or not, currency exchange) and whose activity results in significant risks. [...] As an example, the tax would affect financial market professionals working in the stock, currency or derivatives markets, for the proprietary account of the bank or for the account of the bank’s clients”. On the one hand, the Government’s statement confirms that the tax applies to employees that act “for the account of their employer”, which is consistent with the principles described above. On the other hand, the examples given by the Government seem to include activities that do not affect the bank’s account, such as the mere execution of customer buy/sell instructions.

The Ministry of Finance indicated in a press interview that 2,500 individuals would be affected by the Bonus Tax, which implies a narrow interpretation of the definition of “financial market professionals” (Le Figaro, January 12, 2009). In the same vein, the Reports state that 3,000 individuals would fall within the scope of the tax.

The legislation does not provide for any territorial limitation to the Bonus Tax. In particular, the new legislation does not specify that targeted employees are those who perform their duties in France. As currently drafted, the legislation may apply to bonuses paid to foreign-based employees of French banks and financial institutions, which could result in double taxation with respect to employees working in the London branch of French banks that are subject to the UK bonus tax. 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. However, the Ministry of Finance indicated during the parliamentary debates that only employees having entered into an employment agreement subject to French law would be within the scope of the tax.

WHO PAYS THE BONUS TAX?
The Bonus Tax will not be a tax on employees, who will remain subject to normal income and social security taxes. Rather, the Bonus Tax will be imposed on employers in addition to employers’ social security taxes (imposed at a marginal rate of approximately 25%) and the payroll tax (taxe sur les salaires) due by companies carrying out activities that are not fully subject to VAT (at a marginal rate of 13.6%). Unlike the bonus tax in the UK, the French Bonus Tax is deductible for corporate income tax purposes.

Taxable entities are banks and financial institutions that are subject to corporate income tax in France as of the date the legislation goes into effect. These include entities incorporated in France as well as non-French entities that have a permanent establishment in France (generally, a “branch”) under Section 209-1 of the French Tax Code. Banks and financial institutions are defined by reference to Sections L.511-1 and L.531-4 of the Monetary and Financial Code (Code Monétaire et Financier) and consist of French or
non-French entities that have obtained a license to perform banking or financial services in France, as *établissements de crédit* or *entreprises d'investissement*, or European banks or financial institutions that have passported a branch in France.

The Reports confirm that insurance companies would not fall within the scope of the Bonus Tax.

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**ENDNOTES**

1. Loi n°2010-237 du 9 mars 2010 rectificative pour 2010 (1) – JORF n°0058 du 10 mars 2010

2. Rapport n°2268 de Monsieur Gilles Carrez, rapporteur général de la commission des finances de l'Assemblée Nationale, sur le projet de loi de finances rectificative pour 2010 - Rapport n° 278 de Monsieur Philippe Marini, rapporteur général de la commission des finances du Sénat, sur le projet de loi de finances rectificative pour 2010

3. "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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