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French Withholding Tax

The Transposition into French Law of the New Anti-Abuse Provision of the EU Parent-Subsidiary Directive May Impact Certain Acquisition Structures Commonly Used by Non-EU Funds/Corporate Investors to Acquire French Companies

SUMMARY

The French Amended Finance Act for 2015¹ implements a new EU anti-abuse clause that aims at excluding “non-genuine” arrangements from the scope of the withholding tax exemption applicable to dividends paid by French subsidiaries to EU parent companies.

In particular, the new anti-abuse clause targets EU holding companies, such as Luxembourg holding companies, commonly used as investment vehicles by non-EU entities to acquire French target companies in order to benefit from the exemption of withholding tax on the upstreaming of dividends from France.

Even though there is some uncertainty about the interpretation of the new law, it is likely that the substance requirements for holding companies to benefit from the French withholding tax exemption will be significantly higher than under previous legislation. In particular, the current “substance thresholds” generally recommended for such holding companies (e.g., minimum staff, offices, location of board meetings, etc.) may no longer be sufficient to qualify for the withholding tax exemption.

This anti-abuse clause would apply to both future and existing structures with respect to distributions made during fiscal years beginning on or after January 1, 2016.

BACKGROUND

Before the Amended Finance Act for 2015, the withholding tax exemption on dividends paid by a French subsidiary to an EU parent company was available under two different grounds:

- **Parent-Subsidiary Directive:** The transposition into French law of the previous version of the Parent-Subsidiary Directive included a specific anti-abuse clause applicable to EU parent companies controlled by non-EU shareholders, subject to certain safe harbors. Because of such anti-abuse clause, this ground for withholding tax exemption was generally not used in the context of holding companies set up by non-EU investors for the purpose of acquiring French target companies;
- **ECJ Case Law:** the European Court of Justice (“**ECJ**”) had ruled in the *Denkavit* case² that the participation exemption regime on dividends applicable under French law to French holding companies must be applied to EU holding companies as well, which resulted in an exemption for withholding tax on dividends paid by a French subsidiary to an EU parent company. Such case law did not provide for any specific anti-abuse clause, but only referred to the exclusion of “wholly artificial arrangements” under the meaning of the ECJ case law³. This reference was generally considered as less rigorous than the specific anti-abuse clause under the Parent-Subsidiary Directive since the compliance with certain substance requirements (minimum staff, offices, board meetings, etc.) was viewed as sufficient to claim the benefit of the exemption.

IMPLEMENTATION OF THE NEW ANTI-ABUSE CLAUSE

The Amended Finance Act for 2015 brings two important changes:

- The new anti-abuse clause is applicable to both exemption regimes (Parent-Subsidiary Directive and ECJ case law).
- The new anti-abuse clause is more stringent than the previous clause provided in the transposition under French law of the Parent-Subsidiary Directive. The withholding tax exemption will not apply “*to an arrangement or a series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose [of this exemption], are **not genuine** having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part. For the purposes of [these provisions], an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for **valid commercial reasons which reflect economic reality***”;

The parliamentary debates show that the new anti-abuse clause is specifically aimed at holding companies set up by non-EU investors to acquire French target companies. It is noted in the parliamentary report that the clause especially targets “*schemes that make it possible for EU subsidiaries of international groups to distribute dividends to companies that are established outside the EU in low-tax countries without any withholding tax levied in France. [...] This is the case of schemes involving holding companies the sole activity of which is to hold shares*”⁴.

This is consistent with guidelines released recently by the French Tax Administration stating that it intended to challenge situations where holding companies are set up with the main objective to benefit from the withholding tax exemption⁵.

It is difficult to assess how French courts will interpret the broad wording of the new anti-abuse clause. First, subject to our comment below, the reference to “one of the main purposes” might make it somewhat difficult to qualify for the exemption when an EU holding entity is controlled by non-EU companies, should the benefit of the withholding tax exemption be considered as being “one of the main purposes” for the interposition of a holding company, even though a business rationale can also be proved. Second, the reference to “genuine” arrangements and “valid commercial reasons” may

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indicate that the focus will not only be on the substance criteria as generally used in existing acquisition structures, but also on the business rationale for setting up a holding company and choosing its location.

However, three factors might limit the far-reaching impact of this new legislation :

- As a general matter, the compatibility of such a rigorous anti-abuse clause with the EU's principle of freedom of establishment may be questioned. In this regard, the French Supreme Court has recently referred a question to the ECJ for a preliminary ruling on the compatibility with the freedom of establishment of the former anti-abuse clause provided under French tax law, which will hopefully provide guidelines for the interpretation of the new anti-abuse clause, as well⁶.
- As the text of the new anti-abuse clause reads, it could be argued that the demonstration of "valid commercial reasons" and the compliance with substance requirements are sufficient to claim the exemption, even though tax considerations would also be "one of the main purposes" of the structure.
- In respect of Luxembourg holding companies, the tax treaty between France and Luxembourg may provide for an alternative relief for taxpayers under certain conditions.

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ENDNOTES

- ¹ Article 29 of the Amended Finance Act for 2015 n° 2015-1786, December 29, 2015.
- ² ECJ, December 14, 2006, C-170/05, *Denkavit*.
- ³ See for instance: ECJ, September 12, 2006, C-196/04, *Cadbury Schweppes*.
- ⁴ Report on behalf of the French *Commission des finances, de l'économie générale et du contrôle budgétaire* regarding the Amended Finance Bill for 2015 as modified by the Senate (n°3344), Ms. Valérie Rabault, p.65 to 66.
- ⁵ List of abusive schemes published by the French tax administration on April 2015 and available at <http://www.economie.gouv.fr/dgfip/carte-des-pratiques-et-montages-abusifs>.
- ⁶ Conseil d'Etat, December 30, 2015, n°374836, Sté Holcim France SAS.

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