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Additional 3% tax on dividend distributions

The second amended Finance Bill for 2012 has introduced an additional 3% contribution on all sums distributed by companies subject to corporate income tax (“CIT”). While this additional tax is certainly a surcharge for companies, it also creates tax distortions between consolidated and non-consolidated groups.

1. Scope of application

1.1. Taxable entities

The additional 3% tax is due by French and foreign companies and organizations that are subject - automatically or optionally - to CIT (and even if they are exempt from CIT) and applies on all sums distributed since August 17, 2012 (Article 235 ter ZCA of the French Tax Code). Yet, this tax will not apply to

- small- and medium- businesses (“SMB”), within the meaning of EU legislation, i.e. companies with less than 250 employees, with an annual turnover of less than 50M Euros or a total balance sheet of less than 43M Euros (cf. Annex 1 of Commission Regulation (EC) No 800/2008 of August 6, 2008); and
- companies for collective investment (commonly known as collective investment vehicles) listed in Article L 241-1 of the French Monetary and Financial Code (such as so-called *Sicav*, *Sppicav* and *Sicaf*).

This tax shall also be due by foreign companies or organizations that are subject to CIT through their permanent establishment in France and shall apply on the part of the income that is no longer available to the French establishment (subject, however, to specific provisions set forth in tax treaties entered into by France).

As such, the tax shall be due on profits realized in France and not directly reinvested in the French establishment.

1.2. Distributions subject to the 3% tax

This new tax shall apply to distributed income, as defined in Articles 109 to 117 of the French Tax Code, i.e.

distributions resulting from a deliberation or official decision of the competent corporate bodies as well as sums deemed distributed.

On the other hand, the 3% tax should not apply to sums distributed in the framework of reorganizations/restructurings (such as mergers, dissolutions without liquidation) - but should apply to the so-called *boni de liquidation*, i.e. liquidation surplus.

It targets distributions made to shareholders, no matter whether they are individuals or legal entities and whatever their business location or place of residence (in France or abroad).

Yet, the second amended Finance Bill for 2012 provides for a number of exemptions, notably for intra-group distributions, within the meaning of Article 223 A of the French Tax Code, i.e.:

- Distributions between companies belonging to the same French tax consolidated group.
On the other hand, no exemption will apply to sums distributed by a consolidated entity to a non-consolidated entity and vice-versa. As such, when a tax consolidated subsidiary is held through a foreign company, the income distributed to the latter by a tax consolidated entity will be subject to the 3% tax.
- Distributions between entities belonging to the same cooperative bank and distributions from a *société d'investissements immobiliers cotée* (listed real estate investment company, hereinafter "SIIC") that has opted for the CIT exemption regime to its parent company, provided that the latter holds at least 95% of its SIIC subsidiary and had also opted for the CIT exemption regime.
- Distributions paid in shares or in so-called *certificats coopératifs d'investissement* or *certificats coopératifs d'associé* (two types of non-voting shares that entitle their holders to a share in the company' assets in proportion to the amount of capital they represent). Yet, the exemption is cancelled if the company implements a share buy-back process in the context of a share capital reduction, not justified by losses, within one year from the distribution. The same rule applies if the company buybacks the *certificats coopératifs d'investissement* or *certificats coopératifs d'associé* within one year from the distribution. In these two cases, the tax would be due twice: regularization of the initial distribution and taxation of the income distributed through the buy-back.

2. Regime D'application

The 3% tax on distributions is assessed, controlled and collected in the same manner as the CIT.

This tax must be paid spontaneously, on or before the first CIT installment due date following the month of income distribution (i.e. March 15, June 15, September 15 and December 15 of each year).

- Dividends and assimilated distributions: The first payment date is fixed on December 15, 2012 for dividends distributed before September 1, 2012.
- Income deemed distributed: Income is deemed distributed at the end of a financial year. As such, the payment of the 3% tax must be performed at the time of the first CIT installment following the close of the relevant financial year.

In order to pay this first installment, company must file with the competent Companies Tax Center form n° 2570-SD entitled “*Contribution additionnelle à l’impôt sur les sociétés au titre des montants distribués – échéance du 15 décembre 2012*” and concomitantly proceed with payment by check or wire transfer. This procedure must be applied only for the installment due on December 15, 2012.

Form n°2571 shall be adapted for the March 15, 2013 payment due date in order to allow for the payment of the 3% tax together with the CIT and other assimilated taxes.

3. Remarks

3.1. The new 3% tax has a cascade effect

Except in case of tax consolidation, the 3% tax applies to every single distribution of dividends. As such, each company of a vertical chain of holdings will be taxed each time a distribution is made. Indeed the 3% contribution tax will cascade through distributions made by subsidiaries and then through distributions made by their parent company.

This cascading taxation of dividends falling under the parent-subsiary regime seems to contradict the French law principle of elimination of double or multiple taxation of profits between associated companies and might be questionable under Council Directive 90/435/EEC of July 23, 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States known as the Parent-subsiary Directive.

3.2. Companies engaged in an economic activity

While the 3% tax does not apply to dividends distributed by SMBs within the meaning of EU legislation, it should be underlined that according to the EU definition, an SMB is an entity “*engaged in an economic activity*”. As such, it is likely that the exemption will not apply to dividends distributed by wealth management companies.

Yet, distributions made by a holding company qualifying as a *holding animatrice* (lead holding company) under French wealth tax rules should benefit from the exemption if the group does not exceed the SMB thresholds fixed by EU legislation. In this case, dividends distributed within the group should then be exempted from the 3% tax.

3.3. Impact of the 3% Tax

Lastly, it is necessary to assess the impact that the 3% tax may have on companies’ decisions to distribute profits.

Indeed, this new tax could lead companies to adjust distributed amounts.

- Distributed amounts could remain unchanged since the 3% tax rate is not sufficiently high to discourage

- any and all distributions of dividends. The shareholder would thus be the only one to bear the cost of this tax since the distributed amount would comprise both the income, net of dividends, and the 3% tax.
- Conversely, the 3% tax could be included in the distribution, i.e. the amount of dividends would be increased so that the amount of dividends paid to the shareholder would remain unchanged. This option means that the distributing company will alone bear the cost of the 3% tax.
 - Lastly, the cost of the 3% tax could be borne at the same time by the distributing company and by the shareholder, in which case, this 3% tax should be taken into account in the determination of the amount of dividends to be paid out.

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