Responding to COVID Crisis, French Draft Budget Proposes Tax Cuts for Businesses

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Overview

On September 29, 2020, the French government published the 2021 Finance Bill, against the backdrop of the COVID-19 crisis and an expected 10.2% reduction in GDP in 2020.

In spite of a precipitous drop in tax revenues earlier this year and an increase in expenses aimed at tackling the pandemic and supporting the economy, the proposed budget does not include major tax hikes. Quite to the contrary, it does not reverse the gradual reduction of the corporate income tax headline rate, introduced in previous years, which should bring the rate down to 25% in 2022; similarly, while the cost of the R&D tax credit system had been called into question earlier this year, no significant change to this regime is proposed in the current draft budget. The bill also includes a reduction in business tax (*contribution économique territorial*), which should provide an appreciable boost for businesses engaging in capital expenditures. The introduction of a long-awaited VAT grouping regime should also be welcome by corporate groups operating through multiple subsidiaries and entities.

The budget has just been submitted to the French Parliament, which will review and amend it in the next few weeks; the draft budget is then likely to be reviewed by the constitutional court, before being enacted at the end of December 2020. The main corporate tax provisions and other measures in the bill impacting companies and multinational enterprises with operations in France are summarized below.

Limited Corporate Tax Measures

Tax-neutral revaluation of fixed assets

In France, revaluations of fixed assets, in which a business decides to revise the book value of its assets to reflect their fair market value, are rare, mostly because of the tax cost the process triggers; built-in gains are recognized in the process and generally included in the taxpayer's taxable income subject to corporate tax at the standard rate.

Article 5 of the 2021 Finance Bill provides for a temporary exemption from this rule, in the context of the COVID-19-induced recession, in order to facilitate these operations by limiting their tax impact. As a result, this provision would allow companies, for fiscal years ending from December 31, 2020, until December 31, 2022, to elect for:

- the inclusion of a revaluation surplus relating to depreciable tangible assets in the taxpayer's taxable income ratably over a period of five or 15 years, depending on the nature of the assets, and the right to depreciate these assets by reference to their fair market value, and

- a tax deferral (*sursis d'imposition*) for the revaluation surplus realized on certain nondepreciable fixed assets.

This measure should allow companies to strengthen their shareholders' equity at a limited cost and, accordingly, improve their balance sheets at a time when they have been significantly affected by the crisis. The revaluation also brings certain benefits in relation to corporate law rules (which generally require shareholder equity not to fall below 50% of a company's share capital) or tax rules (which include thin capitalization disallowing the deduction of financial expenses for companies exceeding certain debt-to-equity ratios). Amounts credited to the revaluation reserve, however, are not freely available for distribution to shareholders.

Business Taxes

50% reduction of the contribution on value added for enterprises (CVAE)

The contribution on value added for enterprises (*contribution sur la valeur ajoutée des entreprises* or "CVAE") largely depends on the value of the taxpayer's capital assets, as opposed to the amount of its net income, and therefore is considered as affecting the competitiveness of French companies in relation to their competitors as well as the attractiveness of France by adversely affecting decisions on the location of investments, in particular for industrial companies and multinational enterprises. In July 2020, the French government committed to cut such taxes by €10 billion each year, until at least 2022.

Article 3 of the 2021 Finance Bill marks the first step toward this objective by reducing the CVAE charge by 50%, starting in 2021.

Other technical measures would lead to a downward revision in the way the value of certain real property assets are assessed for the purpose of real estate taxes charged on businesses (*cotisation foncière des entreprises* or "CFE" and *taxes foncières sur les propriétés bâties*). Further exemptions from CFE will also be introduced by Article 42 of the bill, benefiting new businesses and companies making new investments.

Vat Measures

Creation of a VAT group scheme

The EU Directive on the common system of value added tax (VAT)[1] provides for the possibility for an EU member state to regard as a single taxable person any persons established in the territory of that member state who, while legally independent, are closely bound to one another by financial, economic and organizational links. While this single-taxable person mechanism is currently applied in 20 EU member states, France had not elected, until now, to transpose this system into French law.

In 2012, an optional scheme for the consolidation of the payment of VAT charges and refunds of tax credits at the level of groups of companies had been put in place, but this regime merely consolidates the VAT charges owed by each member of the group, each of whom remains subject to individual reporting obligations.

The new regime would be much more ambitious and would allow, upon election, the constitution of a single taxable person. Its members must be taxpayers established in France, with financial, economic and organizational links between them, which should include French groups, as regards their French operations, as well as multinational enterprises with a foreign parent, as regards their French subsidiaries and branches. Groups that have opted to form a single taxable person, which should last for a minimum period of three years, would designate one of their members as the parent company in charge of fulfilling all the VAT tax-related obligations and making a single VAT payment for which all members remain jointly and severally liable. For the determination of the deduction rights of the single taxpayer, each member should be considered as a sector of the group's activity. Intra-group supplies of goods or services would essentially be disregarded for VAT purposes.

This should prove particularly beneficial for entities operating in sectors with limited rights to recover input VAT, such as the financial or pharmaceutical industries, which currently suffer high VAT costs on services provided between group entities. However, for cross-border flows, the standard rules would still apply.

This reform is expected to come into force as of January 1, 2022, to allow the option to be exercised before October 31, 2022, and will apply from January 1, 2023.

Simplification of Business Formalities and Tax-Efficiency Measures

Simplification of certain tax formalities

In order to alleviate the administrative burden falling on companies and businesses, the registration regime applicable to certain corporate decisions and actions would be simplified. In particular, decisions evidencing share capital increases or share capital reductions, which currently must be registered with the tax authorities, would no longer be subject to this requirement.

[1] Council Directive 2006/112/EC, of November 28, 2006, relating to the common system of VAT.

In a similar vein, a number of corporate decisions and actions, which currently must be filed with the tax authorities before being eligible for filing with the clerk's office of the commercial courts to amend the Trade and Companies Register, would remain subject to mandatory tax registration, but the Trade and Companies Register filing could be made first, which should expedite and facilitate the whole process.

Repeal of low-yield taxes

Article 16 of the 2021 Finance Bill provides for the repeal of seven taxes that were deemed obsolete and generate limited revenues, sometimes not even on par with the cost to collect them. Similarly, certain very specific tax exemptions with limited practical use would be cancelled.