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Global Reward Update
France – Proposed income tax withholding for resident individuals

Key Points to Know

As part of the 2017 proposed budget, the French government has confirmed that an income tax withholding system would be introduced for individuals who are France tax resident.

Currently, French tax residents pay income tax in the following year, via their annual tax return. It is proposed that with effect from January 1, 2018 income tax withholding would apply in payroll. If enacted, the draft bill could be adopted into law as soon as December 31, 2016.

As a result, in 2017, French individual tax residents would pay income tax on their 2016 income, while in 2018, they would be required to pay French income tax on their 2018 income as it is earned. Penalties would be imposed for noncompliance.

Types of income to be subject to withholding

Wages, "replacement income" and pensions would be subject to withholding. The payer of the income would have to withhold tax and remit it to the French tax authorities on an ongoing basis.

For wages, employers would be required to withhold tax on the net taxable compensation (effectively, the wages after deducting social security contributions) each time a payment is made. If the employee qualifies for a favorable tax regime, the employer may wish to adjust the taxable basis to account for exemptions under the regime.

Capital gains and equity income (from qualified share plans) would not be included in the types of income subject to withholding. Tax on capital gains would be payable in the following year upon filing an income tax return as per current process. However, it is anticipated that taxpayers would be required to make advanced tax payments by way of a direct remittance to the French tax administration in the year the shares are sold.

Withholding tax rate

The withholding tax rate on wages would generally be provided to the employer by the French tax authorities on a monthly basis, through France's new payroll procedure (DSN). The tax rate would be determined by the tax authorities based on the previous year's tax return.

If the French tax authorities do not provide a withholding tax rate to the employer, the employer would apply a standard tax rate.

The standard tax rate would apply:

- When the taxpayer has never filed a French income tax return (for example, an assignee arriving in France); or
- When the taxpayer specifically requests the use of the standard tax rate (an available option).

Foreign payroll and foreign employers

If a French resident taxpayer is on the payroll of a foreign employer that does not have access to France's DSN payroll system, the withholding of French tax would not be required and the taxpayer would be required to pay his/her income tax directly to the French tax authorities on a monthly basis.

Taxation of 2017 income

To avoid a double tax burden in 2018 (i.e. the income tax due on 2017 income, plus the withholding tax on 2018 income), the government has indicated that, upon filing the 2017 tax return, each taxpayer would benefit from a tax credit to cancel out the 2017 French income tax due on "non-exceptional" income.

The tax credit would be calculated on non-exceptional income only, in an effort to prevent aggressive tax planning. Exceptional income and income that is not subject to withholding would not benefit from a tax credit and would remain fully taxable in 2018 (upon filing the 2017 tax return in May 2018).

Exceptional income for 2017 that would remain taxable in 2018 would include deferred and irregular compensation.

Impact on Share Plans

Under the current rules, only non-qualified share plan income is subject to tax withholding:

i) All gains subject to social security contributions; and
ii) Any income taxes arising when employees are non-resident.

Where awards are granted under a qualifying arrangement, no withholding of any kind is required. However, as referenced above, it is anticipated that in the year the shares are eventually sold resident taxpayers will be required to make advanced tax payments by way of a direct remittance to the French tax administration.

It is expected that the introduction of withholding described above would be limited to non-qualified arrangements (as such gains are captured under the definition of wages).

Deloitte's view

The introduction of a withholding and advance tax payment system, which has been the topic of debate for many years, may now become a reality.

These measures will have a significant impact on the administration and management of compensation, which will present new challenges for companies and payroll providers. The proposed rules will also impact the settlement process on non-qualified arrangements where companies will need to ensure that brokers can facilitate withholding and have a process in place to transfer those proceeds to local payroll.