Legislation changes and clarifications impacting investment funds

A French update

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A couple of clarifications impacting investment management were introduced by the Finance Bill for 2015. In addition, the much commented "Bill for Growth and Activity" (Loi Macron) also introduces a new investement fund dedicated to capital investment.

Withholding Tax Exemption on dividends — Update for non-EU Funds

Until 17 August 2012[1], dividends distributed by French companies to foreign undertakings for collective investment (UCIs) were subject to a withholding tax levied at a rate of 30%[2] (possibly reduced on the basis of applicable tax treaties). Further to the ECJ's judgment[3] sanctioning France for infringement of the freedom of movement of capital, the legislator has introduced an exemption for dividends paid to foreign UCIs comparable to French UCIs.

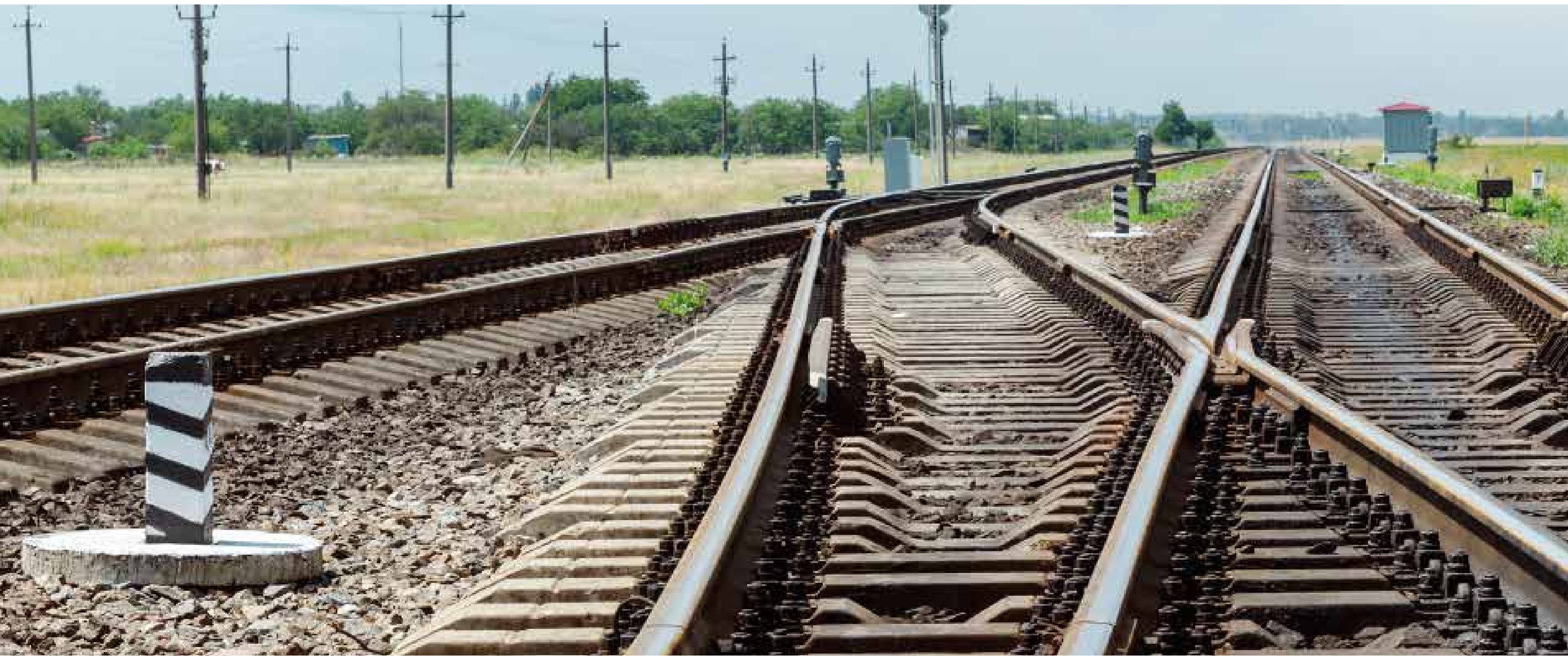
For collective investment funds based in states outside the EU, under the provisions of the 2012 Bill, the exemption was applicable only to the extent that the state had concluded a Convention on Mutual Administrative Assistance with France. However, in practice, the French Tax Authorities (FTA) considered that non-EU UCIs were not comparable, based on their statement of practice dated August 2013. The Amending Finance Bill for 2014[4] states that the Convention on Mutual Administrative Assistance must effectively enable the tax administration to obtain the information necessary to verify that the UCI complies with the conditions provided for the exemption and thus could benefit from it.

Current practice: no tax exemption for non-EU UCIs despite EU law

Article 63 of the Treaty on the Functioning of the European Union (TFEU) provides that "*all restrictions on the movement of capital between Member States and between Member States and third countries shall be prohibited.*" In the Santander Case, the ECJ sanctioned France in 2012 for infringement of the freedom of movement of capital. This led to the abolition of the withholding tax on dividends paid to foreign funds.

However despite the legislative change, the withholding tax exemption was still denied to non-EU funds due to a restrictive interpretation of the law by the FTA. This is not in line with more recent ECJ case law recognising rights to third-country funds (e.g. Emerging Markets Series of DFA Investment Trust Company vs. Dyrektor Izby Skarbowej w Bydgoszczy (C-190/12) 10 April 2014).

1 *Rectificative Finance Bill for 2012 n° 2012-958 of 16 August 2012*
2 *Based on former Art 119 bis of the French Tax Code*
3 *ECJ, case C-338/11 to C-347/11, 10 May 2012, Santander*
4 *Article 58 of the Amending Finance Bill for 2014 n° 2014-1655, 29 December 2014*



Rectificative Finance Bill for 2014: more clarity?

The Rectificative Finance Bill for 2014[5] has introduced a clarification regarding dividends distributed to non-EU UCIs by adding that the implementation of a Mutual Administrative Assistance Agreement must "*effectively enable the Tax Administration to obtain from the Authorities of the State in which the UCI is established on the basis of a foreign law […] the information necessary to the verification*" of compliance with the conditions required in order to benefit from the withholding tax exemption.

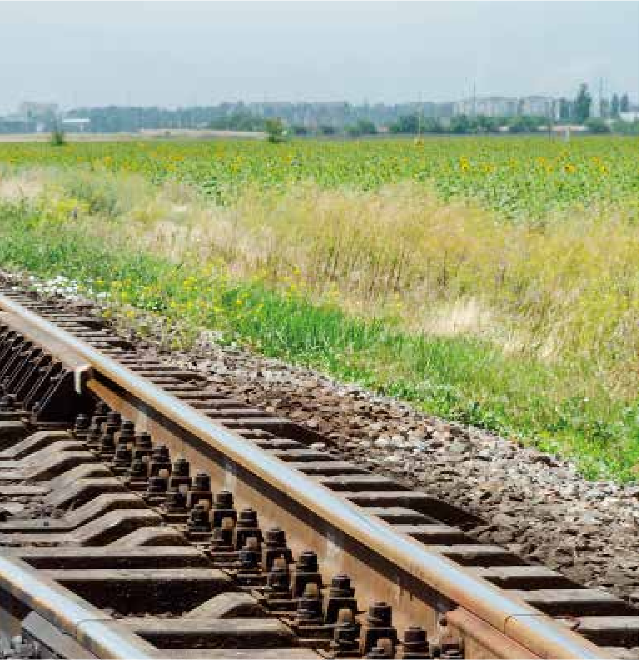
This new provision creates an additional condition for non-EU funds to benefit from a withholding tax exemption for non-EU UCIs although, in practice, both their claims for withholding tax suffered in the past and their application to benefit from an exemption in the future are not dealt with. One may question the relevance and impact of this measure.

However, it is possible to assess this new provision in a more positive light. This addition tacitly implies that the non-EU UCIs cannot simply be excluded from the comparability analysis, contrary to what is mentioned by the current FTA's guidelines.

The parliamentary debates seem to support this analysis. In the context of the preliminary assessment of the measure, French deputies have indicated that the implementation of the scheme would involve the release of updated FTA's guidelines (BOFIP). However, the FTA's current guidelines already provide that "*compliance with the conditions must be verifiable by the French Authorities with the State in which the UCI has its headquarters.*"[6] It is precisely this sentence that leads the FTA to consider that non-EU UCIs are not comparable, which is questionable.

Despite appearances, this text may be interpreted not as an additional condition but as an injunction made to the FTA to amend its guidelines and practice of excluding non-EU UCIs from the benefit of the withholding tax exemption. If this interpretation was to be adopted, it would allow the French regime of withholding tax on dividends to (finally) be compliant with the TFEU and the ECJ case law.

5 *Amending Finance Bill for 2014 n° 2014-1655, 29 December 2014*
6 *BOI-RPPM-RCM-30-30-20-70 n° 100*



Non-EU UCIs cannot simply be excluded from the comparability analysis

Uncertainty around the effectiveness of administrative assistance

This requirement is subject to interpretation, which means that the FTA can argue that the administrative assistance clause is ineffective. However it is unlikely that this argument can be used for all administrative agreements. Until the tax authorities amend their Statement of Practice and/or start looking at claims introduced by non-EU funds, it is likely that foreign UCIs may still be subject to a withholding tax contrary to the EU law and may still have to challenge it to protect their rights.

New favourable tax regime (PEA) for investments in small or medium-sized enterprises

As of 1 January 2014[7], in parallel with the traditional French Plan d'épargne en actions (PEA, i.e. a share savings plan), the PEA SME has been introduced to promote investment in SMEs located in France or in other EU Member States (extended to Iceland, Norway and Liechtenstein). The implementing provisions of this additional PEA were laid down by decree on 4 March 2014[8], and the French Tax Administration (FTA) published its first Statement of Practice on the scheme on 15 January 2015[9].

Key features of the PEA SME

The PEA SME generally works the same way as the traditional PEA, created in 1992. It allows a portfolio of shares to be managed on an income tax-free basis, provided that the taxpayer does not perform any withdrawal for five years and invests in eligible securities. Although based on the same mechanism, the PEA SME must be regarded as a different scheme so that individuals, resident in France for tax purposes, may hold both a PEA and a PEA SME.

Eligible securities

Securities eligible for the PEA SME are the (listed or unlisted) shares, investment certificates and cooperative investment certificates, shares in a limited liability company (SARL) or in companies with equivalent status and equity securities of cooperative companies. The issuer must be liable to corporate income tax (or equivalent tax) and be located in one of the aforementioned countries. In addition, unlike traditional PEA, these securities must be issued by a SME, i.e. a company that does not employ more than 5,000 people and with a turnover of up to €1,500 million or a balance sheet total of up to €2,000 million.

7 Finance Bill for 2014 n° 2013-1278 of 29 December 2013

8 Decree n° 2014-283 of 4 March 2014

9 FTA's guidelines BOI-RPPM-RCM-40-55

Intermediated investments & funds of funds

Moreover, securities held indirectly through a collective investment fund may also be eligible for a PEA SME. These are shares in investment companies with variable share capital (SICAV); units in mutual investment funds (FCP), including venture capital mutual investment funds (FCPR), Innovation-focused mutual investment funds (FCPI) and real estate investment trusts (FIP); and units or shares of coordinated European UCITS, having at least 75% of their assets comprised of securities in SME companies (quota), among which at least two-thirds consist of eligible securities (sub-quota).

Money invested in a PEA SME may also be invested in a collective investment fund, referred to as an organisme de tête (i.e. holding entity), which itself invests:

- in units of French funds (FCPR, FCPI and FIP)
- in units or shares of other funds investing in securities of SMEs, directly or via a "master-feeder" system[10]

It should be noted that following the initial wave of enthusiasm after this mechanism was discussed, and a few months after its implementation, the market feeling towards it is rather mixed.

10 System in which "feeder" coordinated UCITS invest at least 85% of their assets in "master" coordinated UCITS pooling the managed assets

A new contender in the international race for investment: The Open Partnership Company *(Société de Libre Partenariat* or SLP)

Introduced through an amendment[11] discussed in January 2015 in front of the committee in charge of the preparation of the Draft "Bill for Growth and Activity" (the "Macron" Bill, named after the Finance Minister), the open partnership company (*Société de Libre Partenariat* or SLP) aims to be an effective response from the Government to the competition faced by the French financial sector from Luxembourg, Germany and the United Kingdom.

It is largely admitted that—in a post AIFM context—it has become difficult to raise capital, and it is therefore necessary to facilitate investment in non-listed entities for large institutional investors (particularly foreign ones). These investors, due to a lack of clarity, could be tempted by Germany, Luxembourg and the United Kingdom and the choice of vehicles such as the Société en Commandite Spéciale in Luxembourg, or the English Limited Partnership.

Consequently, Article L.214-54 of the Monetary and Financial Code should be amended[12] to add, next to existing common funds (FCP) and investment companies with variable share capital (SICAV), the open partnership companies, which, from a legal point of view, would consist in société en commandite simple (i.e. French limited partnership), incorporated as alternative investment funds.

The idea is to offer foreign investors flexibility comparable with that of Limited Partnerships, in particular with regard to the rules of governance and operational organisation. This includes investor information, or clauses designed to improve the balance of power between managers and investors ("no-fault divorce clause").

From a tax standpoint, the SLP would be transparent, which would allow the company to be recognised as transparent beyond borders in many European states (Germany in particular), while maintaining the same tax treatment as the one applied to French common funds open to professional investors (FPCI).

It will be interesting to see what the take-up for such a vehicle will be in the future.

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11 Amendment n°SPE864 of 8 January 2015

12 The French Senate starts its works on the Bill as from 11 March 2015