Conseil des prélèvements obligatoires
The Council of Mandatory Contributions

# ADAPTING CORPORATE TAX TO AN OPEN ECONOMY

## Summary

December 2016

## DISCLAIMER

This document is designed to help readers to more easily read and use the « Conseil des prélèvements obligatoires » (The Council of Mandatory Contributions)'s report. Only the report is binding upon the Council.

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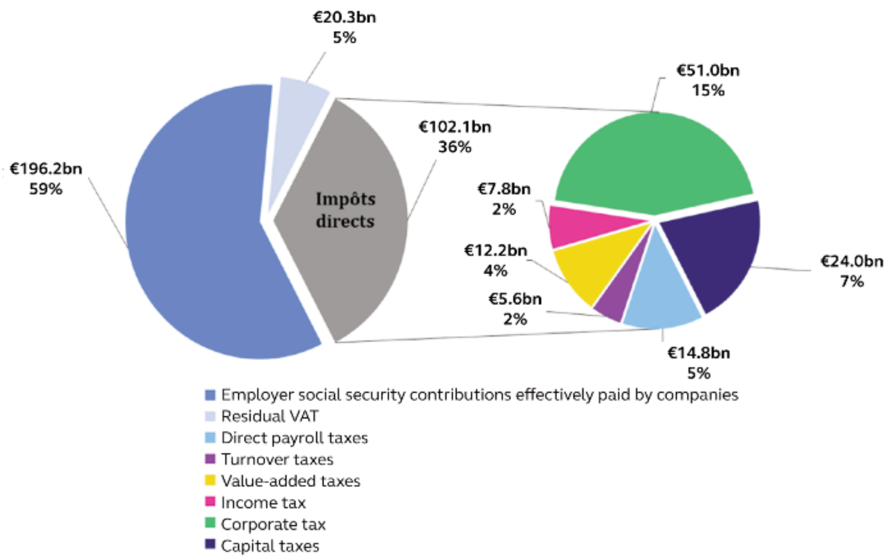
# INTRODUCTION

**Corporate tax, which has existed in its current form since 1948, was introduced in a much less open economy than currently prevails, before the integration of the European market, and long before the eurozone was created.**

Gross corporate tax, in other words tax before reductions and tax credits, which is paid by half of taxable companies, amounted to €51bn in 2013. It is the largest direct tax, and the second largest mandatory levy borne by companies, which were liable for total direct taxes of €102bn in 2013, rising to €319bn if we include effective social security contributions (€196.2 bn) and the residual share of VAT payable by companies (€20.3bn).

**Corporate tax as a share of the mandatory levies payable by companies in 2013 (%)**




*Source: French national accounts, INSEE (French statistics office). CPO calculations, % rounded to the nearest unit*

**In 2015, total corporate tax, net of refunds and rebates (€17.5 bn), amounted to €33.5bn.** These refunds and rebates include the research tax credit (CIR, €5.3bn in 2015) and the tax credit for competitiveness and employment (CICE, €12.5bn in 2015), which are more like mechanisms for financing public policy by way of corporate tax.

# INTRODUCTION

In an economic environment where capital, companies and high-skilled individuals are mobile, multinational firms are looking for tax optimisation and there is fierce tax competition between countries to attract companies, deeper European integration and the combating of tax avoidance and optimisation are resulting in major changes to, and the reexamination of, national frameworks for the taxation of company profits.

The French economic environment is also in flux, particularly due to the implementation of Brexit, which could prompt the UK to cut its profit tax rate still further.

The lowering of corporate tax rates has already begun in France, moreover, with the 2017 finance bill.

**French corporate tax, which taxes companies operating in an open economy, must undergo change, which may be a source of opportunities.**

For France, this means developing a medium-term strategy aimed at building a framework that is simultaneously more in harmony with its European partners, is able to effectively combat the erosion of tax bases and tax avoidance, and is more attractive for companies.

This report contributes towards this aim by analysing the advantages and needs influencing French corporate tax in terms of the tax base, applicable rates and legal security for taxpayers.

The issue is considered very much from the perspective of the supranational economic environment, whose features include intense tax competition between countries and its consequences for their economic appeal. The most recent European legal changes are also taken into account, specifically the ATA directive to combat artificial profit shifting and the CCCTB directive proposals for the creation of a common consolidated corporate tax base.

**As a result of these analyses, the Summary - The Council of Mandatory Contributions is able to set out precise reform scenarios based on the need to continue combating tax avoidance, while increasing legal security and ensuring the convergence of tax rates.**

# 1 Coherence put to the test by an increasingly open economic environment

Traditional thinking about corporate tax appears out of date in the light of recent developments.

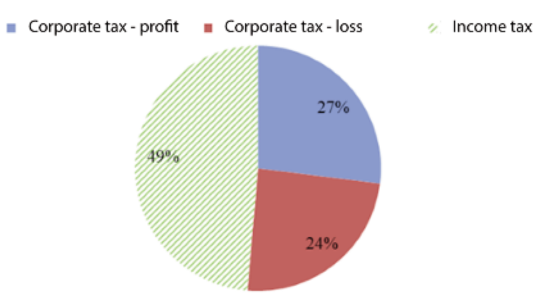
**A tax whose rate is high, but whose revenue is low, despite the significant expanding of the tax base since 2011**

Corporate tax is paid by half of taxable companies, which account for nearly two thirds of the added value produced in France. In 2013, 51% of companies were liable for corporate tax (i.e. 1.5 million businesses) and only 27% effectively paid it, as the others (i.e. 1.4 million) were subject to income tax because of their legal status.

84% of the 1.5 million taxable companies were microenterprises and around 300 were large corporations.

**Corporate tax represents only 15.4% of the mandatory levies payable by companies**. Revenue is so low due mainly to the low profitability of companies, which explains most of the difference in the tax revenue from one point of French corporate tax and one average point of European corporate tax.

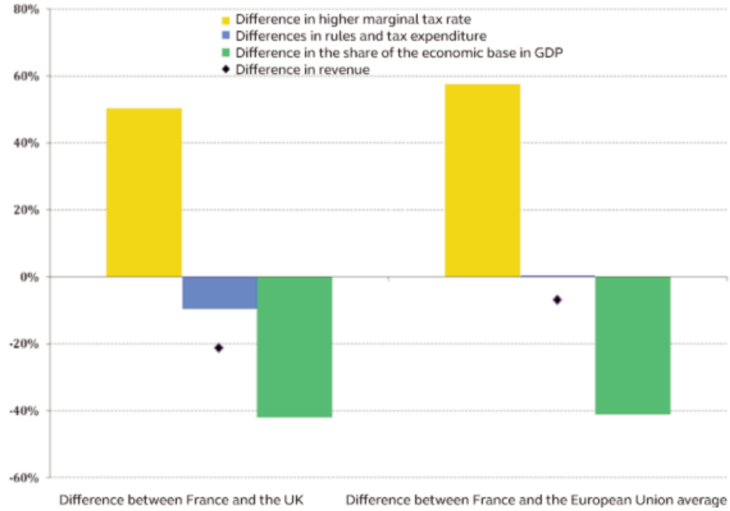
**Breakdown of companies (by number) according to their tax regime in 2013**




**Breakdown of the added value of companies according to their tax regime in 2013**


*Source: INSEE data*

**Relative importance of the various sources of differences in the net corporate tax revenue in France compared with the UK and the European Union average in 2012**




*Source: Eurostat and CPO. Average calculated for the 23 EU countries for which the data are available*

The net revenue from corporate tax, of €33.5 bn, is also greatly affected by its use as a "cost allocation vehicle" for two major subsidy schemes, one of which is based on R&D expenditure (the research tax credit-CIR), and the other on payroll (the tax credit for competitiveness and employment-CICE).

**Due to the complexity of the tax base, the nominal rate of tax alone is not an adequate indicator of the actual tax pressure on companies**

France applies the principle of territoriality, making it relatively atypical, as European Union member states generally apply the principle of the globality of profits.

**Taxable income is not easy to locate, however, especially because of transfer pricing**, whereby the stable establishments of companies with operations in a number of countries invoice each other in connection with cross-border flows, for example the purchase and sale of goods or services, royalties, interest, guarantees, or the assignment or granting of the right to use intangible property such as trademarks or patents.

**There are differences between accounting income and taxable income.** The tax base is defined based on accounting income, but differs from it due to a number of mechanisms, the main ones being loss carry-forwards and carrybacks, the elimination of double taxation, the treatment of groups of companies and the deductibility of financial expenses.

**France's 38% maximum nominal tax rate is the highest of the European Union's 28 member states.**

The nominal tax rate stands at 33.33% in France, to which the social security contribution on profits is added (3.3% of the corporate tax payable by companies with revenue of at least €7.63 m if their corporate tax liability exceeds €763,000). Eurostat adds the exceptional contribution, which brings the maximum nominal tax rate to 38.0%.

**France also sets itself apart by granting a lower, 15% rate to SMEs**, which is applicable to profits up to €38,120 for companies whose revenue is less than €7.63m (cost for the public finances of €1.47bn).

**The implicit tax rate can be used to compare different countries' tax systems, but this requires more advanced methods**

**The implicit tax rate offers a way to compare countries' tax systems that differ both in their rates and tax base rules**.

It sets the amount of tax collected against its economic base so that the actual tax burden can be assessed (in this case the numerator is the amount of corporate tax before loss carryforwards or carrybacks and the charging of tax expenditure).

***Corporate tax would create a bias towards debt***

*Under the corporate tax rules, interest on loans and dividend payouts are treated differently, the former being a tax deductible expense, and the latter, as a choice of income appropriation, being non-deductible. Applying a different tax treatment to the costs linked to these two financing methods creates a bias towards debt.*

*The reality of the bias towards debt must be assessed by considering the effect of the tax system as a whole, and particularly income tax, as dividends paid to shareholders are included in their taxable income. Rules on tax credits or rebates on dividends received may reduce the tax payable by individuals to factor in the tax already paid by companies, making corporate tax a kind of downpayment on shareholders' income tax.*

*Assessing the tax bias is more complicated in an open economy, however, as shareholders are not necessarily residents subject to French income tax.*

**Implicit tax rates have changed since:**

**Implicit tax rate of companies (tax before carryforwards or carrybacks/operating income): by size, including all companies that pay corporate tax (taxable income > 0)**

| Category of company | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|
| Microenterprises | 27.0% | 27.0% | 26.1% | 25.7% |
| SMEs | 33.3% | 33.8% | 32.7% | 31.0% |
| Mid-cap companies | 27.8% | 30.0% | 30.0% | 30.8% |
| Large corporations | 25.2% | 23.9% | 29.5% | 31.0% |

**by size, including all profit-making companies (method used in the French Treasury's memo of June 2011)**

| Category of company | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|
| Microenterprises | 22.4% | 22.3% | 21.3% | 20.6% |
| SMEs | 30.4% | 30.6% | 29.3% | 27.4% |
| Mid-cap companies | 24.2% | 25.7% | 25.3% | 25.7% |
| Large corporations | 19.6% | 19.8% | 23.0% | 24.3% |

*Source: CPO, mainland France tax return data; calculations exclude agricultural, financial, insurance and real estate activities*

In a memo dated June 2011, the French General Directorate of the Treasury arrived at the following implicit rates for the fiscal year 2007: 27% for microenterprises, 32% for SMEs, 25% for mid-cap companies and 24% for large corporations.

The idea that large groups are managing, through various deduction and profit shifting mechanisms, to significantly reduce the tax that they pay, while small and medium-sized businesses are bearing a disproportionate tax burden by comparison, now seems to have little validity.

The differences between implicit tax rates must be interpreted with caution, however, which argues in favour of **establishing a rigorous method to allow consensual comparisons of implicit rates.**

## National tax systems still fail to offer adequate legal security, which is vital for investors

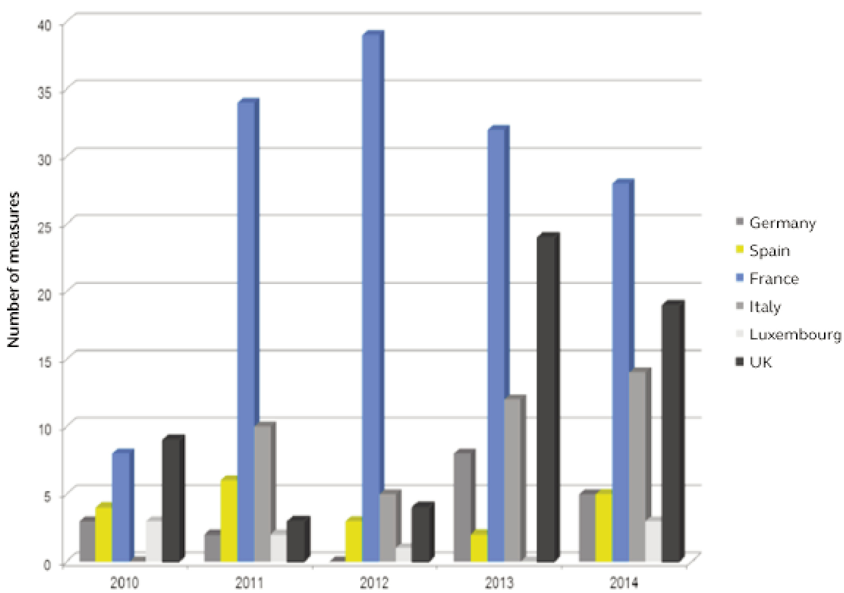
**The tax standard**, which itself depends on the framework rules governing retroactivity and the consideration of existing situations when there are legal or regulatory changes, needs to be made more predictable in France.

Rulings, which are issued by the tax authorities in response to questions from taxpayers about the interpretation of tax rules, and are binding upon the authorities, have recently been reinforced by a recent decision by the French Council of State whereby an appeal against an unfavourable ruling may be brought before an administrative court on the grounds of abuse of power.

**The speed with which the tax authorities respond to questions from taxpayers is therefore an important issue.**

**Finally, with regard to tax inspections, which are a means of ensuring fair competition,** a balance must still be found between their enforcement role and the building of a relationship of trust between the tax authorities and companies.

**Change in the number of tax measures regarding companies between 2010 and 2014 for six European Union countries**




*Source: "Nouvelle donne fiscale en 2015 – points clés et perspectives", EY Société d'Advocats, January 2015.*

# 2 The economic environment and the changes to the supranational legal framework call for changes to be made to corporate tax

Significant changes should be made to corporate tax in the next few years, driven by multiple factors that France is more or less able to influence.

## Corporate income tax rates have a measurable effect on economic appeal

**France's corporate tax rate puts it in a unique position in Europe.** In the mid-80s, the normal French tax rate was gradually lowered from 50% to 33.3%. This rate, which was one of the lowest in the European Union at the time, stayed the same, while the tax rates of the other member states continued to fall.

The available data on effective average and marginal tax rates also show a divergence in the trend for France and the European average.

**Comparison of the change in the effective average rates of taxation of company profits**

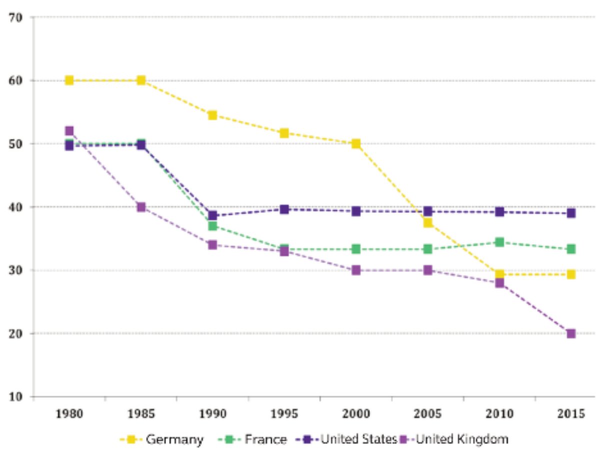
| | 2005 | 2010 | 2015 |
|---|---|---|---|
| France | 29.7% | 29.3% | 32.4% |
| EU15 average | 26.2% | 23.7% | 23.0% |
| 46 country average | 24.9% | 22.6% | 22.1% |

**Comparison of the change in the effective marginal rates of taxation of company profits**

| | 2005 | 2010 | 2015 |
|---|---|---|---|
| France | 17.8% | 17.5% | 19.9% |
| EU15 average | 15.7% | 14.3% | 13.3% |
| 46 country average | 16.4% | 15.2% | 14.8% |

*Source: Oxford University Centre for Business Taxation*

**Change in the normal corporate tax rate in a selection of countries from 1980 to 2015 (%)**




*Source: OECD. Rates resulting from the combining of the normal rates applied at national and local levels*

# The economic environment and the changes to the supranational legal framework call for changes to be made to corporate tax

**The tax rate has an impact on where companies choose to locate their operations.**

Countries with a potentially high market potential for companies have higher rates of taxation of company profits, on average, than countries with a low market potential. From this perspective, France is a large country within the context of the European Union, which is in line with its initial positioning as a country with a comparatively high corporate tax rate.

**Economic integration may have pushed large countries to react to competitive pressure, however, which has tended to close the gaps between tax rates**, with a member state reacting to a one-point reduction in corporate tax by another country by reducing its own rate by 0.86 points if another member state is involved, and only 0.02 points if the original reduction was by a third-party country.

**Where there is tax competition, the tax rate may influence companies' choice of location for their operations**.

Countries with high market potential, like France, would be well advised, in terms of their appeal, to set an average tax rate, rather than competing on tax and aligning themselves with the lowest rates.

**The average corporate tax rate of France's partner countries in the European Union is around 25%.**

France is not included in the calculations of the average rate that follow, as the aim is to assess the effect on France of the tax decisions of the other member states, and the level arrived at by its large country peers.

**A rate of 25% might be a target for a large European economy like France**, the more so as there are no signs of the tax competition easing up at present, given that an announced objective of the United Kingdom is to lower its rate, like Hungary and Luxembourg, and, outside Europe, the US).

**Weighted (for the private sector's added value) and unweighted average corporate tax rate within the European Union**

| Taxes included | EU | Average Excluding France | Eurozone excluding France | Large EU economies, excluding France |
|---|---|---|---|---|
| All taxes on company profits | Unweighted | 22.2% | 23.9% | 25.1% |
| | Weighted | 25.6% | 28.4% | 26.2% |
| Corporate tax as strictly defined | Unweighted | 21.7% | 23.1% | 22.9% |
| | Weighted | 22.0% | 22.9% | 21.7% |

*Source: Oxford University Centre for Business Taxation*

## The factors enhancing France's appeal in terms of the tax base are declining

France has not followed the rate-cutting trend, while measures designed to reduce the taxable base, which have long been a distinguishing feature of the French tax system, have become less favourable.

**The possibility of deducting financial expenses has lost some of its appeal.**

In 2013, France set a general cap on the deductibility of loan interest, reincluding 25% of the interest paid in excess of €3m in the tax base. This cap is combined with measures to combat optimisation, such as those aimed at under-capitalised companies. France is the only country to have combined these two types of measure, and one of the only ones to have adopted a general cap mechanism for budgetary reasons.

**Loss carryforward mechanisms no longer give France a comparative advantage.**

Since 2011, there have been no time limits on loss carryforwards, but the amount has been capped at €1m, plus 50% of any losses over this amount. This rule is one of the strictest in the OECD and contrasts with the absence of a cap, which was the case until 2010.
In the same year, the time limit on the carryback option was reduced from three years to one.

**The conditions for the exemption of capital gains from the disposal of equity securities are not very advantageous.**

Capital gains from equity securities are partially exempt from tax in the majority of OECD countries, reflecting the taxation of dividends. Apercentage for fees and expenses is reincluded in taxable income, and was raised in France from 5% (the rate for dividends) to 10% in 2011, and 12% in 2013. This is one of the highest levels in the OECD.

**The benefits of the French tax integration framework have lessened.**

This framework in fact includes the consolidation of the profits and losses of all of a group's entities, and the elimination of a number of transactions carried out purely within the group, such as the payment of dividends from one member to another. This mechanism was invalidated following a decision by the European court, in the name of freedom of establishment.

**The future of the preferentialtax treatment of income from intellectual property also seems uncertain.**

France has a special tax measure for income derived from intellectual property, which is taxed at the lower rate of 15%. Work by the OECD has led to a "nexus" approach, which, in the form in which it should be interpreted by the European Union, could result in the conditions for eligibility for the French measure being viewed as too permissive.

## The changes to the international and European tax framework for companies will affect national systems

French corporate tax is set to change significantly in the coming years, especially due to European legal harmonisation.

**The European ATA directive aimed at combating the erosion of tax bases, adopted in July 2016, will have to be transposed into French law** by the end of 2018. Although the French tax system mostly already has anti-abuse rules in the areas covered by the directive, it is likely that several measures will need to be changed:

- The **deductibility of interest**, limited, above total interest paid of €3m, to a fixed ratio equal to 30% of the company's EBITDA;
- A **general anti-abuse clause** must be adopted by all member states that differs from abuse under French law.

The rules set forth by this directive are only a **minimum standard**; national or treaty-based measures may still be applied to maintain a higher level of protection of the national tax bases for corporate tax.

**International sources of changes to corporate tax**

| Theme | Source | Possible margins for manoeuvre |
|---|---|---|
| **Deductibility of loan interest** | Anti-tax avoidance (ATA) directive | Mandatory European harmonisation<br><br>Possibility of introducing a stricter measure than the capping of net financial expenses at 30% of the EBITDA of multinational groups |
| **Preferential treatment of intellectual property** | Anti-BEPS/Code of conduct work | France might argue that the long-term capital gain rules for income from disposals and from granting the right to use patents are not harmful.<br><br>Probable changes due to the characteristics of the French rules, which differ from those recommended by the *nexus* approach. |
| **Group - tax integration rules** | Developments in ECJ case law | Gradual reexamination of intragroup eliminations that go beyond the scope of merely offsetting the losses and profits of integrated companies. |

**The case law of the European Court of Justice (ECJ) is undermining the French tax integration rules**

The case law of the ECJ is calling into question numerous tax measures reserved for resident companies in the name of freedom of establishment (particularly through the *Papillon*, *X Holding BV* and *Stéria* decisions).

**The proposed CCTB/CCCTB directives for the European harmonisation of the corporate tax base could affect the unique features of the French corporate tax rules.**

The European proposal has two aspects : firstly, the convergence of national calculation rules towards a common corporate tax base (CCTB) and, secondly, examining the possibility of consolidating the base and distributing it between countries (CCCTB).

For large countries like France, which is less aggressive in terms of tax competition, the convergence of the tax base rules would make their position even more unfavourable with regard to rates, but the consolidation and distribution of the tax base could "return" taxable income to them. This would depend on the distribution key, which should be based on three weighted factors: consumption, payroll and productive assets, excluding intangible assets.

According to estimates by the European Commission, in 2010 the French corporate tax base accounted for 8.3% of all the European tax bases, whereas if tax bases were consolidated Europe-wide, then distributed between countries according to the CCCTB proposal's criteria, the French taxable base would be 10.0% of the total.

The benefits of such a harmonisation of corporate tax across Europe lie in the development of the exchanges that could result from simplifying the tax rules for companies established in several member states, and in the lessening of tax competition between European partners.

**France supports this initiative in theory, although the technical means of implementation must be examined in greater depth over the next few years.**

# 3 Continuing the combating of tax avoidance, legal security and rate convergence : a winning short- and medium-term strategy

France will need to address its tax base, rate and the legal security attached to corporate tax, in the short to medium term, adopting a coherent approach that does not prevent certain opportunities from being seized.

**The consolidated European corporate tax base will be introduced in the medium term, but France must bear it in mind as of today**

**France's support for the CCCTB proposal should not be unconditional**. It could suffer a negative impact from starting with tax rule convergence and postponing the consolidation and distribution of the tax base to a later, hypothetical, stage, especially if its tax rate stays at its current level.

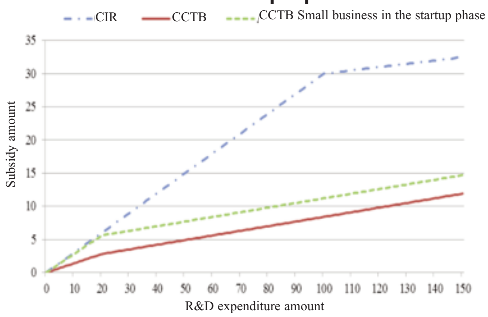
France could make sure, during the negotiation of the directive, that the period of harmonisation without consolidation or distribution of the tax base was as short as possible. If the transition from the CCTB to the CCCTB cannot be achieved, it could make progress on the common tax base conditional upon the introduction of a "rate tunnel" similar to the one in place for VAT.

**Likewise, the introduction of a system of notional interest to mitigate the bias in favour of debt requires the measuring of its effects beforehand, with regard to both the reality of the economic benefits to be expected and its cost for the public finances.** By enabling the deduction, from the taxable base, of a "normative" level of theoretical dividends, as part of the company's costs related to the return on capital, this system would reduce the level of taxation, and therefore lower the cost of capital and boost investment.

**Several French measures might need to be adjusted, such as the limiting of loan interest deductibility,** for which the European directive proposals give member states that already have domestic legal measures with an equivalent effect some leeway in the deadline and also, partly, the means, for the transposition of these rules.

**This is also the case for the deductibility of research and development expenses, which should take the place of the research tax credit**, as the overdeduction of R&D expenses provided for by the draft CCTB directive is less advantageous than the CIR.

**Comparison of the tax advantage gained through the CIR and the framework set forth in the CCTB proposal**




*Source: CPO*

**More generally, there must be an analysis of the compatibility of the tax expenses attached to corporate tax, which are relatively numerous in France, with the future European common tax base**. The reexamination of certain tax expenses would be an important element in ensuring that the public finances do not lose out from this reform.

## The convergence of the corporate tax rate towards the average European tax rate is desirable in the short to medium term

**The lowering of the tax rate, which was started with the 2017 finance bill, and the gradual introduction of a 28% rate for all companies by 2020, must continue.**

To avoid suffering too much from the effects of tax competition on its appeal and the competitiveness of its companies, and without embarking on a race that would be unsustainable to say the least, France might aim for greater convergence of its rate towards the European average for large economies, of around 25%.

**The lowering of the tax rate should be applied to all companies**, whereas, in 2014, 670,000 SMEs benefited from a lower, 15% rate.

In 2015, less than a third of OECD member countries (10 countries out of 34) had a lower tax rate for SMEs.

**Lower rate for small businesses in the main OECD countries**

| Country | Lower rate for small- and medium-sized enterprises (%) | Normal corporate tax rate (%) |
|---|---|---|
| Germany | No lower rate for SMEs | 30.2 |
| Belgium | 24.3 | 34.2 |
| South Korea | 10.0 | 24.2 |
| Spain | No lower rate for SMEs | 25.0 |
| United States | 15.0 | 38.9 |
| France | 15.0 | 34.4 |
| Greece | No lower rate for SMEs | 29.0 |
| Ireland | | 12.5 |
| Israel | | 25.0 |
| Italy | | 27.5 |
| Japan | 15.0 | 30.0 |
| Norway | No lower rate for SMEs | 25.0 |
| Netherlands | 20.0 | 25.0 |
| Portugal | No lower rate for SMEs | 28.0 |
| United Kingdom | | 20.0 |
| Sweden | | 22.0 |

*Source: CPO, according to the OECD Corporate tax database*

**The justification for having different tax rates for different sizes of companies is debatable**, given that, unlike the taxation of households, the desirability of redistribution between these economic players is not self-evident.

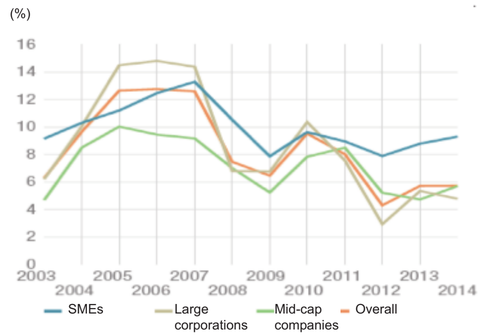
**The assumption that small companies are less profitable is not borne out by the evidence**. Firstly, the profit ratios[1] of small companies with employees (not including microenterprises) were comparable, in 2012 and 2013, to the profit ratios of companies with more than 250 employees, or even higher for companies with between one and nine employees.

**Profit ratios of companies (excluding agriculture and financial services)**


*Scope: France, profiled companies and legal units with employees mainly in commercial sectors, excluding agriculture and financial services, and excluding self-employed entrepreneurs and microenterprises, as defined in tax terms*
*Source: INSEE, Les entreprises en France, 2015 edition*

Secondly, the return on equity[2] for non-financial companies has been higher for SMEs than for mid-cap companies and large corporations since 2007.

**Change in return on equity by category of company between 2003 and 2014**




*Scope: Non-financial companies as defined by the LME (law for the modernisation of the economy)*
*Source: Banque de France, FIBEN database (SMEs with revenue of more than €750,000), December 2015*

The difference in the implicit tax rate for SMEs and large corporations is largely absorbed.

**Change in the implicit tax rate (corporate tax before loss carryforwards or carrybacks/operating income) by category of company**

| Category of company | Scope of the 2011 French Treasury memo (companies with operating profits) | | |
|---|---|---|---|
| | 2007 | 2011 | 2014 |
| Microenterprises | 24.2% | 25.7% | 22.5% |
| SMEs | 30.5% | 30.5% | 27.8% |
| Mid-cap companies | 25.6% | 24.0% | 24.6% |
| Large corporations | 22.3% | 20.6% | 23.5 |

*Source: French General Directorate of the Treasury, calculations carried out for the CPO*

[1] *Gross operating surplus to value added ratio.*

[2] *Net cash flow to equity ratio.*

**Financing margins are available to finance the convergence of tax rates.**

Financing margins may be found, particularly due to European and international tax developments.

**Different scenarios can be planned such as:**

**Financing scenarios for a rate cut**

| Measures | Current situation | Possible change | Impact in €m of a 25% rate |
|---|---|---|---|
| **Minimal alignment** | | | |
| **Exemption of a percentage for fees and expenses - capital gains (groups)** | 0% | Elimination (ECJ, uncertain risk) | 146 |
| **Lower rates for patents** | 15% | Nexus approach (OECD) | Positive |
| Total | - | - | **>146** |
| **European harmonisation of the tax base** | | | |
| **Declining-balance depreciation** | Current | Elimination (EU convergence) | Positive |
| **Extraordinary depreciation** | Current | Elimination (EU convergence) | 75 |
| **Overdepreciation** | End of 2017 | Elimination (EU convergence) | 326 |
| **Carrybacks** | 1 year | Elimination (EU convergence) | Positive |
| **Carryforwards** | Limited to 50% above €1m | Unlimited (EU convergence) | Negative |
| **Tax integration: scope** | According to choice | All or nothing (EU convergence) | Positive |
| **Tax integration: thresholds** | 95% | 50% of votes and 75% of equity (EU convergence) | Negative |
| **Tax integration: eliminations** | Multiple | Elimination (EU convergence) | ~750 |
| **Lower rate for SMEs** | 15% | Elimination (EU convergence) | 1,467 |
| Total | - | - | **2,617** |

*Source: CPO*

**The lowering of the corporate tax rate from 28% to 25% may be partly self-financed by changes to the tax base and the tax calculation methods**. The issue of whether the remainder to be financed should be provided by reducing or eliminating certain tax expenses attached to corporate tax, by reducing public expenditure, or by increasing other levies, is a political decision.

**The rise in economic activity following the lightening of the tax burden may limit the measure's long-term cost for the public finances.**

### The need to continue to combat tax avoidance and increase legal security remains the same

**Tax base and rate convergence measures might be supplemented by continuing with initiatives, begun on a European and international scale, to combat aggressive tax optimisation**, for example by improving international transfer pricing standards, doing more to stop artificial profit shifting in tax treaties, and eradicating "tunnel state" practices within the European Union.

**Legal security is very important in a country like France, where the tax law is frequently changed.**

It is vital for companies that tax cuts are predictable, so that economic players know what to expect and investment decisions can be made. **The French reform strategy might be implemented gradually and early.**

**It is just as important to correctly factor in current economic situations and to ensure effective dialogue with the tax authorities**. Various techniques used in Germany and the UK, which give economic players more security and predictability without lessening the sovereignty of policymakers, could be usefully adapted to France. These techniques include "grandfathering" clauses, which allow the existing tax framework to be permanently or temporarily maintained for current situations.

# CONCLUSION

Over the next few years, corporate tax must successfully combine a complex set of opportunities and needs:

• Making sure that companies effectively contribute to the financing of the public services from which they benefit, particularly by combating aggressive optimisation;

• Enhancing the country's appeal and competitiveness, through tax base and rate rules that ensure that France does not compare unfavourably internationally, that support its companies' development abroad and that are able to accommodate the most diverse production setups;

• Ensuring the security and stability of the legal environment.

The guidelines proposed by the CPO for the adaptation of corporate tax are intended to be effective and pragmatic. They are based on four sets of measures, relating to the tax rate, the tax base, the combating of tax optimisation and the increasing of legal security, which might be introduced gradually and early.

# PROPOSALS

**In the short term:**
**the convergence of the corporate tax rate**

***1. Establishing a rigorous and consensual methodological framework for comparing the implicit tax rates for different companies*** *that also encompasses companies in the financial sector;*

***2. Converging the corporate tax rate towards the average for large economies in the European Union*** *(which is around 25%), by following a clear, predefined timetable, and providing for the application of this rate to all companies, regardless of their size, while managing the transition for businesses that currently benefit from a lower rate of tax on all or part of their profits;*

***3. Contributing to the financing of this rate convergence through adjustments to the tax base and the methods for calculating corporate tax:***

*• Bringing the application of the lower, 15% tax rate for income derived from intellectual property into line with the OECD's nexus approach ;*
*• Aligning the French rules on the deductibility of depreciation charges with European standards, by eliminating declining-balance depreciation, extraordinary depreciation, and overdepreciation measures;*
*• Eliminating the possibility of carrying back losses;*
*• Making tax integration a simple mechanism for profit consolidation, by eliminating the numerous possibilities for eliminating intragroup transactions, including the exemption of a percentage of the fees and expenses relating to capital gains from the disposal of equity investments;*
*• Requiring that all direct subsidiaries and sub-subsidiaries that meet the tax integration criteria are automatically included in the consolidation scope, according to the "all or nothing" principle.*

# PROPOSALS

## In the short and medium term: increasing legal security

***4. Making the tax environment more predictable for companies when changes are made to taxation,*** *through:*

- *The application of "grandfathering" clauses that allow the maintaining of the existing tax framework for current situations;*
- *The limited application of changes to the tax rules to new operations;*
- *Their deferred introduction to give economic players time to adapt.*

***5. Making the spontaneous tax adjustment procedure more flexible to make tax inspections easier to conduct****, even if penalties are applied (excluding penalties other than those applied to taxpayers acting in good faith), so that cases are settled and taxpayers pay more quickly, and legal disputes are avoided.*

## In the medium and long term: the convergence of the corporate tax base

***6. With regard to the draft CCTB and CCCTB directives, supporting the European Commission's initiative in theory, but examining and negotiating its content :***

- *Supporting the European Commission's initiative in theory;*
- *Ensuring the examination of the various measures proposed by the Commission, and particularly the rules governing the deductibility of loan interest and notional interest based on changes in equity, and the basis for the distribution of the tax base between member states;*
- *Negotiating a stipulation that, if the consolidation and distribution of the common tax base between member states is not adopted within a certain time, a corporate tax rate tunnel, similar to the VAT rate tunnel, must be introduced.*

***7. Before the CCTB is implemented, analysing the alignment of the French framework with European standards regarding the carrying forward of losses and tax integration thresholds:***

- *By eliminating the limits on loss carryforwards introduced in 2011;*
- *And by lowering the tax integration thresholds to 50% of voting rights and 75% of equity.*

# PROPOSALS

## Ongoing:
## the continuing of measures to combat aggressive optimisation

***8. Making greater use of the existing anti-avoidance tools, and especially the most recent** (mutual administrative assistance with the recovery of tax receivables and automatic information exchanges), which requires continued measures to enhance the professionalism of the tax authorities' tax inspection teams;*

***9. Continuing the work on defining reference standards for transfer pricing:***

*• On an international scale, by clarifying the OECD guidelines, particularly by inserting real examples;*
*• On a national scale, by publishing tax instructions explaining the principles and methods that the tax authorities intend to implement to apply them;*

***10. Doing more to combat artificial profit shifting in tax treaties** by including the general anti-abuse clause in all of France's treaties, by spreading the practice of inserting effective beneficiary clauses in treaties, and by clarifying the definition of this concept and continuing to strengthen national anti-avoidance measures;*

***11. Continuing action against "tunnel state" practices within the European Union:***

*• By acting in favour of revising parent-subsidiary and interest and royalty directives to insert an obligation for all member states to introduce a withholding tax on dividends and royalties leaving the European Union, with a floor rate;*
*• By advocating the negotiation of single tax treaties for the whole of the European Union with third-party states, to prevent the optimisation behaviour that might result from differences in the web of treaties of member states;*