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Objet : LOOKING FOR ELIMINATION OF DOUBLE TAXATION ON INTERNATIONAL FLOWS.

Elimination of double taxation on international flow, which is the main purpose of bilateral tax treaties, is not perfectly achieved in several situations. The recent changes of case-law highlight again the fact that that the solutions found over time concerning elimination of double taxation deserve to be harmonized, under the leadership of the judge, or even, of the legislator.

1 - Most of bilateral tax treaties signed by France provide for beneficiaries of foreign source passive income (dividends, interests, royalties) the allocation of a tax credit on the French tax, corresponding to the tax collected in the source State, within the limit of the conventional rate.

In a recent decision *Faurecia*[1], the Conseil d'Etat stated that the tax credits linked to foreign source income that are not set off by a company subjected to corporate tax on French tax are not refundable.

This decision permits us to examine the several issues at stake concerning elimination of double taxation on foreign source passive income:

- Does a withholding tax collected abroad on a passive income always give the right to a credit tax that can be set off against the French tax?
- What are the mechanisms that limit the amount of credit tax that can actually be set off against the French tax?
- When the creditor settled in France isn't able to use all or part of the relevant credit tax, can he benefit from a reimbursement or from a deferral of the credit tax not set off?

[1] *Conseil d'Etat, 10th and 9th ch., June 27th 2016, n° 388984, SA Faurecia : JurisData n° 2016-013166 ; Dr. Fisc. 2016, n° 41, comm. 54, concl. by E. Crepey.*

- Alternatively, can he note an expense deductible from the taxable base up to the withholding tax amount not offset by the set off of a credit tax?
- What about the situations in which the withholding tax is levied in the other State in violation of the conventional provisions?

The answers to those questions mostly result from case law which made a fragmented, partially incomplete and sometimes unsatisfactory precedent, regarding the desired purpose of the bilateral tax treaties, i.e. the elimination of double taxation.

1. Withholding taxes on foreign source income levied according to tax treaties.

A. The amount of foreign credit tax is limited, according to the "stopper rule" ("*règle du butoir*").

2 – Most of tax treaties signed by France provide for beneficiaries of foreign source passive income the set off, against the French tax due to this income, of a tax credit corresponding to the tax actually levied in the source State, within the limit of the conventional rate. More seldom, the tax treaty provide a tax credit at a rate globally set and that can exceed the amount of the withholding tax ("fictitious" tax credit).

According to the "stopper rule", the tax credit is limited to the portion of the French tax (at the common law rate or at the reduced rate, plus the additional contributions) corresponding to the income leading to a set off. The stake is therefore to determine the income, net of the expenses that have to be deducted according to French lax, for the calculation of the "corresponding French tax".

As a matter of principle, the method to use is the one of the direct allocation of the expenses to the income leading to a tax credit.

Concerning the investment income *("revenus de capitaux mobiliers"*), the scope of the expenses that have to be set off against the foreign income could still be discussed. The tax administration wants to deduct from this income, the totality of the expenses linked to the acquisition, the maintaining and the selling of the asset that is the income generator, according to article 39 of the French tax code (CGI). However, the Conseil d'Etat, in a notice given by the Finance Section[2], only takes the custody fees *("frais de garde"*) and the collecting costs *("frais d'encaissement"*) ; he rejects the global approach wanted by the tax Administration and therefore refuses the set off of the loan interests relating to the acquisition of the assets that are income generator. More recently, the Conseil d'Etat, in a case of purchase-resale of shares around the ex-date ("*autour de la date de détachement du coupon*"), dismissed the restrictive analysis of the expenses to be decuted proposed by the Finance Section and considered that the provisions of article 39 of the CGI had to be applied[3]. However, the practical scope of those divergences has to be relativized.

First, a specific anti-abuse system is likely to be applied since 2011, when the companies make purchase-resale of shares around the ex-dates (*article 220, 1, a of the CGI*). In this

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[2] *CE, notification, sect., March 31th 2016 n° 382545, in Rapport public du Conseil d'Etat : activité juridictionnelle et consultative des juridictions administratives en 2009 : Dr. Fisc. N° 2010, n° 22, 339.*

[3] *CE plén. fisc., December 7th 2015, n°357289, min. vs. SA Crédit Industriel et Commercial Alsace-Lorraine : Dr. fisc. 2016, n° 3, comm. 80, concl. B. Bohnert, note Ph. Durand.*

situation the financial expenses incurred for the acquisition of the shares, and the capital loss on sale and/or the retrocession given to the seller of the shares according to the contract between the assignor and the buyer, have to be deducted for the calculation of the capping set off of the tax credit – except cases where the safeguard clause ("*clause de sauvegarde*") applies.

Besides, the "stopper mechanism" only applies, concerning dividends, only to products that do not benefit from the "parent-subsidiary" regime ("*regime mère-fille*"). Indeed, for dividend under the regime of mother companies, the tax credits cannot be reused if this is a tax-free dividend. Nor cannot they offset on the tax relative to the share for fees and expenses (*"quote-part de frais et charges"*), not considered as a partial taxation of the dividend, but as a global method of exclusion of expenses linked to the acquisition of the exempted income[4].

Concerning interests on debts, the amount of expenses to be deducted from the interests levied should be limited to expenditure on management and collecting, except for situations of *back-to-back* financing.

Finally, concerning the foreign source royalties, the principle is the direct allowance of the expenses made for the levy of those revenues. This method can and has to be favoured by the beneficiary of the income, as soon as the tools of supervising and management permit it. However, in order to avoid the difficulties that can arise an exact ventilation of the exploitation fees between the foreign source royalties and the other categories of operating revenues, the tax administration accepted that the affectation should be achieved by allocating the operating net income to the extent of the gross amount of royalties coming from a State compared to the total revenues of the company[5].

B. The tax credit could not be offset against the French tax, in the base in which the corresponding revenues have been included.

3 – Case law strictly considers, that it follows from Article 220 of the CGI that a tax credit can only be offset against the portion of the corporate tax, at the common law rate or at the reduced rate, which applies to the considered income. In other words, a tax credit attached to income subjected to the corporate tax common law rate cannot be set off against the amount of corporate tax at reduced rate possibly owed by the company[6], and vice versa[7].

This approach seems questionable as Article 220 of the CGI aims at calculate the cap of tax credit but does not provide the terms of use of the capped tax credit.

In any event, according to the actual case law, in the case of an absence or of a lack of tax owed by the company, the residual tax credit would be written off ("*tomberait en non valeur*"). The withholding incurred abroad would therefore be, in proportion to the tax credit not usable, deductible from the taxable bases only when the applicable conventional provisions do not prohibit such a thing.

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[4] *CE, 9th and 10th subsect., 23 avr. 1997, n° 145611, SA Fournier Industrie et Santé : JurisData 1997-044530 ; Dr. fisc. 1997, n°44, comm. 1141, concl. G. Goulard ; RIF 1997, n°543.*

[5] *Instr. April 1st 1976: BOI 14 B-1-76, § 21 and 22 ; Dr. fisc. 1976,n° 19, instr. 5087- not in the BOFiP.*

[6] *CE, 9th and 10th subsect., 29 oct. 2012, n°337253, Sté Crédit Agricole SA: JurisData n° 2012-024734 ; Dr. fisc. 2013, n° 7-8, comm. 163, concl. C. Legras, note O. Fouquet ; RIF 1/2013, n°84.*

[7] *IT/ CE, 7th and 9th subsect., March 19th 1980, n° 10708: JurisData n° 1981- 606477 ; Dr. fisc. 1980, n° 26, comm. 1439 ; Dr. fisc. 1981, n° 9, comm. 416, concl. D. Fabre ; RIF 5/1980, n°401.*

C. A tax credit concerning a debt remaining uncashed at the end of the fiscal year can be directly offset on the tax considered for this fiscal year.

4 – Finally, a last restriction to the use of tax credit has to be considered, linked to the delay between the income accounting giving right to the tax credit (that leads to the due of corporate tax at the end of the fiscal year) and the payment of the considered income (which is the operative event of the withholding tax and entitle to the tax credit).

Regarding those principles, the entitlement to a tax credit may not yet be born at the date of the end of the fiscal year of taxation of a debt of a foreign source income. In this case, the tax should, in principle, be calculated without the offset of a tax credit, and then given back later on on the basis of a claim by the taxpayer after payment of the foreign withholding tax that is the compensation of the tax credit.

However, by way of simplification, the Administration admits, as a practical guideline, a method consisting in pairing, by advance and under subsequent control of the Administration, the income that benefited from a tax credit calculated according to the provisions of the tax treaty between France and the source State[8].

D. A loss-making company, that cannot use foreign tax credit, won't be able to obtain the reimbursement…

5 – This is what is said in the *Faurecia* decision of the Conseil d'Etat, in which the judges decided that tax credits relating to withholding tax collected abroad, not offset on the French tax notably because of the deficit situation of the taxpayer, cannot be refunded.

The company asserted, in support of its reimbursement application, the fact that the mechanism of tax credit offset in only a method of reimbursement of the debt owed by the French Public Treasure (*"Trésor Public"*) and therefore, there is nothing to argue against their repayment in cash.

However, the Conseil d'Etat assessed that it does not result *"from the provisions [of the tax treaties], nor from any provision or any principle of national law that the tax credit that could not have been set off has to be returned by France to the resident beneficiary of those revenues".*

The submissions of the public prosecutor (*"rapporteur public"*), Edouard Crépey, highlight two arguments in favour of the rejection of the return of foreign tax credits. First, it is recalled that *"the subsidiary possibility of a reimbursement in cash is not attached to the tax credit mechanism"*, but that it should be relied on the text that deals with the tax credit to know the treatment that needs to be done. Indeed, in national law, several tax credits, of which the rules of use have been planned by the legislator, on a case-by-case basis: thus, some tax credits are refundable, others are deferrable, and others ones are lost because of a lack of set off. Furthermore, it is highlighted the existence of a principle of literal interpretation of the tax treaties that the Conseil d'Etat applies in the case in point: thus, if this is true that one of the purposes of bilateral tax treaties is to eliminate double taxation, this purpose can only be achieved if the relevant tax treaty actually provides for this absence of double taxation.

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[8] *IT/ Rép. min. n° 11833 to Michel Sordel : JO Sénat Q 8 sept. 1983, p. 1247 in the BOI- IS-RICI-30-10, June 27th 2014, § 440.*

E. … nor deduce from its taxable bases in France the amount of the foreign withholding tax, if the applicable tax treaty precludes such a possibility.

6 – The question of the deductibility of foreign withholding taxes, in the case of the non-use of the relevant tax credit, has led to several disputes almost concomitant, to numerous comments and has been widely been discussed.

It results now from the Conseil d'Etat case-law that the foreign withholding tax is not deductible, when the clear provisions of the applicable tax treaty precludes such a possibility[9]. This is the case, in the case *Céline*, of the tax treaties signed by France with Italy and Japan. By analogy, this is the case, more widely, with numerous tax treaties signes by France.

It does not result explicitly from this decision that the deduction would be granted, conversely, in the case in which the tax treaty would not include an explicit prohibition on this point. However, the Versailles Administrative Court of Appeal (*"Cour administrative d'Appel de Versailles"*) decided in this way, concerning a French company earning royalties of Greek source[10]. As the Administration did not file an appeal in to the Court of Cassation (*"Cour de Cassation"*), we can legitimately consider that this solution has been endorsed.

On this basis, it results from the main tax treaties signed by France that only withholdings tax levied on royalties in a limited number of countries can lead to a deduction in France, when the conventional tax credit cannot be used:

Signatory country of the tax treaty	Date	Article relating to royalties	Article specifying methods to avoid double taxation
Greece	21/08/1963	11	21-A.5
Brazil	10/09/1971	12	22-2.c
Indonesia	14/09/1979	12	24-2.b
Philippines	09/01/1976	12	23-2.b
Poland	20/06/1975	12	23-2.b
Portugal	14/01/1971	13	24-1.e
Thailand	27/12/1974	12	23-1.b
Turkey	18/02/1987	12	23-2.a
Lebanon	24/07/1962	17	26-3

[9] *CE, 9th and 10th subsect., March 12th 2014, n° 362528, Sté Céline : JurisData n° 2014-004866; Dr. fisc. 2014, n°22, comm. 356, concl. F. Aladjidi, note by Ph. Durand ; RIF 6/2014, n° 602.*
[10] *CAA Versailles, 3rd ch., July 18th 2013, n° 12VE00572, min. vs. Sté Egis SA, préc.*

2. Withholding taxes levied in breach of conventional provisions.

7 – This situation can include several realities to which are faced companies in the context of their international trade relations:

- A withholding tax is levied by a State pursuant to its national law, in breach of the tax treaty convention –for instance, on a class of income for which the bilateral treaty give an exclusive taxation right to the residence State) ;
- A withholding tax is levied by a State because of an extensive interpretation of the definition of an income submitted to a withholding tax given by the treaty. Indeed, we know that the definitions of the concepts of royalty and dividend can lead to a disagreement of interpretation. Some States, for example, call it a royalty a payment given for an operation that is not a skills transfer, but is limited to technical assistance service or the provision of qualified staff ;
- A withholding tax is levied according to the allocation terms of taxing power provided by the tax treaty, but at a higher rate than the maximum rate provided ;
- Some States have created withdrawals for which the company is neither the liable, nor the debtor, even though it bears the charge on an economic plan.

The main examples we can note are the following ones:

- The withholding tax at a rate of 24% levied in Algeria on service deliveries made by an agent located in France for a client located in Algeria (withholding tax on income tax (*"impôt sur les bénéfices"*), tax on professional activity (*"taxe sur l'activité professionnelle*") and VAT) ;
- The withholding tax at a rate of 10% levied in some cases in China on the corporate gain made by the transfer of shares of a foreign intermediary company owning a participation in a Chinese company ; this text is applied by Chinese authorities in breach of the tax treaty between France and China, of which the substantial participation clause should only apply for a direct transfer of shares of a Chinese company by an shareholder located in France.
- The *dividend distribution tax* of a rate of 20,358% levied in India on the dividend distributions realized by resident companies for their shareholders, whether they are resident or not.

We can note that France could also be blamed on this point. Especially, the contribution of 3% on the revenues allocated provided by Article 235 ter ZA of the CGI, could be considered as not compliant to the conventional provisions, as it can be analysed as a dividend taxation contrary to some tax treaties concluded by France.

8 – The French company that bears a foreign withholding tax levied in breach of the relevant tax treaty does not benefit from a tax credit in France. In the alternative, we therefore look at the deductibility of the foreign withholding tax, the question is to know how a tax treaty which expressly provides the prohibition of deducing the withholding tax in the residence State, can apply to the French taxpayer, while this tax treaty is not respected by the source State.

Following the *Céline* decision, the Administration considered that the deduction is forbidden, when the tax treaty expressly provides so, even when this treaty is not respected by the source State.

The administrative court of Montreuil finally ruled on this question, considering that the deduction of the foreign tax of the taxable results of a French company would be in any events granted, when the foreign tax has been levied in breach of the tax treaty[11]. Indeed, the provisions of the clause relating to the elimination of double taxations which, in some treaties, prohibit this deduction would only apply to revenues considered as taxable or not taxable "in accordance with the provision of this Treaty", according to the terms laid down in most of the treaties.

According to our information, the tax administration would have changed its position in the context of tax controls, following this decision.

Conclusion

9 – The tax treatment of withholding taxes and conventional tax credits on foreign passive income has been forged over time by case law. This Praetorian construction is based on the appreciation made by the judge concerning the articulation of the rules of French national law and of the conventional provisions.

The last decision of the Conseil d'Etat (the *Faurecia* decision above-mentioned), saying that the tax credit that cannot be set off, cannot be refunded to the French taxpayer, illustrates again the limits of the tax payers to ensure the neutrality of international flows.

Another issue, not yet decided by the judged but evoked by the public prosecutor in this case seems important though: the possibility to delay the use of foreign tax credits in the time. And, on this aspect, it is interesting to note that the legislator considered, some years ago, to include in the French General Tax Code a delay mechanism of conventional tax credits over a two-year period, coupled by an acknowledgement of the tax credit to be lost at the end of the delay period[12].

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[11] *TA Montreuil, 1st ch., December 1st. 2014, n° 1301376, SA L'Oréal : JurisData n°2014-029239 ; Dr. fisc. 2015, n° 10, comm. 191, note A. Marmier.*
[12] *PLF 2011 (1st lecture), amdt Sénat n°1-446 rect.*