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PERIODIC LEGAL AND TAX INFORMATION REVIEW

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ARE NON-FRENCH TAX RESIDENTS ELIGIBLE TO THE EXEMPTION OF WEALTH TAX ON SECURITIES OF FRENCH COMPANIES?

Pursuant to Article 885 L of the French Tax Code, financial investments made in France by individuals who are not French tax residents are not subject to wealth tax (Impôt sur la fortune – ISF) *in France. This legal provision has an incentive nature, since it aims at encouraging non-residents to maintain or increase their savings in France. However, the law does not provide for a clear definition of* «financial investments»*, opening the door for the tax administration to distinguish between exempted* «financial investments» *and non-exempted* «equity securities».

The tax administration considers that **financial investments** *« include all investments made in France by an individual and whose proceeds of all kinds, except for capital gains, are or might be included in the category of investment income, such as notably cash and term deposits in euros or in currencies, partners' current accounts held in a company or a legal entity having its registered office or its effective management in France, bills and securities of the same kind,* ***bonds, equities and rights in companies,*** *life-insurance or endowment contracts taken out with insurance companies established in France »*. This definition does not raise any particular objection.

However, it should be pointed out that the tax administration excludes from the scope of this exemption provision **securities representing an interest,** i.e. securities *« allowing to exercise some influence on the issuing company »* (cf. BOI-PAT-ISF-30-40- 50 n° 60 to 90, 10 June 2013). According to this doctrine, are deemed equity securities *« securities representing* ***at least 10 % of a company's capital.*** *However, the qualification as equity securities is assumed only when the securities have been either subscribed at the time of issuance, or held during at least two years. Moreover, the taxpayer may, in any case, provide proof that the securities held in these conditions are not equity securities. »*

In this respect, the tax administration refers to the distinction between « investment securities » and « equity securities » existing with regard to industrial and commercial profits and corporate tax, notably for the application of the parent companies and subsidiaries tax system.

There is little case law regarding this issue. However, we may mention the existence of a decision rendered by the Clermont-Ferrand Court on 9 January 1992. The taxpayer, a Spanish tax resident, argued that he was eligible for the exemption of taxation of financial investments, even if he held 43 % of the capital of a company incorporated by shares (SA). He claimed that he had been ousted from the executive bodies of the company by a coalition of majority shareholders. Nonetheless, the Court rejected his arguments, considering notably that the number of securities he held conferred upon him a dominant position in the company allowing him to exercise influence on the company.

A critical analysis of this interpretative doctrine requires an *in extenso* reminder of the law.

Article 885 L of the French Tax Code provides that:

1 *« Individuals who are not French residents for tax matters are not liable to taxes on their financial investments.*

2 ***Are not deemed financial investments*** *shares or share capital held by these individuals in a company or legal entity whose assets are mainly composed of immovable properties or immovable rights located on French territory, in proportion to the value of these assets against the overall assets of the company. The same applies to shares, share equity or rights held by these persons in the legal entities or bodies mentioned in paragraph 2 of Article 750 ter. »*

Thus, according to a strict reading of these provisions (which is generally the case in tax matters):

– In para. 1, the text provides for a general exemption of all financial investments made in France ;

– In para. 2, only shares of predominantly real estate companies and more generally shares held in companies or bodies holding real estate in France are excluded from its scope.

In principle, when tax provisions have a clear and precise meaning, the tax administration cannot introduce distinctions that have not been contemplated by law (doctrine is of course in a lower level than the law in the hierarchy of norms).

However, this reading must be attenuated in the light of the reading of the parliamentary debates that governed the adoption of this legal provision.

Indeed, at the time of the introduction of the tax on large fortunes *(Impôt sur les grandes fortunes – IGF)* in 1981, an exemption provision in strictly similar terms had been introduced in the general tax code. When this provision was voted, an amendment had been suggested in order to exclude from the exemption *« the case where financial investments are composed of equity securities subject to the provisions of Art. 160 of the general tax code »* (i.e. participations equal or exceeding 25 %). The commission had rejected this amendment, considering that the text proposed by the Government only aimed at *« investments »* and not *« participations »*.

Note nonetheless that when ISF was introduced through the reinstatement of the legal provisions on the IGF (which contained some amendments, but not regarding the provision at hand) the Finance Committee of the National Assembly had issued a report on 3 September 1988 during the preparatory work. The latter challenged the legality of the distinction the tax administration already made in its doctrine between financial investments and equity securities, as follows :

« This administrative interpretation raises several questions : firstly, one can question the possibility for the tax administration to establish an exception « alongside the law », since Article 885 L only provides an exception for financial investments in predominantly real estate companies. It should be borne in mind that pursuant to Article 34 of the Constitution, the rules governing the tax base shall be established by law.

Secondly, from the economic rationality point of view, this scheme leads to a curious situation. Indeed, the foreign investor faces surprising effects on the tax base : if his investment represents less than 10 % of the company's capital, it is tax exempt since it is deemed an investment ; if it exceeds 10 %, it is taxable since it is deemed a participation. He will then be eligible for the tax exemption again if he holds 25 % of the company and performs the functions giving rise to a right to have the participation qualify as professional assets, which is hardly compatible with the non-resident status.

Finally, one may question the notion of participation held, since the scope of the 10 % rule deriving from the General Tax Code or from the Law on commercial companies of 1966 is not absolute.»

It is worth mentioning that further to this report, the legislators did not amend the provisions as they had been drafted in 1981.

Accordingly, one could argue that their new intention was to reserve a large scope of the provision on the tax exemption of financial investments…

Even if a distinction between investments and equity securities can be admitted, their definition, based on the notions applicable with regard to industrial and commercial profits and corporate tax, does not seem appropriate. Indeed, such definition is difficult to adapt to the situation of individuals.

As a matter of fact, neither the tax schedule nor the system of taxation of investment products with variable income varies according to the number of securities held by the individual in the company.

Moreover, according to an *a contrario* reading of the interpretative doctrine, securities representing more than 10 % of the capital but that have not been subscribed at the time of issuing and will not be held for at least more than two years could qualify as financial investments. As regards corporate taxation, the intention of the taxpayer is assessed on the basis of the accounting category attributed to the securities held. On the other hand, when an individual purchases shares of a company, it is not possible to assess whether he intends to keep them or not, except in the event of accounting

obligations, and there is no way to prove it with certainty, unless *a posteriori*.

Furthermore, the decision rendered by the Court of Clermont-Ferrand shows that the evidence of the contrary may hardly be accepted, despite the fact that the taxpayer can no longer interfere in the management of the company, does not perform corporate functions and does not receive any income from the structure anymore, except for the dividends (taxed as investment income).

In our view, two alternative interpretations could be retained.

– The first is based on a highly restrictive interpretation of the legal provision, according to the analysis mentioned above.

In this hypothesis, shares of French companies held by non-residents would be tax exempted in all cases. This interpretation may seem rather extreme and is very likely to be finally rejected by the Courts.

– The second could consist in considering that the notion of « financial investments » opposes to that of professional activity, which is defined by the carrying out of a minimum of material and intellectual means. « Financial investments » would then be characterized by the passivity of the taxpayer, who would only reap the benefits of his investment.

In this hypothesis, the non-resident, who only receives dividends, could qualify for the exemption system, regardless of the amount of the participation held, since his only purpose would be to draw profits.

PERSPECTIVES

In conclusion, practically speaking, a non-French tax resident holding more than 10 % of the share capital of a French company has two options :

– ***He can file an ISF return, pay the corresponding taxes and afterwards file a claim for the reimbursement of the tax paid by providing legal and factual evidence of his eligibility to the exemption provision ;***

– ***If the non-French resident taxpayer considers he qualifies for the tax exemption on financial investments, he may alternatively decide not to file a tax return and wait to receive a formal notice from the tax administration. He shall then discuss with the tax administration with the assistance of a tax advisor.***

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FMIA – EXTENSION OF TRANSITIONAL PERIODS

The Financial Market Infrastructure Act (FMIA) and its two implementing ordinances (FMIO and FMIO-FINMA) entered into force on 1 January 2016. This regulation introduces a harmonised regime for all «financial market infrastructures». Moreover, it provides for new rules of conduct on derivatives trading (duty of clearing, of reporting and of risk mitigation). Besides, it extends the scope of the existing duties of record keeping and on reporting applying to securities transactions.

The concerned players benefit from transitional periods that have been established on the basis of similar provisions of European regulations (MiFID II / MIFIR). Now, since the implementation of these provisions has been postponed until the 3 January 2018 by the European Commission, the Federal Council has decided on 29 June 2016 to extend some of the transitional periods set forth in the FMIO. In the wake of the Federal Council, the FINMA has also taken measures through a Circular dated 6 July 2016 (01/2016). Banking institutions are mainly concerned by the following extensions:

– Exchange of collateral for non-centrally-cleared OTC derivatives (Art. 131 para. 4 to 6 FMIO): the duties thereto related shall be fulfilled when the technical standards pertaining to the regulations in this area will have been adopted at European level;

– New duties of record-keeping and of reporting applying to transactions in derivatives whose underlying instruments are securities admitted to trading on a trading venue (art. 36 para. 2 and 37 para. 2 FMIO) and the duty to mention the details necessary to identify the beneficial owner applying to the transactions subject to the reporting duties (art. 37 para. 1, let. d FMIO) : the deadline to fulfil these new duties has been extended until 1 January 2018.

On the other hand, the transitional periods relating to other rules of conduct remain unchanged. Note however that the starting point of the transitional periods applying to the duty of clearing and of reporting transactions to a trade repository are still unknown: they will be known when the FINMA will have established the categories of derivatives subject to the duty of clearing – which implies the authorisation or the recognition by the FINMA of a central counterparty –, respectively when the Supervisory authority will have authorised or recognised a central repository. In this respect, the FINMA indicates in its Circular of 6 July 2016 that to date this has not occurred yet, but it does not specify when said authorisations or recognitions could occur.

Despite this delayed implementation of the clearing and reporting duties and the extension of the transition periods decided by the Federal Council and the FINMA, Banks and other subjects shall be audited as from the financial year 2016 on the measures taken in order to fulfil their new duties (of course, to the extent of the duties already applying and whose implementation methods are known).

PERSPECTIVES

The initiative taken by the Federal Council and the FINMA is to be welcome: it gives time to institutions in challenging regulatory times, thus allowing to avoid a Swiss finish that would be harmful to the interests of the concerned players, in particular those operating on the derivatives market. This being said, the institutions concerned by this new regulation should already analyse the consequences thereof on their business model. By doing so, they will be able to set up the first implementing measures and justify as from 2016 that they fulfil their duties with regard to the FMIA and its implementing ordinances.

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FINTECH : SWISS FINANCIAL REGULATIONS ADAPTED TO THE DIGITAL ENVIRONMENT

Financial Technology or « FinTech, such as online banking services, mobile payments, bitcoins, crowdfunding, algorithmic trading, for example – challenges more traditional business models on which Swiss regulations are based. While these technological innovations contribute to increasing the attractiveness and competitiveness of the Swiss financial centre, Swiss regulations on licensing requirements and rules governing the financial activity are no longer adapted and should be revised.

FINMA has adopted a neutral approach with respect to different business models, aiming at both maintaining the financial centre's competitiveness and protecting investors.

Hence, the regulator has undertaken to adapt Swiss regulations, starting with the **anti-money laundering field,** since most FinTech financial intermediaries fall within the scope of this regulation. In its new Circular 2016/07 « Video and online identification », the FINMA provides for a more flexible interpretation of the financial intermediaries' due diligence duties under the Federal Act on Combating Money Laundering and Terrorist Financing (Anti-Money Laundering Act – AMLA) and its implementing ordinances in order to allow them to apply to a digital environment. This Circular, which is applicable since 18 March 2016, allows the verification of the financial intermediary's contracting party through an online video conference, under certain conditions. It also allows the identification of the beneficial owner through digital means thanks to electronic signature or a scanned copy of a signed document, in particular. Finally, by offering a technologically neutral interpretation of certain provisions of the FINMA Anti-Money Laundering Ordinance (AMLO-FINMA), the FINMA allows for example that some of the required clarifications be received by e-mail, chat or video conference. The FINMA's Circular applies only to financial intermediaries subject to its direct supervision. Thus, it belongs to self-regula-

tory organisations to adjust their regulations in the light of the said Circular.

In parallel, the FINMA examined all its prudential regulations in order to ensure that it guarantees neutrality vis-à-vis different business models. As a result, only the provisions of the **Guidelines on Asset Management (Circular 2009/1)** prescribing the form and the content of the asset management contract proved to be a problem since they provided that the asset management contract must be concluded in writing, i.e. in a paper form bearing the signatures of the parties. This obstacle has now been removed, since the amended guidelines provide that the asset management mandate may from now on be concluded in any form which can be evidenced by a text, such as for example in a digital form bearing an electronic or physical signature, for as long as the e-mail can be attributed to the client in a reliable manner. The amendments to Circular 2009/1 entered into force on 1 August 2016.

PERSPECTIVES

Let us hope that the financial regulations will continue to respect the principle of neutrality, setting forth identical guidelines for the different market players. The licensing of FinTech companies and the new risks related to their activities are two issues still to be examined. In this perspective, the Federal Council entrusted the Federal Department of Finance with the task of analysing the need for a specific regulation on FinTech companies. Moreover, the FINMA has declared that it is in favour of a new licensing category, bearing less strict conditions than the banking licence, for companies whose activities include only certain aspects pertaining to banking activities such as payment service providers, asset management applications or crowdfunding platforms. Finally, the FINMA recommends an exemption of licence under certain thresholds in order to promote in particular start-ups.

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CLIENTS' ASSETS FROZEN BY BANKS AS SECURITY AGAINST CLAW-BACK CLAIMS RELATING TO FAIRFIELD FUNDS

Further to the Madoff fraud, the liquidator of the Fairfield fund (the « Fund ») filed in May 2010 a claim in the United States against several Swiss Banks aiming at the reimbursement of the amounts they received on behalf of their clients further to the sale of Fund's units between May 2004 and December 2008. The liquidator claims that these amounts are undue since the units were over evaluated because of the Madoff fraud. Decision No. 4A_540/2015 of the Swiss Federal Court deals with the freezing by one of these banks of one client's assets as security against the amount the client could be condemned to pay back to the bank should the claim filed by the liquidator be successful.

The Federal Court examines mainly two issues: (i) Does the Bank have a claim against its client, which obliges the latter to bear the economic burden of said reimbursement? (ii) In order to guarantee the reimbursement, can the bank exercise a pledge on its client's assets?

Regarding the first issue, the Federal Court has noted the following facts: the parties were bound by a current/deposit account and occasional investment advisory relationship; the bank received a «brokerage commission» on the sale price of the Fund's units; the bank contributed to the decision of the client to purchase the units but cannot be held liable for any breach of contract; it did not have the duty to monitor the evolution of the Fund or to advise the client to adapt his investment in the event of change of situation; at the time of the purchase of the units of the Fund, the client signed a statement whereby he certified he had instructed the bank to perform this transaction on his behalf at his own risks; he acted on his own will when the bank advised him to sell his units.

For the Federal Court, these elements prove the existence of a previous agreement providing that the client would entirely assume the risks involved in the investment in the Fund. The risk associated with an action for the recovery of the income received further to the sale of the units of the Fund shall accordingly be borne by the client.

Thus, the bank has a claim against the client to be released from the recovery claim filed by the liquidator of the Fund in the United States.

As for the second issue, the Federal Court reminds that the pledge is admitted if it guarantees claims the pledgor could reasonably foresee at the time of conclusion. It notes that regarding the case at hand, according to the pledge agreement, «all current or future claims the bank may have against the pledgor» are secured. According to the Federal Court, said claims are the claims resulting from the current or future business relationships between the bank and the client.

Does the bank's claim fulfil this condition? The Federal Court notes that the client explained he intended to deposit his money and at the same time earn a return, and that terms such as securities, paper-securities, collective deposits were mentioned in the pledge agreement. Accordingly, the purchase of units of investment funds such as the Fairfield Fund, is a transaction the client could and should contemplate at the time he opened his bank account. Thus, the Federal Court deems that it is an investment transaction performed within the framework of foreseeable business relationships. Since the bank's claim is closely linked to this transaction, it is covered by the pledge.

As a consequence, the bank may freeze its client's assets, regardless of the fact that the proceedings in the United States are on-going: the fact that the bank is the object of a procedure aiming at the recovery of the amount of the redemption of the Fund's units suffices to allow the exercise of the pledge.

PERSPECTIVES

This decision underlines the importance for the banks of clear contractual documents such as precise general conditions or deeds of pledge, in order to protect themselves against claims resulting from the business relationships with their clients.

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QUALIFIED TAX OFFENCE AND TRANSITIONAL PERIODS

In a world that no longer tolerates tax incivilities, Switzerland must update its domestic laws in order to comply with international standards. Thus, since 1 January 2016, it punishes acts of money laundering related to certain tax offences. However, this change raises important practical issues, notably with respect to the temporal application of this legislative change.

The provision punishing money laundering was amended in two respects on 1 January 2016. On the one hand, the legislator introduced the *« qualified tax offence »* as a predicate offence for money laundering in paragraph 1 of Article 305bis of the Swiss Criminal Code (SCC). On the other hand, and in an unusual way, it defined the latter in paragraph 1bis of this same provision.

Use of a false or forged document within the meaning of Article 186 of the Federal Act on the Federal Direct Tax (FDTA) or **tax fraud** within the meaning of Article 59 of the Federal Act on Harmonisation of Direct Taxes (HDTA) is deemed a qualified tax offence **when it will allow the author to evade over CHF 300,000 of taxes during the same tax period.**

The qualified tax offence is thus a **result-based offence,** since it implies that the criminal activity eventually allows its author to evade the above-mentioned amount. This actual result will however occur months, or even years later, at the time of the entry into force of the taxation. Moreover, the qualified tax offence is not an autonomous offence since **it is not punished as such,** but it is only a predicate offence for money

laundering. The autonomous offence is the mere tax offence, punished according to **tax laws,** which do not mention the amount of CHF 300,000. On the other hand, the evaded amount is an element of the qualified tax offence, conceived as a predicate offence for money laundering, as opposed to a « mere » tax offence (resulting in the evasion of an amount inferior to CHF 300,000 per tax period). Only the « qualified » tax offence constitutes an essential prerequisite for the money laundering offence so that only the author of the laundering of proceeds of such a qualified tax offence may be punished for money laundering pursuant to Article 305bis SCC.

Since Article 305bis SCC provides for the CHF 300,000 threshold in relation to the predicate (qualified tax) offence, the question arises as to the time at which the said qualified tax offence was committed : is it the moment when the author of the qualified tax offence performed his criminal activity or the (later) moment when he effectively benefitted therefrom ?

It is particularly important to establish the time at which the offence was committed, since the new Article 305bis SCC *does not apply* to qualified tax offences « committed » *before* the entry into force of the amendment. The Federal Act of 12 December 2014 for implementing the Revised Financial Action Task Force (FATF) Recommendations of 2012 provides indeed for a transitional period in this sense.

According to the Federal Council's message accompanying the Federal Act of 12 December 2014, only suspected acts of money laundering in relation to qualified tax offences « committed » after the entry into force of the amended Art. 305bis SCC may be reported by financial intermediaries under Article 9 of the Anti-Money Laundering Act or Article 305ter SCC, since they were not yet deemed as predicate offences for money laundering in the legislation in force until that date (principle of non-retroactivity).

Although the Federal Act of 12 December 2014 and its accompanying Message confirm the importance of the time of commission of the qualified tax offence, unfortunately they do not provide any answer regarding its establishment. During the present transitional period, there will be numerous cases where the author will have acted before the entry into force of the new provisions while the results will only occur after their entry into force.

In our opinion, the qualified tax offence is « committed » at **the time the forged or false document is provided to the tax authority** (moment when the author acted), for two reasons :

On the one hand, because this solution is compatible with the opinion expressed by the prevailing doctrine on the question of the time a criminal offence is committed : the doctrine considers indeed that a criminal offence has been committed at the time when the author *acted* and, in the event of a crime of omission, at the time the author *should have acted*. In the cases of tax offences, the author acted at the time he provided the tax authority with the forged or false document.

On the other hand, because the intent of the law is to punish the author of money laundering who assists the taxpayer who commits a particularly serious tax offence, i.e. the said « qualified tax offence ». The (ordinary or qualified) tax offence implies above all the use of a forged document or tax fraud. And both the use of a forged document and the tax fraud are committed at the time the false document is provided to the tax authority, since they are activity-based and not result-based offences.

As a consequence, we consider that the criminal activity – i.e. the use of a forged or false document (Article 186 FDTA) or tax fraud (Article 59 HDTA) – must have occurred after the 1st of January 2016 so that it can be deemed to constitute a qualified tax offence within the meaning of new Article 305bis SCC, opening the way – if the criminal activity in question has led to tax evasion of more than CHF 300,000 over one tax year – to criminal proceedings against the author of the laundering of the proceeds of this qualified tax offence.

PERSPECTIVES

The punishment of acts of money laundering related to tax offences constitutes a legislative change with substantial implications, in particular for financial intermediaries. The latter must now be aware of the overall tax situation of their clients, as well as of the businesses and transactions made by the latter ; they must also carefully document them, in compliance with their legal and regulatory duties. This knowledge is absolutely necessary in order to be able to detect a possible criminal activity of their clients within the meaning of the qualified tax offence. Finally, it is worth mentioning that they will have to update their procedures and internal documents.

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HIRING IN SWITZERLAND A CROSS-BORDER WORKER RECEIVING INCOME IN HIS STATE OF DOMICILE

The Agreement on the Free Movement of Persons between the EU and Switzerland (AFMP), which entered into force on 1 June 2002, aims at allowing citizens of the Contracting States to freely choose their place of work and residence. This agreement also aims at coordinating the different national social security schemes. For companies employing « multi-active » workers or for persons receiving unemployment benefits, criteria aiming at the affiliation of the employee to only one social security scheme trigger a situation that is contrary to the original purpose of the agreement. If for the persons receiving unemployment benefits the situation is frozen for the time being, it is still problematic for multi-active workers.

1) MULTI-ACTIVE WORKERS

A « multi-active worker » means a person who pursues simultaneous or alternating activities as an employed person in two or more Member States of the European Union (Art. 14 para. 5 of Regulation (EC) No 987/2009).

Pursuant to Art. 13 para. 1 lit. a of Regulation (EC) 883/2004, this person shall be subject to *« the legislation of the Member State of residence if he pursues a substantial part of his activity in that Member State »*. In this context, one may consider that a working time and/or a remuneration representing a share of more than 25 % of the overall activities of the employee in his State of residence shall be an indicator that the activity is « substantial » in that State (Art. 14 para. 8 of Regulation (EC) 987/2009).

According to this rule, a Swiss company employing a worker domiciled in France who pursues activities already representing 25 % in his country shall affiliate itself to the French social security scheme and pay the corresponding contributions, which can be significantly higher than the contributions due in Switzerland.

2) WORKERS RECEIVING UNEMPLOYMENT BENEFITS

Further to the agreement concluded between France and Switzerland within the framework of the AFMP on 7 September 2006, the situation was similar when a person receiving unemployment benefits in his State of residence was hired in the other State. Thus, when a worker received unemployment benefits in France, the Swiss employer had to join the French social security scheme.

Under the pressure of the defenders of cross-border workers, the French government has decided, in May 2016, to suspend application of the agreement of 7 September 2006. This means that all requests of the French organizations for the payment of social security and family benefit contributions *(Union de Recouvrement pour la Sécurité Sociale et les Allocations Familiales – URSSAF)* sent to Swiss employers are suspended until the entry into force of a possible agreement between France and Switzerland. Thus, the Swiss employer must withhold social contributions from the salaries pursuant to Swiss law.

On the other hand, the situation of the multi-active worker provided for in the European Regulation remains unchanged.

PERSPECTIVES

In the case of a multi-active French cross-border worker, the application of the agreements concluded within the framework of the AFMP triggers for the Swiss employer the duty to join the social security scheme in France. Besides its administrative challenges, this regulation represents a heavier financial burden for both the employer and the employee. Moreover, the employer is not in a position to know the real extent of the activity pursued by the employee in France. Finally, even if the employer knew these elements, the method of calculation allowing to conclude that the 25% threshold defining the «substantial activity» was exceeded has not been clearly defined yet.

Faced with all these obstacles, the Swiss employer wishing to fill a half-time vacant position could naturally be reluctant to hire a cross-border worker and only receive Swiss resident candidates. Now, this result is precisely the opposite of the purpose of the Agreement on the free movement of persons.

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