

Controversial tax goes to boost business climate

The French government has abolished the unpopular tax *professionnelle*. David Stevenson finds out why it has done so and the prospects for the tax's replacement.

Investment in France will cost companies less after the repeal of an unpopular local tax. In a bid to stop businesses from moving to lower-tax jurisdictions and to encourage new investment, the government has scrapped the *taxe professionnelle*.

In the more than three decades of its existence, the *taxe professionnelle* became one of the most loathed parts of the corporate tax burden in France. The tax, which was a local charge on business and was used to fund local government, had to be paid even if a company was losing money.

A new tax partly assessed on real estate and partly on added value replaced the scrapped tax at the beginning of this year.

Even Francois Mitterrand, the future president of France, at the time of its introduction in 1976, derided the *taxe professionnelle* as "imbecile". As many others argued later, Mitterrand believed the unusual nature of the new tax would hamper the competitiveness of French companies against their global rivals.

Opponents of the tax complained loudest about its impact on corporate investment, as it was levied on the assets of the company, including their property and capital equipment. It meant that any investment triggered an increase in a company's tax burden. The tax was instantly unpopular almost as soon as it came into force. "Six months after the tax was introduced, there was already talk of a reform due to its impact on investment," said Frederic Laureau, head of business tax services at Ernst & Young in France.

The *taxe professionnelle* didn't just have consequences for a company's tax burden. "The key issue with the business tax is the fact that it is impacting operating expenses and margin which may have tax but also management consequences," said Raphael Coin, tax director of General Electric in France.

The irony was that the *taxe professionnelle* was itself the replacement for an unpopular tax. It had the notable distinction of taking the place of the *taxe patente* which was the last tax created during the French Revolution to be abolished.

The idea behind the tax had been to provide revenue to French localities, but in the 1960s small businesses reacted violently to the *taxe patente*, believing it had become too much of a burden. The purpose of the *taxe professionnelle* was to shift the cost of the tax away from small business to big companies, which were charged a higher rate.

For most companies the *taxe professionnelle* was charged at a fixed rate of 16% of the value of assets used in the business. For smaller businesses with few assets, the charge was made according to an income tax rate of 6%. In 2001 the portion of the tax that applied to wages was removed as it created a disincentive to increasing numbers of employees and their wages.

But the amendment backfired in the eyes of some critics.

"It was a total mistake [to remove the taxation of wages] as the burden was shifted entirely onto capital and equipment. There was a real decrease in taxes for services and after 2001 the tax was very unbalanced," said Michel Taly, a partner at Arsene-Taxand in France, who worked for the ministry of finance in the 1970s and oversaw local taxes including the *taxe professionnelle*.

Abolition now

The state of the French economy is key to why the *taxe professionnelle* has gone now. "The tax was unpopular since it was introduced in 1976, however the financial crisis acted as a catalyst for the reform," said Laurence Toxé, partner at Norton Rose in France. Political considerations also played their part in the timing of the reform. President Sarkozy had been calling for the abolition of the tax for more than a year. He described the tax to reporters as an 'economic aberration'.

"I am proposing to abolish the *taxe professionnelle* which exists nowhere else in Europe. This system has to end because it's leading to the ruin of French industry," said Sarkozy in a speech at Saint Quentin in March 2009.

And the government also felt the tax had to go if it was to keep investment in France.

"The *taxe professionnelle* taxed investment, causing the flight of some companies to lower tax jurisdictions," said Nicolas Jacquot, a partner at Landwell & Associés in France.

"There are many factors as to why companies left France including labour costs, although the *taxe professionnelle* was certainly one of them," said Blaise-Philippe Chaumont, fiscal adviser to French finance minister, Christine Lagarde.



Blaise-Philippe Chaumont: The reform is globally good for companies

Winners and losers

While taxpayers cheered the move to get rid of the *taxe professionnelle*, there were obvious losers, too. For example, local authorities depended on the levy to raise a lot of money. In 2007, the tax produced e28 billion (\$40 billion) in revenue, of which e17 billion went to the local communes. Around e8.5 billion went to the *departments*, and the remaining e2.5 billion to the regions.

"Local municipalities resisted the reforms as they received a lot of revenue from the tax," said Gianmarco Monsellato, managing partner of Taj, the legal and tax advisers, in France.

Regions could compete with each other by offering different rates of the *taxe professionnelle* in an attempt to attract businesses. "One reason for opposing the reform is that localities used to have control over tax, now they are reliant on compensation from central government," said Chaumont.

New tax

The *cotisation économique territoriale* replaced the *taxe professionnelle* on January 1 this year. The tax has two components, the *cotisation foncière des entreprises* which is assessed on real estate, and the contribution on added value. It is the added value portion of the tax which means that certain industries may be worse off under the reform.

"Revenues from the new tax will be lower than the old tax, the difference will be compensated by central government in the form of subsidies," said Taly.

Still, some commentators do not think that localities will lose out that much from the reform. "In terms of the financing of localities they don't lose everything, they will still receive lots of revenue. Two changes, the tax on real estate goes to the localities whereas the added value goes to everyone," said Benjamin Homo, a partner at Mayer Brown in France.

"There have been complaints by real estate companies as they are now taxed," said Dorothee Traverse, partner at Moisand Boutin & Associés in France.

Companies that employ a lot of people may also be taxed more under the reform. Previously, service industries got off lightly under the *taxe professionnelle*, especially since the tax on wages was removed in 2001.

"All services were taxed at the minimum rate of *taxe professionnelle* so they will be losers in the reform," said Taly. "Industries such as financial services and insurance companies will have to pay a bit more than before as the professional property tax has to be paid."

"Manufacturers will be big winners compared to service industries, with heavy salaries being worse off," said Laureau.

However some commentators insist that the new tax will benefit the majority of corporate taxpayers. "The reform is globally good for companies. Only 1.5% of companies will pay more tax. There will be a marked decrease in taxation," said Chaumont. "Industries such as manufacturers will pay 23% less than before, while services will benefit but not to the same extent," he added.

Energy suppliers and railway companies would have been big winners from the reform as they would no longer pay tax on equipment but they are subject to the *imposition forfaitaire des entreprises de réseau* (IFER). This tax specifically targets those industries who do not have international competition. Without the IFER, there would have been a significant loss in revenue for the French Treasury.

"The tax on energy network providers is so they don't win too much from the reform," said Monsellato. "However they are likely to pass on the tax to their clients in the form of higher bills, which would reduce the positive impact of the reform,"

Tax benefits of the new tax

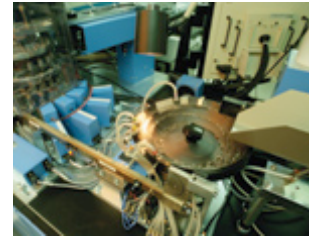
The abolition of the *taxe professionnelle* has removed the tax on investment for companies in France and that could prove to be the biggest positive result of the reform.

"The reform is going in a very positive direction reducing costs on industrial activities as a general principal," said Coin.

"The reform simplifies a regime that was "one of a kind" with a cost that you may not find anywhere else at least with this magnitude," he added.

"The big benefit is that companies no longer pay tax on moveable assets. There is scope for companies to define assets as moveable assets even if they are extremely large," said Homo.

And there is a progressive scale for the added value tax. The rate starts at 0% for companies with a turnover of €500,000 (\$705,000) to a maximum of 1.5% for large companies. "Companies such as small manufacturers will get a great benefit from the reform," said Chaumont.



Manufacturers will benefit greatly from the tax reform

There was previously a ceiling of 3.5% of the value added component of the *taxe professionnelle* meaning the new tax will cost less. "There is almost a 2% saving for the industrial groups which are now subject to the 1.5% contribution on the added value and to the real estate contribution," said Traverse.

Coming back

Companies that left France because of the *taxe professionnelle* could return now it is gone. The carmaker Daimler is reported to have chosen to manufacture its electric Smart car in France because of the reform.

"Apart from Daimler we are aware of a number of companies that are considering locating to France because of the reform," said Chaumont.

Renault is another manufacturer that will benefit from the reform. "Last year, it cost €250 (\$360) more to produce a car in France than Eastern Europe and. 70% of this additional cost was due to the *taxe professionnelle*," said a spokeswoman for Renault.

"Because the *taxe professionnelle* has been removed, it increases the competitiveness of production in France," she added.

Government officials believe the reforms have cut the average cost of investment in France by 22%.

"The government has a strong agenda for making structural reform and seeks to create a favourable environment for industry," said Chaumont. "The reform of the *taxe professionnelle* fits into this goal as it is focused on easing the burden on investment," he added.

If the government can build on this reform with other changes that improve the investment climate, taxpayers will have every reason to applaud such moves.

Other tax reforms

The French government began its programme of improving the business climate in 2007, when it implemented a 5% capital gains exemption for those with a 5% stake and ownership for at least 24 months.

In December 2007 there was a substantial enhancement of the R&D credit system. The ?16 million (\$23.6 million) limitation was removed. It eliminates the variation component to 30% of

the qualifying R&D expenses of the year.

The government's plan to introduce a carbon tax this year received a setback in January when the Constitutional Court ruled that its proposal for the tax was unconstitutional because it contained too many exemptions. An amended proposal that will tax all enterprises including those within the EU Emission Trading Scheme has been put before parliament. The tax may be introduced in July.