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TRILATERAL IFA CONGRESS

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Tax Treatment of Hybrid Instruments

French Presentation

SIAMAK MOSTAFAVI

OECD BEPS

French Government Policy
Non-deductibility of interest

- Pro-active French Government to implement BEPS
- Legislation approved end of December 2013
- Article 212, I-b of the French General Tax Code
- It goes beyond hybrid instruments
- Interest paid by a **French borrower to an affiliate lender** is deductible only to the extent the lender's tax liability in respect thereof is **not lower than 25% of the corresponding French corporate tax liability, i.e., around 8.33%, or 8.6%, or 9.5%** (according to the FTA)
- No safe harbour clause, potentially unconstitutional

OECD BEPS

French Government Policy
Non-deductibility of interest

•Regs issued by the FTA provide that the relevant tax comparison is based on the treatment of the interest **on a stand alone basis** and not the overall P&L of the lender **(e.g., any back-to-back financing of the lender is disregarded)**

•If lender is a tax transparent entity or a UCIT (within EU or in a jurisdiction with an administrative assistance clause with France), the affiliation condition must be met also at the level of the partners/shareholders of such transparent entity/UCIT (**double affiliation rule**); if the double affiliation is met, no interest would be deductible if any of the affiliates is not subject to the minimum taxation

Parent Subsidiary Directive changes French implementation

No Participation exemption for deductible distributions

•Legislation applicable from 1st January, 2015
•Article 145, 6-b of the French General Tax Code
•The 95% exemption is not available for the French recipient to the extent the distribution (from EU and non–EU sources) is deductible for the distributing entity

ATA Directive

Potential French implementation

- The current French legislation on hybrid instruments (non-deductibility of interest) applies only to affiliate lenders; the ATA Directive would apply to affiliates and non-affiliate lenders

Practical Implications
French hybrid instruments (1)

- **« Popular » French instruments issued by French issuers**
- **TSS (Super Subordinated Securities)**
  - Very junior ranking (senior only to shares)
  - Undated
  - Remuneration may be indexed on the profitablity of the issuer
  - Generally viewed as deductible (subject to anti-abuse rules)
  - **Example:** used by French financial institutions for regulatory purposes (AT1)
  - Tax treatment should not be impacted if subscribed by the market (i.e., non-affiliates), but ATA Directive may have an impact

Practical Implications
French hybrid instruments (2)

- **ORA (Mandatory Convertible Bonds)**
  - Potentially same features as TSS plus conversion into shares
  - Generally viewed as deductible subject to certain abusive arrangements (e.g., cancellation of shares replaced by ORA)
  - **<u>Example</u>:** between a French Sub and a US Parent
  - Impacted by anti-abuse legislation

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