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Client Alert

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Jersey, Bermuda and the British Virgin Islands now included to the list of Non-Cooperative States

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The list of Non-Cooperative States has been expanded to include Jersey, Bermuda and the British Virgin Islands. As from 1 January 2014, sums paid into these states are subject to a withholding at the source of 75% and are no longer deductible from corporate income tax.

At the end of 2009, on the basis of the resolutions expressed following the G20 summits, France reinforced its arsenal for combatting fraud and tax evasion for transactions made with regard to the countries appearing on a list known as Non-Cooperative States and Territories ("NCSTs"). The list of the NCSTs originated from the list of tax havens that was established by the OECD by taking into consideration their generally very low direct taxation, their rather opaque regulations and their lack of cooperation in transmitting information to the tax authorities of other countries.

Since its entry into force, the regime for the NCSTs has not often been applied since the list was short and did not include countries with which France had regular economic partners. This is no longer the case since the publication of the decree of 21 August 2013. This decree updated the list of NCCTs as of 1 January 2013 by adding Jersey, Bermuda and the British Virgin Islands, three countries which had moreover signed an administrative cooperation and assistance agreement with France in 2009.

By making this update, these States are now required to rapidly review their policy of cooperation with France if they wish to leave the list of NCSTs. Similarly, France has warned States that may be tempted not to strictly apply the cooperation agreements they have signed with it.

The other countries on the list of NCSTs to which the measures are currently applicable are Botswana, Brunei, Guatemala, the Marshall Islands, Montserrat, Nauru and the Island of Niue.

Relations, particularly financial and capital relations, by French residents with persons domiciled, established or having a bank account in these NCSTs must be reviewed with the greatest caution, with the understanding that these States have not signed any agreement with France to eliminate double taxation:

- Interest is in fact subject to a withholding at the rate of 75% when it is paid in an NCST. As only the place of payment is taken into account, it is however possible to circumvent this by using a pivot account opened in a cooperative country. Additionally, certain exemption make it possible to avoid the withholding at the source on interest paid in an NCST: (i) borrowings (or similar) incurred outside of France before 1 March 2010 are not subject to this; bonds exchanged on the markets are also exempted; financial flows generated by a Credit Default Swap are considered to be outside of the scope of the withholding at the source.

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- Interest and other financial charges, when they are owed or paid to individuals or legal entities domiciled or established in an NCST or when they are paid to a bank account held in an NCST, are not deductible unless the company can demonstrate that the operations principally had a purpose and an effect other than to allow these sums to be located in an NCTS. The nature of the proof is such that the deduction of these charges is in practice most often excluded. Because of their non-deductible character, these sums are potentially assimilated to distributed income and, in this connection, are subject the 3% contribution on distributed income.

- Within a group of companies, Article 209 B of the General Tax Code applies to NCSTs. This provision allows profits and active revenues realised outside of France by subsidiaries established in tax havens to be taxed as revenue from movable capital. For subsidiaries established in an NCST, a specific exclusion from the regime for parent companies (the regime for exclusion of dividends received) is added. The risk of double taxation in France, if these subsidiaries distribute their results, is however eliminated since a French shareholder may deduct the amount of the distributions received from its subsidiary from its taxable result. Similarly, the shares of companies established in an NCST are not eligible for the regime of exempting capital gains on participation securities. A French shareholder thus will be taxed at the full corporate income tax rate on capital gains regardless of the duration of holding these shares.

- Conversely, dividends paid by a French company to a shareholder located in an NCST give rise to application of withholding at the source at the rate of 75% and the capital gains realised by this shareholder from the sale of the shares of a French company are taxable in France at the rate of 75% regardless of the participation held by the seller in the share capital of the French company.

These repressive measures will force the French companies and persons concerned to reorganise their financial flows and the intra-group relationships with these States entering the list at the end of the year. There also remains the possibility for these States to strictly apply the agreements signed with France and thus to hope to be removed from the list on 1 January 2014 before the consequences of the August decree take effect.