

A photograph showing three petanque balls on a gravel surface. In the foreground, there are two large, dark grey/black balls with a prominent vertical ribbed texture. One ball is slightly behind the other, both angled towards the right. Between them and slightly behind is a smaller, solid white ball. The background is a blurred, light-colored gravel or sand surface.

FRANCE

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At the present time there is a certain reluctance to invest in France, whereby in particular investors are frightened off by the lack of predictability with taxes and labour law in combination with the traditional willingness of workers to protest in France. But companies from Germany remain the most important investors in France. Germany and France continue to work closely together and still represent the largest and most closely connected economic partnership in Europe. In figures, more than 3,100 offices of German companies employ approx. 300,000 people in France.



Beyond the cultural affinity these two countries share, the "Grande Nation" offers definite advantages for the German entrepreneur in the areas of technology, innovation and creativity.

Different types of investment incentives encourage foreign companies to make investments and create jobs, such as interest-free loans, subsidies for investments, in research and development and tax exemptions or tax credits for research expenses. These will shortly be expanded to the innovations of small and Mittelstand companies.

In geographical terms France lies at the centre of Europe and offers first class infrastructures for freight and public transport and advantageous energy price regulations. This central position attracts numerous German companies which plan to distribute their products in France, Southern Europe and the countries of Northern Africa.

Under certain conditions which are checked in advance by a tax specialist, foreign companies with reduced activity in France can be declared eligible to use a liaison office with the result that in France the company is not bound to financial accounting and tax obligations.

The founding of a new business in France increasingly leads to choosing between the branch office which has no legal personality (and from this clearly indicates its German origin) and the joint stock company which enables operation as an entity under French law. On the financial accounting and tax level the two choices are the same, i.e. the company is subject to tax in France and must maintain its own financial accounting. It is a particular feature of the country that the French legal system requires a uniform and obligatory chart of accounts. If a tax audit is carried out, each violation of this regulation can lead to the risk of non recognition of the financial accounting and taxation by the authorities, whereby it should be noted that these audits are made at random (without a comprehensive inspection). Our German clients strongly tend to centralise their financial accounting and financial transactions at the headquarters in Germany which enables direct integration of the turnover of the foreign branch offices and better control over reporting and consolidation. Using this

arrangement we recommend the keeping of parallel independent financial accounting in order to avoid any significant tax risk. This is despite the additional work which this means for the companies.

The most used legal form for the subsidiary of a group is the SARL (GmbH), which offers the advantage of simplicity in its organisation with one or two managing directors who may have German nationality. The SAS (joint stock company in simplified form) is the more recent legal form which we cannot necessarily recommend to our clients due to the fact that an auditor for the annual financial statement is stipulated even if there are no activities as soon as the controlling interest is held by a legal entity (applicable to groups which own a subsidiary in France).

Concerning the audit of the annual financial statement, France is considerably different to the other European states with regard to the legal duration of an auditor's mission which is six financial years and the applicable statutory fees which are determined according to the normal number of working hours dependent on turnover, financial income and the balance sheet total. It should be noted that the majority of German groups are not familiar with this regulation and only first learn about it when a decision is made at an international level to change the auditor. The statutory audit of the annual financial statement usual in France which is required for companies with consolidated group accounts enables the entry of a new auditor without, however, being able to force the official auditor to withdraw. When appointing a uniform auditor worldwide care should be taken to ensure that the French auditor of the annual financial statement must be appointed by a shareholders' meeting within six months after the end of the financial year, i.e. much earlier than in Germany.

In the area of the accounting standards there are no substantial differences between the French and German annual financial statement. There are only significant adjustments of the result to be made with companies which operate with long-term contract agreements to take into account the differences between the French accounts system (percentage of completion method) and the German HGB (completed contract method).

In spite of the apparent uniformity, care should be taken that the structure of the income statement shows different allocation differences, in particular because the French legal system lists all taxes, with the exception of corporation tax as operating expenses. This distortion can lead to serious disputes between purchasers and sellers in connection with cross-border acquisitions with a price determined by an EBIT multiplicator. Bearing this in mind, we therefore recommend beforehand the commissioning of an expert who is familiar with these differences to confirm the financial conditions in letter of intent or if applicable the sales contract (SPA).

The standard corporation tax rate in France is currently 33.33 %, payable in four quarterly advance payments on the basis of the taxable income of the previous year and a final payment (in April of the year following the reporting date of the annual financial statement, December 31). Companies with a turnover lower than 7.63 million euros and whose capital is held at least 75 % by natural persons or by companies which correspond to the same conditions, are taxed at the reduced rate of 15 % limited to 38,120 euros. This is a tax advantage which German family-owned companies benefit from as they run their operations in France with small company structures.

If the situation indicates a loss, the subsidiary (or the branch office) generates tax losses which are not limited in time and which can be offset against future taxable profits. Recently, the French system has allowed itself to be inspired by the German method to the extent that a limit for offsetting losses per year of 1 million euros + 50 % of the taxable income of the financial year was introduced. Here it is made clear that the principle of carrying forward losses not yet offset is maintained without a time limitation. According to the French accounting standards, the future tax advantage formed by the existing tax losses is not recorded in the local annual financial statement, but it can possibly be taken into account with the HB2 adjustment.

The French social law is perceived by other countries as being the social system in Europe with the most obligations and each potential investor considers these specialities of the system before he makes his investment decision. The specialities of the French system are numerous, whereby a special mention can be made of the systematic binding to tariffs for each activity to secure a minimum income, the regulation of the 35-hour week, the obligation to have a works council, the statutory profit-sharing mechanism for employees where there are more than 50 employees in the company, and an extremely strict employment termination procedure which is designed to offer legal protection for employees and penalise companies which do not comply with the formal requirements.

The social security structure is very advantageous for those insured and the associated costs for the employer are correspondingly high as the burden of social contributions on average is 50 % of gross pay. The recently introduced social law highlights the competitiveness of the companies, whereby in January 2013 a tax credit was introduced for competitiveness and employment (CICE) which for a gross monthly pay below 3,600 euros corresponds to a reduction in social contributions of 4 % in 2013 and 6 % in 2014.

The provision of a company car in France is not advantageous, whereby although it represents a benefit for the employee, in return on the entrepreneur side is subject to extraordinary taxation. This is particularly valid for the sales tax in the purchase price and the operating costs/maintenance, depreciation of the purchased vehicle or leasing rate, which are non-

deductible with a vehicle value above 18,000 euros. The French car tax is paid by the companies for each vehicle used in French national territory, including for vehicles acquired or rented abroad.

It should also be noted that in connection with the payment of salaries French companies do not hold back any tax for wages as is the case in Germany. The submission of the income tax return and the payment of this tax is purely a private matter.

Practical examples

M&A

Background facts:

The Stressteam company has decided to acquire a competitor in France. Negotiations have been in progress for months with the management of the target company and finally late in the night on account of a closing organised by a Paris law firm a sales contract (SPA) is signed. The price noted in the protocol to the contract consists of a fixed price and an additional price payable within the next two years. During this time period the seller will continue to manage the purchased company. He receives an earn-out to the amount of 50 % of the annual EBITDA which is corrected by a certain number of expenses and earnings listed in the SPA, and here in particular the services of the seller which will be invoiced by his private company.

When the first annual financial statement is due the contract parties prepare the calculation of the earn-out and discover that the results determined from both sides are not in line with each other. The seller especially questions the application of the method by presenting a drafting error and he is of the opinion that the formulation of this paragraph is not true to the spirit of the contract.

What can be done now?

Pursuant to the SPA it is expressly stated that the audit firm Schlauberger will be engaged in the case of a dispute between the contract parties regarding the fixing of the additional

price. Therefore this firm is contacted and the firm carries out a corresponding audit and presents its conclusions which draw attention to a certain number of deviations in the handling of the so-called current expenditures which are or are not used to calculate the EBITDA. Incidentally, the term of operating expenses is defined by the French conditions differently to the conditions of the German commercial code (HGB). Worthy of special note here are the taxes which with the exception of corporation tax in France are recorded in the operating results and discounted costs which are shown as a financial loss while in Germany these are treated as a reduction in margin. Finally the auditor concludes that in financial accounting terms the calculation formula agreed by Stressteam and the seller represents an irregularity. The contract parties, however, have signed the contract and therefore they are obliged to fulfil the agreement.

On the basis of this expert opinion the contract parties cannot come to an agreement and feel compelled to re-negotiate the additional price which leads to extreme tension and a loss of confidence between the investor and the seller who continues to manage the acquired company.

What should one have done differently from the beginning?

For cross-border investments we urgently recommend to investors that before a closing they should engage an expert consultant who has good knowledge about the financial accounting regulations which apply in the respective countries of the purchaser and seller and in particular to pass on the paragraphs of the SPA concerning price determination. This will enable the expert to recognise any lack of clarity in the definition of the financial references chosen by the contract parties (e.g. EBITDA/EBIT, net financial debt) and possibly to highlight the distortion resulting from the application of the local financial accounting regulations.

The handling of off-balance-sheet obligations (traditionally provisions for retirement as a potential liability) is also a complicated issue which is often only later on identified in the course of due diligence and afterwards causes disputes if this is not clarified prior to the signing of the SPA.

Taxes

Background facts:

The Spardose company has been distributing its products on the French market for a number of years with the aid of a small team covering the commercial and marketing aspects of the operation. After an enquiry from the German administrative authority which intends to check whether the results are not burdened by losses abroad, the company asks a French tax consultant to check the situation. After a corresponding investigation of the organisation and the area of responsibility of the team on French national territory, the tax consultant declares that the activity carried out essentially represents a dependent branch office which is liable to pay tax in France. The German company was previously of the opinion that the operation was a liaison office and not an entity with regard to the legal or tax systems in France. The results achieved through these activities were entered into the financial accounts in Germany and taxed accordingly there. The input tax on the acquisitions and services in France were retrieved via the portal set up for this purpose for foreign companies.

What can be done now?

Every branch office in connection with corporation tax and other taxes is subject to the same tax obligations as a company, including sales tax. As a result, the Spardose company should have been registered in France and should have maintained financial accounting according to the system of accounts prescribed by French law. The non-observance of these regulations can lead the administrative authority to initiate a taxation of income due to the rejection or absence of the financial accounting, i.e. it can apply flat-rate taxation based on the turnover.

As soon as a foreign company identifies the existence of a branch office in France, a voluntary declaration is a possibility, whereby it must be clear that the correction regarding the last six financial years is costly because these costs result from the work involved in reconstructing the annual financial accounting according to the French regulations. This work must be entrusted to a local tax consultant who will formalise the information he receives from the German company concerning the French activity. However, we recommend that our clients should first of all make an estimation of the results achieved in the past in order to estimate the deferred tax expenses and the risks associated with previous financial years which were not properly recorded.

In respect of the future (and possibly previous) operating activities, the principle of the remuneration of the branch office must be defined and if possible using a transfer price policy which is documented according to the regulations. The invoices issued by the branch

office must include all the obligatory notes according to French law. In addition, the opening of a local bank account is recommended.

What should one have done differently from the beginning?

The above story clearly indicates that before the start of any activity in France, there should be a cautious and organised procedure with an analysis made by a tax specialist in order to determine whether the foreign company is acting in the context of a liaison office without being a legal or tax entity or in the form of a branch office. This examination enables – along with your safety aspects regarding the German and local administrative authorities – the anticipation of obligations and regulations which will have to be observed after the activity commences. If the hypothesis of a liaison office is rejected, then indeed the tax system and the maintenance of financial accounting according to the French system of accounts will become obligatory for the foreign company.

Even when more and more companies opt to carry out the financial accounting in their offices in Germany, it is quite common for our clients to entrust us with the execution of parallel financial accounting to enable complete compliance with the local regulations. In January 2014, new regulations came into force defining the content and format of computer files used in electronically generated financial accounting required for audits. This represents a sound argument for the parallel option.

Law

Background facts:

For a number of years now the Mannschaftsgeist company has had to deal with repeated, serious economic difficulties which have forced it for operational reasons to consider the cancellation of an employment contract of an employee. In order to prevent such a measure French labour law obliges the employer to offer the employee a different job if possible in one of the companies of the group before the decision to cancel the employment contract is made (in France or outside France).

In practice the employer has to offer the respective employee a free position in the same category in his position or possibly a position from a lower category provided that such positions which exist in the company group are available. To the extent that this is not the case with the Mannschaftsgeist company and the impossibility of offering a different position can be justified, the company decides to lay off the employee and to invite him to the preliminary meeting prescribed by law to announce the decision. According to the regulations, in the course of the meeting the employee is handed documents about the possibility of concluding a so-called "contrat de sécurisation professionnelle" contract for unemployment insurance benefits (see "CSP" below). The employee is entitled to accept the CSP within a period of 21 days.

After observance of the statutory period of notice of 15 days, the company sends the notice of termination of the employment contract by registered letter with acknowledgement of receipt and advises the employee of the commercial grounds for the dismissal. Too late! In the meantime the employee had accepted the CSP. In this respect the notice of termination is deemed to be illegal because the notification of the grounds was not made in time.

What can be done now?

If notice of termination is deemed to be illegal because it was made due to a late statement of grounds and ultimately without an "effective and serious reason", the employee is entitled to compensation which he can claim before court. French labour law proceedings are made in two steps. The first step consists of arbitration. In order to reach agreement outside court, the parties have the possibility of concluding a so-called "transaction" (settlement contract). This avoids legal proceedings and saves time.

What should one have done differently from the beginning?

Even when the employee accepts the CSP and as a result notice of termination is not given, the employer is not released from his obligation to communicate the grounds for the dismissal in writing. The notification must be delivered before the CSP is accepted. But in practice it is impossible for the employer to foresee the point in time when the employee will give his opinion on the subject of the CSP. As he can declare his acceptance before the employer sends the notice of termination, the employer must communicate the grounds for the dismissal as soon as possible. The presentation of the commercial reasons in a written document to be given to the employee during the course of the preliminary meeting regarding termination of the employment at the same time as the documents regarding the CSP option appears to be the most secure method to pass on the grounds for dismissal.