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FRENCH TAX AUTHORITIES OPINE ON WITHHOLDING TAX TREATMENT OF MANUFACTURED DIVIDENDS

On 15 February 2023, the French tax authorities issued two public rulings relating to the withholding tax treatment of manufactured dividends paid by French banks to non-residents. The interpretation retained by the French tax authorities in these tax rulings considerably extends the scope of French dividend withholding tax rules to encompass manufactured dividend payments made notably under temporary acquisitions of French equities and derivatives transactions with an underlying in French equities.

Key issues

- The French tax authorities issued two tax rulings on the withholding tax treatment of manufactured dividends paid by banks to non-residents.
- The two tax rulings cover dividend equivalent payments made under temporary acquisitions of French equities and delta-one derivatives transactions with an underlying in French equities.
- The interpretation retained by the French tax authorities significantly extends the legal scope of French dividend withholding tax rules.
- Such rulings raise considerable uncertainty with respect to their exact scope, as well as their legal grounds.

BACKGROUND

Under French domestic rules (Articles 119 bis, 2 and 187 of the French tax code) and subject to the provisions of applicable double tax treaties, French-source dividends are generally subject to a withholding tax levied at a rate equal to that of the French corporate income tax (25%) when distributed out to non-individuals that are not tax residents of France. An increased 75% rate applies in the situation where the French-source dividends are paid to certain non-cooperative jurisdictions defined under Article 238-0 A of the French tax code.

As from 1 July 2019 a specific anti-abuse rule against dividend arbitrage transactions (in substance the so-called "internal Cum/Cum" arrangements) was introduced under Article 119 bis A of the French tax code resulting in manufactured dividend payments made to any person not resident or established in France by any person resident or established in France under stock lending arrangements (and certain assimilated transactions) being assimilated to dividend payments and being subject to the aforementioned French dividend withholding tax when the temporary transfer of securities is in place for less than 45 days (including the dividend date). Such dividend withholding tax under Article 119 bis A of the French tax code may be refunded if it is evidenced that the transaction had not as principal purpose and effect to avoid the French withholding tax on the underlying dividends or obtain a tax advantage.

Until the introduction of this specific anti-abuse rule targeting dividend arbitrage transactions and subject to general anti-avoidance rules and to the exception of certain qualified repos, neither French tax law, nor case law or

the official guidelines published by the French tax authorities provided for any specific legal ground enabling to consider that French-source manufactured dividend payments as having the same legal qualification as dividend payments made on the underlying securities and therefore triggering an obligation to pay French withholding tax.

Following recent media attention in France and general public debate on whether enforcement targeting "Cum/Cum" and "Cum/Ex" arrangements was effective, several proposals had been submitted to French Parliament within the context of recent parliamentary debates to extend the scope of the specific anti-abuse rule under Article 119 bis A of the French tax code to all derivatives transactions where the underlying would be French equities. Such proposals had been rejected with the support of the French Government.

The two rulings are published within a wider context of scrutiny from the French tax authorities on the involvement of financial institutions with dividend arbitrage.

FIRST RULING (BOI-RES-RPPM-000122)

Under the first ruling published under reference BOI-RES-RPPM-000122, the French tax authorities were requested to opine on whether the French dividend withholding tax under Article 119 bis, 2 of the French tax code should be levied by a bank on payments made to non-residents other than payments related to dividends attached to French equities.

The French tax authorities take the position that the French dividend withholding tax applicable under French domestic rules does not solely apply to situations where a bank pays actual dividends attached to French equities and can also notably apply to situations where the bank passes-on "dividend equivalent" payments to a non-resident in cases where the actual dividend has not been paid directly to the bank.

A "dividend equivalent" payment (or manufactured dividend) is defined in the tax ruling in very general terms as any transfer of value that is subordinated or determined, explicitly or implicitly, by reference to a dividend.

The position taken by the French tax authorities appears to be based on the fact that the non-resident, recipient of the dividend equivalent payment, is the beneficial owner of the underlying dividend distribution.

The tax ruling references as an example master securities lending agreements by noting that such agreements generally provide that the lender shall be entitled to receive from the borrower such sum of money or property equivalent to the type and amount of such income, net of any deduction or withholding for or on account of any tax, that would have been received by the lender in respect of the loaned securities assuming such securities were not loaned to the borrower and were retained by the lender on the given income record date.

SECOND RULING (BOI-RES-RPPM-000123)

Under the second ruling published under reference BOI-RES-RPPM-000123, the French tax authorities were requested to opine on whether banks should levy the French dividend withholding tax under Article 119 bis, 2 of the French tax code on temporary transfers of French equities and certain derivatives transactions performed with non-resident taxpayers.

The French tax authorities examine in this second ruling a list of ten different transactions, noting as in the first ruling, that within the context of such

transactions, a "dividend equivalent" payment (or manufactured dividend) is defined as any transfer of value that is subordinated or determined, explicitly or implicitly, by reference to a dividend.

Temporary acquisitions of French equities

In relation to temporary transfers of French equities involving non-residents, the French tax authorities first opine on intermediation transactions performed by banks and resulting in them receiving, as an intermediary, a dividend equivalent payment from a third party, such payment being passed-on to a non-resident for the same amount. The French tax authorities state that these transactions are neutral for the bank's result and are not aimed at avoiding French withholding tax. On this basis, the French tax authorities confirm that these transactions (and more specifically the payment by the bank to the non-resident) do not give rise to French dividend withholding tax provided that the bank demonstrates that the following cumulative conditions are fulfilled:

- The third-party borrower of the French equities is not a related party to the bank, i.e., does not have any personal, financial or economical link to the bank;
- The transaction does not involve any benefit for the bank (or for any related party to the bank) through other transactions entered into with the third-party borrower or the non-resident recipient of the payment (or their respective related parties).

In contrast, the French tax authorities take the position that payments made by the banks within the context of temporary acquisitions of French equities from non-residents and which are related to transactions aiming at hedging short selling positions, scrip dividend arbitrage transactions or even inventory building, may give rise to French dividend withholding tax even in situations where the lender or seller of the French equities does not necessarily, or at least not exclusively, seek a tax benefit.

Derivatives transactions with non-residents

In relation to derivatives transactions with non-residents involving underlying French equities, the French tax authorities make a distinction between (1) non-delta-one transactions which are generally not subject to French dividend withholding tax (unless the relevant transaction is part of a series of transactions whose overall effect results in a delta-one situation), and (2) delta-one transactions which may give rise to French dividend withholding tax where there is a dividend equivalent payment, such as transactions hedged through the acquisition of French equities, total return swaps or ex-dividend delta-one transactions involving dividend risk for the bank.

It is recalled that delta-one products are financial derivatives that have no optionality and as such have a delta of (or very close to) one, meaning that for a given instantaneous move in the price of the underlying asset there is expected to be an identical move in the price of the derivative. The French tax authorities qualify as "delta one", financial derivatives which have a delta equal or close to one.

OUTLOOK

The tax rulings published by the French tax authorities and the generality of their terms (often unbeknownst even to a French tax practitioner) raise a considerable amount of questions in relation to both their scope and their legal grounds.

Whereas the French tax authorities seem to have taken their position by referencing transactions entered into by banking institutions, one could first question whether these tax rulings should be construed as a general position of the French tax authorities on the treatment in an international context of payments within the context of temporary acquisitions of French equities or derivatives with an underlying in French equities.

In relation to their legal grounds, the position taken by the French tax authorities considerably extends the scope of French dividend withholding tax to "dividend equivalent" payments which (subject to certain exceptions) are not currently legally assimilated to dividend distributions or deemed distributions. Whether or not such extensive interpretation of the provisions of the French tax code is lawful could therefore in itself be debated.

The tax rulings being an official interpretation of French tax laws (as opposed to a new legislation which would generally not be retroactive), the French tax authorities present this (novel) interpretation as the rightful interpretation of the provisions of the French tax code – which therefore carries a significant element of tax risk for historical periods in a context where the position taken by the French tax authorities was not the generally accepted interpretation taken in the market.

Moving forward, this interpretation implies additional tax compliance and monitoring to ensure withholding and relevant reporting to the French tax authorities is made when due.

Notwithstanding the questions raised by such rulings and whether this interpretation will effectively be upheld by French tax courts, these rulings illustrate the continuous concern and increased scrutiny from the French tax authorities around French withholding tax avoidance through stock lending arrangements or other temporary transfers of French equities and equity derivatives, and an open invitation for persons involved in the trading of instruments involving French equities to carrefuly consider their position.

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