

France

Taxation

HEDGE FUNDS 2009

Hedge fund managers/advisors

Taxation

Tax rates applying to hedge fund managers/advisors

If the management of a hedge fund is carried out through a corporate structure rather than as individuals, the manager will be subject to the usual French corporate tax rate of 33.33 percent on its taxable profits. In addition to corporate tax, companies with turnover exceeding EUR 7,630,000 and which are subject to corporate tax higher than EUR 763,000, are liable for an additional contribution of 3.3 percent of the corporate tax. As a consequence, the aggregate corporate tax rate applicable to hedge fund managers/advisors may be 34.43 percent.

The effective tax rate usually suffered by hedge fund managers/advisors

If the hedge fund manager/advisor is a corporation, the effective tax rate usually suffered would be 34.43 percent.

Tax concessions, allowances, or exemptions specifically available to hedge fund managers/advisors

There are no concessions, allowances or exemptions that are specifically available to French hedge funds managers/advisors.

Details of anti-avoidance tax rules that could bring the profits of an offshore hedge fund into tax

If a hedge fund manager does not hold a substantial participation in the fund's units, French anti-avoidance tax rules should not apply to the profits of an offshore hedge fund where the hedge fund manager/advisor is established in France and merely carries out an activity of management of the fund.

Requirements to charge VAT (or equivalent sales tax) and the rate

From a French VAT viewpoint, hedge funds management companies are taxable in the same way as the French asset managers.

Fees and commissions for the issuance and placement of a hedge fund's units are VAT-exempt with no possibility to elect for VAT. Management fees and commissions paid to the managers of hedge funds are also VAT-exempt, but can be subject to VAT upon election. This election covers a five-year period and is renewable by tacit agreement for an additional five-year period.

Due to their VAT-exemption, hedge fund managers cannot recover input VAT, except where they elect for VAT on financial products.

Hedge fund structures

Taxation

Tax rates applying to the fund

French law does not provide for a definition of hedge funds. As a consequence, no legal form exists specifically for these funds. In most of the cases, they are constituted as Organisme de Placement Collectif en Valeurs Immobilières (OPCVM) under one the following forms:

- Fonds Communs de Placements (FCP): an FCP is a co-ownership entity without legal personality.

In addition to the usual and common FCP, specific kinds of FCPs exist under French law. They have the same tax regime as ordinary FCPs. These specific FCPs are Fonds Communs d'Intervention sur les Marchés à Terme (FCIMT) which invest in futures markets and FCP à règles d'investissement allégées (ARIA) which are funds with fewer regulatory restrictions. Both of these kinds of FCPs are restricted to qualified investors.

- Sociétés d'Investissement à Capital Variable (SICAV): a SICAV is a corporate structure.

Specific kinds of SICAVs also exist under French law and have the same tax regime as ordinary SICAVs. They are ARIA and contractual SICAVs. Both of these kinds of SICAVs are restricted to qualified investors.

The tax regime applicable to hedge funds varies, depending on their form.

An FCP, because it is a co-ownership entity without legal personality, is considered, for tax purpose, as a transparent entity and is not liable to tax itself. Each unit holder is deemed to receive directly the FCP income.

A SICAV is exempt from corporate tax on its portfolio income whatever the origin, that is, fixed income instruments, such as bonds and negotiable notes or variable income instruments, such as dividends.

Access to double tax treaties

- In principle, a hedge fund constituted as an FCP is not entitled to the benefits of French double tax treaties. However, in some cases its unitholders may be entitled to claim such benefits under their own relevant double tax treaties in view of the transparency of the FCP.

Under certain circumstances and specific tax treaties, a hedge fund constituted as an FCP can be entitled to the benefit of these specific double tax treaties.

- A hedge fund constituted as a SICAV may be entitled to the French double tax treaties depending on the wording of the relevant tax treaty.

Value-added tax registration and charging requirements

Under French law, hedge funds constituted as FCPs or SICAVs are outside the scope of French VAT. Consequently, they are not required to register for VAT and cannot charge VAT nor recover suffered VAT.

Withholding tax on dividends or interest payments

As regards withholding tax requirements, the situation of hedge funds depends on their form (that is, FCPs or SICAVs).

FCPs

Distributions of overseas sourced revenues by a French FCP to a non-French resident unitholder are not, in principle, liable to French withholding tax since the FCP is considered as a transparent entity.

Distributions of French source income by an FCP to non-French residents unitholders are subject to a French withholding tax, according to the nature of the financial product distributed (such as, dividends and interest), and subject to relief under double tax treaties.

Capital gains realized by non-resident unitholders are withholding tax exempt on the sale of their units in the FCP.

SICAVs

Income (whether French source or not) derived from SICAVs and paid to foreign tax resident beneficiaries, are in principle subject to a 25 percent withholding tax, subject to relief under double tax treaties.

It may also be possible to have tax paid in the source state (that is, in the foreign third country in which the French resident hedge fund invested in underlying assets) credited against the French withholding tax so as to reduce the French withholding tax. This is dependent on the terms of the double tax treaties.

A non-resident unitholder in a SICAV is not liable to capital gains tax in France on the disposal of his units unless he has held more than 25 percent of the shares in the SICAV in the previous five years.

Tax return requirements

FCPs and SICAVs are not liable for French corporate tax. Accordingly, hedge funds constituted as FCPs and SICAVs do not have to file income tax returns to the French Tax Authorities (FTA).

However, FCPs and SICAVs are liable for tax returns as regards income they distribute to their unitholders. In this respect, the situation of FCPs and SICAVs is different.

Managers of hedge funds constituted as FCPs have to file to the FTA a form 2561 as regards all operations carried out by the fund during the calendar year.

Moreover, managers of such hedge funds have also to provide the FTA, within 30 days of the payment of income to unitholders, with information regarding the total amount of revenues paid, as well as the payment date of these revenues.

Hedge funds constituted as SICAVs have also to provide the FTA with the above-mentioned information. However, due to the fact that they distribute only dividends to their shareholders, the reporting obligations are limited to this category of income.

Investors

Taxation

Under French law, no distinction is made between open ended and close ended corporate structures, or between open ended and close ended Unit trusts.

French CFC rules (detailed below) provide for the taxation of individuals on profits realized by foreign funds where they hold at least 10 percent of the fund's units. These rules apply would the hedge fund be a partnership, a corporate or a trust. As a consequence, because of these rules, the type of entity individuals would prefer to invest in depends on each particular case.

French resident companies are subject to similar CFC rules (detailed below). These rules apply where these companies hold at least 50 percent (5 percent in certain cases detailed below) of the hedge fund units.

Moreover, French resident corporate structures are taxed each fiscal year, on the difference between the market value of the hedge fund's units they hold at the end of the fiscal year, and their value at the opening of the fiscal year, or at their acquisition date in the case units have been acquired during the fiscal year.

Consequently, the type of entity French resident companies would prefer to invest in depends on each particular case.

Specific anti-avoidance tax legislation applying to an investor in an onshore fund

There is no anti-avoidance tax legislation in France, applying to French resident investors where the hedge fund is located in France.

However, there is a specific provision regarding FCPs. Where individuals hold more than 10 percent of the units of the FCP, all the unitholders are taxed on the income or revenue received, as well as on capital gains realized by the FCP, even though no distribution occurs, nor any resale of the units.

Specific anti-avoidance tax legislation applying to an investor in an offshore fund

French law provides for different CFC rules depending on the quality of investors (that is, companies or individuals).

These rules provide for the taxation of companies on the profits realized by foreign entities (including all types of funds) subject to a favorable tax regime in which they hold, directly or indirectly (that is, through a chain of participations in the case of interposed companies) at least 50 percent of the shares/units. This holding rate is reduced to 5 percent where the French resident company, along with other group companies, holds more than 50 percent of the foreign entity.

As regards individuals, these rules provide for the taxation of individuals on the profits realized by foreign entities (including funds) subject to a favorable tax regime in which they hold, directly, or indirectly (that is, through a chain of participations in the case of interposed companies, or with their families) at least 10 percent of the shares/units.

Tax information needs of investors

A French tax resident should only require details of distributions, acquisitions, and disposals in respect of the offshore fund. Details are not normally required

for tax purposes in relation to the income, gains, loss, etc. within the offshore fund.

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.