Proskauer

Opinion Leaders

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Editorial – by Estelle Piazza

New obligations in relation to money-laundering prevention

Anti-money laundering (AML) obligations were subject to radical reform following France's transposition of directive 2005/60 of 26 October, 2005.

The system is based, as previously, on an obligation of vigilance and obligations to inform the financial information unit (Tracfin).

The content and scope of these obligations was defined by order n° 2009-104 of 30 January 2009 and associated implementing legislation.

Firstly, in terms of **vigilance**, the new provisions introduce various degrees to which this obligation must be applied. Starting from the basis of a constant and standard obligation of vigilance, this new approach involves applying a simplified obligation of vigilance if the risk of money-laundering and funding of terrorism is low and stronger obligations of vigilance when the risk is higher.

The obligation of vigilance may now be implemented by a third party under certain conditions. This possibility was introduced to avoid the administrative burden of repeated identification and information gathering procedures concerning business relationships. For example, a portfolio management company can draw on due diligence work already carried out by another financial institution in France.

The **declaration** obligation was also significantly amended. Previously, the declaration obligation only covered certain misdemeanours specified in a restricted list (drug trafficking, organized crime, funding of terrorism, etc.). The scope of the declaration now extends to sums or transactions which the financial institutions subject to the declaration obligation know, suspect or have good reason to suspect may originate from any misdemeanour liable to a prison sentence of more than a year or which could contribute to financing terrorist activities, including tax fraud. It should be noted that the declaration concerning tax fraud was defined according to 16 criteria in order to avoid too many declarations to Tracfin.

As well as the declaration obligation based on the financial institution’s judgment, there is an automatic declaration system based on objective criteria defined by legislation.

The new regulations should result in institutions which are subject to AML obligations updating and reinforcing their money-laundering and funding of terrorism risk prevention systems.

This system also includes regular training** being given to staff in order to raise awareness of obligations of vigilance.

** ***See page 7***

Tax News

Reduction to FCPR, FCPI and FIP investment deadlines: publication of a tax ruling

A ruling expected at the end of this month is due to set out the conditions for applying a reduction to investment deadlines for FCPIs and "income tax" FIPs and FCPRs, FCPIs and "wealth tax" FIPs. According to our information, the tax authorities are planning to draw a distinction between Funds formed before the date this law was passed and those formed after that date.

For the former, it will distinguish between those whose subscription period was open on 30 December 2009 (which will have 16 months to reach their investment quotas and eight months to reach half the quota, whatever the length of their subscription period) and those whose subscription period was closed on that date, which will have 24 months to achieve their ratios.

It is vital that the ruling stipulates the investment quotas affected by the reduction in deadlines. The investment quotas of 60% of FCPIs and “income tax” FIPs are undoubtedly affected. The same goes for "wealth tax" Funds, with quotas of 20% or 40% and the investment quota for eligible SMEs featuring in the regulations. These quotas are explicitly set out in law. We believe that the investment sub-quotas of 6% and 10% of FCPIs and “income tax” FIPs are also certain to be affected. But what about the quota referred to in article 163 quinquies B of the CGI (French Tax Code) applicable to tax FCPIs and FIPs?

Wealth tax holding companies: instruction commenting on the Adnot amendment is published

Tax instruction 7 S-2-10 of 29 December 2009 stipulated in particular that the limit of 50 shareholders "*does not in itself preclude the formation, by the same operator, of several holding companies each limited to 50 partners or shareholders. However, when this is the case, each holding company may only legitimately allocate funds raised from subscribers to the capital of separate recipient companies*.”

Wealth tax: exemption of shares in FCPRs and holding companies

Article 885 I ter exempts all shares in companies, holding companies and "wealth tax" funds from wealth tax, capped at a certain percentage for the latter two. However, the decree setting out the declaration obligations which apply to taxpayers, holding companies and fund managers has still not been published. Neither has the tax instruction commenting on this system.

Carried Interest: instruction publication

Instruction 5 C-1-10 of 12 January 2010 stipulates that to benefit from the tax regime for capital gains on securities:

- the statutes (or regulations) for European venture capital companies (SA, LP, etc) must indicate very clearly that their purpose is to invest in non-listed companies under similar conditions to FCPRs and SCRs,
- units of carried interest acquired (rather than subscribed) must be acquired at a price equal to at least their latest market value or, if it is higher, their subscription value,
- beneficiaries may also own units or ordinary shares for which they benefit from exemption on distributions and capital gains,
- all units of carried interest, whether owned by individuals or legal entities, must represent a minimum investment rate met at the end of each subscription period. If the units of carried interest are paid up gradually they must be paid up at the same rate as ordinary shares,
- the five-year distribution ban applicable from the date the Fund is formed or shares are issued only applies to individuals likely to benefit from this regime.

Finally, the instruction prohibits shares in active holding companies or acquiring holding companies from entitlement to the favourable carried-interest tax regime.

Amended 2010 Finance Bill

The Bill creates a 50% tax, assessed on the variable portion of remuneration allocated by credit institutions and investment companies in 2009, "*to their employees who are financial market professionals and whose market activities have a significant impact on the company's risk exposure, as well as the market professionals under whose control these employees operate*." This tax is payable by credit institutions and investment companies.

Although the Bill targets investment companies and therefore portfolio management companies, the Government has stipulated that the latter are excluded. However, credit institutions and investment companies other than management companies will in principle have to pay this tax.

Furthermore, several amendments were debated during its reading in the Senate:

- an amendment by Senator Adnot aiming to extend the reduction in income tax for FCPIs and FIPs to 31 December 2013. This was rejected.
- another amendment by Senator Adnot aiming to extend the scope of those benefiting from the French National Research Agency to innovation financial companies, whose investment conditions (innovation financial companies' profile ratio, investment rate and periodic portfolio renewal) and capital approval will be modernized according to conditions set out by decree. This was also withdrawn.
- an amendment by the socialist party aiming to submit credit institutions to an additional tax of 10% as part of corporation tax for 2010. This was rejected.
- an amendment by the same party aiming to challenge the capital-gains exemption regime for SCR and FCPR securities, benefitting legal entities subject to corporation tax. This aimed to increase the tax rate for capital gains achieved from the sale of FCPR or SCR shares and sums distributed by FCPRs and SCRs from 0% to 8% from 1 January, 2010. Furthermore, to benefit from this rate, the amendment required FCPRs and SCRs to have retained the securities for at least five years, instead of two. This was rejected.
- an amendment aiming to redirect the benefit of the research tax credit to SMEs, as defined by EU law and less than 25% of whose capital or voting rights are owned by a company or several companies that do not meet these conditions. This was rejected.

Capital gains from sales: the National Assembly's Finance Commission Chairman Didier Migaud wants a debate

The regime of exemption of capital gains from sales which companies have enjoyed since 2007 is the subject of scrutiny and criticism by the National Assembly's Finance Commission Chairman, Didier Migaud. He wants to know who benefits and to check whether there is any real advantage to the measure in France.

New value-added contribution comes into force

The value-added contribution which has replaced the minimum professional tax contribution has come into force. The tax authorities are due to publish an instruction commenting on this reform.

Legal News

Wealth tax holding companies: AMF clarifies conditions for marketing them

Despite the ban on new wealth-tax holding companies having more than 50 shareholders, several of them are planning public offers. It is for their benefit in particular that the AMF has recently restated its position*. Firstly, in relation to the procedure for increasing share capital, the AMF recommends issuing share options rather than shares, provided that exercising the share options is optional and not related to when they are subscribed. Secondly, the AMF wants the information provided to potential investors to be improved in various respects (principal risks, investment policy, expenses, etc.). It also requires that the subscription period closes by 5 June at the latest so as to be able to inform investors in the event the project is abandoned. Finally, the AMF reiterates that marketing shares (or share options, as applicable) must be carried out by investment services providers certified for non-guaranteed investment.

* *In a document entitled: "Offre au public de titres financiers à vocation principale de déductibilité fiscale soumise au visa de l'AMF" ["Public offer of financial securities whose main purpose is tax deductibility subject to approval by the AMF"], 22/01/2010*

New European Commission

The new 27-member European Commission has met for the first time. Michel Barnier is the new internal market and financial services commissioner.
This puts him in charge of the project relating to the draft AIFM Directive, which has again been criticized by the City and the House of Lords.

IGS report on costs charged for Holding companies and "Wealth-tax" funds

This report of more than 200 pages was commissioned by Minister Christine Lagarde and carried out by the French General Finance Inspectorate. It was completed in October but has only just been made public. Its conclusions, which were widely reported in the press, point the finger at a number of practices:

- A high level of costs, estimated at an average of 5.5%, for funds,

- excessive distribution costs due to annual retrocessions "*which are not justified either economically nor legally*" and which represent around 35% of total costs,
- annual retrocessions paid to distributors "*without any return for the investor in terms of advice*".

The report concludes by suggesting a "*ban on annual retrocessions to distributors for these products. Although this ban is the result of application of existing laws* [the report states that the retrocessions do not fulfil the condition of improving services provided to the client as set out in legislation governing the practice of retrocessions] *a provision in the monetary and financial code stipulating a ban on this practice for FIPs, FCPIs, tax FCPRs and SME wealth-tax holding companies would make it possible both to define the scope of the ban and avoid the pitfall of penalties for practices previously tolerated by the regulator*."

The report's conclusions are likely to be used as the main inspiration for the bill setting the framework for distribution and investment costs which is now being drafted.

In brief

Creation of Insurance and Banking Supervisory Authority

The Insurance and Banking Supervisory Authorityis a new body, created from the merger of the Credit Institutions and Investment Companies Committee (CECEI), the Banking Commission, the Supervisory Authority for the Insurance industry and Mutual associations (ACAM) and the Insurance Companies Committee. It is particularly responsible for approving and supervising investment services providers (credit institutions and investment companies), except for portfolio management companies which continue to be covered by the AMF.

Decree no 2010-40 of 11 January 2010 relating to agreements between producers and distributors over marketing of financial instruments and life insurance products

The aim of this decree is to better define the responsibilities of producers and distributors; the former being responsible for transmitting the information required to understand the financial instrument and the latter being required to submit all draft marketing documents to the producer.

Instructions:

- 5 C-3-10 n° 18 of 9 February 2010: **Gains from the sale of securities and pension entitlements by individuals - Updating of the annual taxation limit ("handover threshold")** - Handover threshold applicable to income tax for 2010.
- 5 F-6-10 n° 17 of 8 February 2010: Income tax. Income from employment. Professional costs. Option of real and justified costs regime. **Deductibility of interest on borrowing by employees to acquire securities in their company** . Article 37 of the 2008 Amended Finance Act no. 2008-1143 of 30 December 2008.
- 4 A-1-10 no. 15 of 2 February 2010: **Tax credit for executive production costs in relation to cinematographic and audiovisual works incurred by companies registered outside France.**
- 4 H-5-10 no. 15 of 2 February 2010: Corporation tax – Special provisions – Tax treatment of groups of companies - Determination of overall result – Amendments to make by the parent company in order to ensure the neutrality of certain operations between group companies - **Reintegration of directors' fees and profit shares paid by group subsidiary companies.**
- 5 A-1-10 no. 15 of 2 February 2010: Clauses common to direct taxes. Various declarations. **Declarations of securities transactions.**
- 4 H-3-10 no. 14 of 1 February 2010: Corporation tax - Special provisions – Scope of corporation tax - Exoneration and special regimes – **Public real-estate investment companies.**
- 4 H-4-10 no. 13 of 29 January 2010: Corporation tax - Special provisions - **Offset of losses made by subsidiaries of French SMEs located outside France.**
- 4 C-1-10 no. 11 of 25 January 2010: Costs and expenditure (Industrial and commercial profits, corporate income tax, Common provisions). Interest on third-party equity - **Conditions and limits for deduction of interest on advances granted by shareholders over and above their shareholding** - Maximum rates of interest deductible for tax purposes.
- 4 H-1-10 no. 7 of 14 January 2010: Corporation tax. Special provisions. Tax treatment of groups of companies. **Transfer of losses in the event of collective**

proceedings.

- 5 B-3-10 no. 7 of 14 January 2010: Income tax - **Tax reduction for cash shares in non-listed small and medium-sized companies (SMEs) ("Madelin" tax reduction).** Increase in tax reduction ceilings for subscriptions to share capital in SMEs during start-up, launch or expansion. Extension of the "Madelin" tax reduction until 2012. Comments in article 86 of the 2008 Amended Finance Act (act no 2008-1443 of 30 December 2008) and article 88 of the 2010 Finance Act (act no.2009-1673 of 30 December 2009).

Upcoming conferences and latest publications

Events

Training courses in new money-laundering obligations are available from PROSKAUER. For more information, contact Kathleen Maurand, by e-mail : kathleen.maurand@proskauer.com or by phone 01.53.05.60.00

- 11 March : Seminar organized by AGF Private Equity on : Holding ISF 2010, comment faire ? - Hôtel Meurice - 8.30 - 10.00. Speakers include Daniel Schmidt, Partner at Proskauer.
- 15 Mach : Breakfast Seminar "Matinée Débat LJA : Les contentieux liés aux risques psychosociaux : comment les gérer et les prévenir ?" (disputes related to psychosocial risks : how to prevent and manage them?) - Hôtel de Crillon - in partnership with Lamy and la LJA - 9.00 - 11.30 Speakers include Yasmine Tarasewicz, Partner at Proskauer.
- 18 Mars : Labor Monthly Breakfast Seminar "Club RH" - Paris office - in partnership with AEF - 8.30 - 10.30. Speakers include Béatrice Pola, Partner at Proskauer.
- 25 March : Breakfast Seminar on : "La rupture des relations commerciales : les grandes tendances de la jurisprudence" (Breach of commercial relations : legal update)- Paris office - in partnership with the European American Chamber of Commerce - 8.30-10.00. Speakers include Mireille Dany, Valérie Lafarge-Sarkozy, Partners at Proskauer and Nicolas Faguer, Associate, Proskauer.
- 30 March : Convention Finaréa "Entreprendre Ensemble en 2010" "Entrepreneurship in 2010" - Maison Champs Elysées - 8.30 - 18.00 Speakers include Daniel Schmidt, Partner at Proskauer, who will speak on « Vers un nouveau rôle pour les Conseils en Gestion de Patrimoine » (a new role for the Conseil en Gestion du Patrimoine).

- 4 May : Seminar organized by the CNCEF on "Du particulier à l’entreprise : lecapital investissement ", at the Press Club de France - Speakers include Daniel Schmidt and Florence Moulin, Avocats Proskauer.

Publications

"***Les Fonds de Capital Investissement, Principes Juridiques et Fiscaux*****",** *2nd edition,* Daniel Schmidt and Florence Moulin (Proskauer), Preface by Mr Hervé Novelli, Published by Gualino. Currently on sale from the AFIC.