

## French Senate Amends the Tax Regime for “Carried Interest”

During the debates on the Finance Bill for 2009, the French Senate voted on 24 November 2008 for an amendment concerning the tax regime applicable to “*carried interest*” received by French resident managers.

In short, the new law:

- extends the favourable regime to carried interest received from foreign funds; and
- provides for new restrictive conditions to benefit from such regime.

### The Current Rules

As a reminder, the current tax rules applicable to carried interest are described in Administrative Guidelines published by the French Tax Authorities on 28 March 2002.

According to these Guidelines, under certain conditions, French resident managers receiving carried interest from French fund structures for the private equity market (“*Fonds communs de placement à risques*” or FCPR) or from venture capital companies (“*Sociétés de capital risque*” or SCR) benefit from the treatment as capital gain of the income they receive. While employment income is subject to French progressive income tax rates up to approximately 40% and require 23% of social security contributions for the employee and 40–45% for the employer, capital gain taxation rate amounts to 30.1% (18% income tax, plus 12.1% of social security contributions).

Under the current rules, carry received by French resident managers from foreign partnerships cannot benefit from the French special regime.

### The New Rules

The amendment voted by the Senate:

- extends this regime to carry received from a foreign investment entity (this has previously been interpreted as a fund organized in the form of a partnership); and
- provides for additional conditions to benefit from the favourable tax regime of capital gains received from a FCPR, SCR, or from a foreign partnership.

These new conditions can be summarized as follows:

- the interest or shares must have been acquired at an arm's length price;
- the managers' investment must represent at least 1% of the total amount of the subscriptions in the fund; (the threshold may be lowered by future application decree after prior opinion from the French Financial Authority (“AMF”), which could concern certain specific funds, such as “FCPI” and “FIP”, given the specific nature of their investments);
- the carried interest must be paid at least five years after the date of the constitution of the fund or the issuance of the parts of carried interest.

These new provisions would apply to carried interest deriving from funds created as FCPRs or SCRs as from the publication of the future application decree, and no later than June 30, 2009, as well as to carried interest deriving from a share/interest in a foreign entity issued as from the same date. Existing French “FCPR” funds would not be subject to the new conditions (though SCRs would), even for newly issued interest after this date.

Please note that, in the case of foreign partnerships, these new provisions are applicable only to the holders of a direct interest in the foreign partnership. However, in practice, French managers of foreign funds are frequently employed by a local management company that supplies services to the partnership, and not by the partnership itself. As a result, there is a difference of tax treatment between the French managers of FCPRs and SCRs (who are employed and paid directly by the FCPR or the SCR) and the persons working for foreign investment structures, which often employ them and pay their carry through management companies.

Finally, the investments of managers in a holding company under a LBO structure are not covered by the amendment as currently draft.

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