WOODS HUSTON
TAX

ANNÉE BLANCHE AND PRÉLÈVEMENT À LA SOURCE: HOW DOES IT AFFECT ME ?

Below is a summary of important changes to the French tax system that are scheduled to come into effect on January 1, 2019.

French tax law changes starting January 2019

As of January 1, 2019, France is switching to a payroll withholding system called "Prélèvement à la Source". This means that if you are a salaried employee, your employer is required to start withholding income tax in addition to the social tax (approximately 23%) that is already withheld. If you are a self employed individual you will be required to pay monthly or quarterly tax installments to the government.

If you receive retirement income from a French pension (whether it is private or government), you will also have income tax withheld directly. Rental income will also be subject to quarterly payments for income tax purposes - similar to a self employed individual.

Changes to 2018 Tax Year Filing

You will still be required to file a tax return for income earned in 2018 in May/June 2019. However, depending on your personal situation you may not owe any income tax due to the *Crédit d'impôt de Modernisation du Recouvrement (CIMR)* that you may receive for 2018 revenues.

In the current system an individual is always a year behind in paying their income tax. In the case of revenues earned in 2017, you would pay the income tax on this in 2018 regardless if you are on the monthly or trimester payment scheme. In theory, if this were to continue for the 2018 tax year you would pay tax on 2018 revenues in 2019 and in addition to this, your employer will also be withholding income tax on all 2019 revenues from January 2019 ongoing. Therefore, individuals would have to pay twice in the same calendar year for two separate tax years.

This is where the *CIMR* credit comes into effect. The French government will reduce an individual's income tax on their 2018 revenue by granting a credit to the extent your *non-exceptional revenue* for the 2018 tax year does not exceed the highest one in the three previous years (2017, 2016, 2015). Please see the following pages for what revenue is considered exceptional revenue that will not be eligible for the CIMR.

Let's look at an example to demonstrate how this would work:

Sarah earned a net salary of €120,000 in 2018. Sarah is single with no dependents. Her income in 2017, 2016 and 2015 was €110,000, €100,000 and €90,000 respectively.

Her tax normally on €120,000 would be approximately €30,000 but due to the *CIMR* credit this amount will be reduced by the prorata share of the highest income in the years 2015, 2016 or 2017. In this case it is €110,000 from 2017.

Therefore, Sarah will receive a CIMR credit of €27,500 (€110,000 / €120,000 x €30,000) on her tax return reducing her income tax liability on 2018 revenues to €2,500 (€30,000 – credit of €27,500). This €2,500 is the amount that Sarah will have to pay in 2019 on her 2018 revenue, in addition to the amount being paid on an ongoing basis on the 2019 income using the new prélèvement à la source methods above.

If we change the scenario slightly and say Sarah earned €110,000 in 2018 and €120,000 in 2017 the *CIMR* would reduce her income tax liability to €0 but not more than that. The *CIMR* is a **non-refundable** tax credit meaning that it can lower your additional 2018 income tax payable to €0 but it will not generate a tax refund.

There are a few specific scenarios to consider for the 2018 tax year:

1) *An individual typically claims a credit for charitable donations or household help but the CIMR will reduce their taxable income to €0. What then happens to these credits?*

The French government has indicated that the tax credit you would have received in a normal year for these will be refunded to you via check in the summer of 2019.

2) *What is exceptional revenue that will not be considered for the CIMR?*
   a. Restricted share unit or stock option income
   b. Capital gains or losses
   c. Interest or dividends
   d. Taxable portion of an indemnity from a rupture conventionelle

3) *An individual relocated to France in 2018 and has never filed a tax return before.*

In this case there will be no benefit from the *CIMR* as there is no prior year French income for comparison. The individual should set aside the appropriate amount of income tax to be paid on the 2018 revenues in September 2019 as well as having the tax withholdings implemented as of January 2019.

Amount that will be withheld starting January 2019

For salaried individuals the Trésor Publique will communicate to their employer the amount of tax to withhold. The default amount that will be withheld is at the average tax rate for the household. Tax returns in France are filed as one single household. Take for instance, Taxpayer X earns €400,000 and Taxpayer Y earns €40,000 the income of each individual will be levied at the top marginal rate of 41%. However, Taxpayer Y can change the tax withholding rate to be at the effective rate for €40,000 through their account at www.impots.gouv.fr. If an individual does not have an account at www.impots.gouv.fr unfortunately the withholding rate cannot be altered.

Also note that this withholding is not the final tax on your income - you will still be required to file a tax return on 2019 (and future years) revenues to ensure the final amount taxed is correct.

If you have never filed a French tax return before and you become a salaried employee during 2019 your employer will not receive any communication from the Trésor Publique regarding your withholding rate and so your employer will implement a rate assuming that you are single, no dependents and at the appropriate tax rate for your salary.

If you have filed a tax return in France before and you do not adjust your rate of withholdings through your www.impot.gouv.fr account, the rate that will be communicated to your employer should be indicated on your Avis d'Impôts 2018 (on your 2017 revenues).

Filing for 2019

Tax returns for 2019 revenues will still be required to be filed in 2020. There will be a comparison to what your final tax liability is, taking into consideration each individual situation (i.e. PACs, married, number of dependents, credits for household help, exceptional income earned etc…) versus the amount of tax already withheld by your employer.

If too much tax was withheld, the individual will receive a refund or if the reverse is true, there will be a balance due. The due date for these tax returns is still anticipated to be late May to early June.

It should be noted that the tax rates are not changing, just the timing of paying tax on revenue earned (as it's earned versus the year following).

How this affects U.S. citizens living in France

Due to the unique nature of US citizens having to file tax returns regardless of place of residence, it is worth mentioning the impact this will have on US citizens resident in France.

The two main ways U.S. citizens alleviate themselves of potential US tax while living abroad is:

1) *Foreign Earned Income (FEI) exclusion*
    a. The FEI is a deduction (up to $102,100 for the 2017 tax year) that an individual can take on their US tax return if they are a bona fide resident outside of the US for the entire year or, were physically present outside of the US for 330 days during the year. The amount is prorated if a different period is chosen for the physical presence test or if bona fide residency was either started or ceased during the year.

2) *Foreign Tax Credit*
    a. This is a credit that reduces the income tax an individual would otherwise pay in the US based on the amount of income tax that they paid in France on the same income. Note to the extent that the FEI is claimed the Foreign Tax Credit is reduced by a prorated share.

US taxpayers can still use the FEI for 2018 revenues. If an individual's brut (gross) salary converted to USD is less than $102,100, they will not owe any US income tax on this income. However, to the extent this income exceeds the Foreign Earned Income amount, tax may be owed to the IRS since the amount of income tax an individual will pay in France on 2018 income will be significantly reduced due to the *CIMR*.

We strongly urge you to contact us (unless we have already been in touch) if your income is going to exceed the FEI for 2018. There are some planning opportunities available - for instance an individual can use Foreign Tax Credit carryovers - and it could be a good year in France to realize some unexercised stock options or sell restricted share units held in a blocked account in France.

If you have any questions, please do not hesitate to contact us.

Kind regards,

Paul Woods, CA CPA