

ALLEN & OVERY

Reform of Income Tax in France: One Month Left for Companies to Comply with their New Obligations

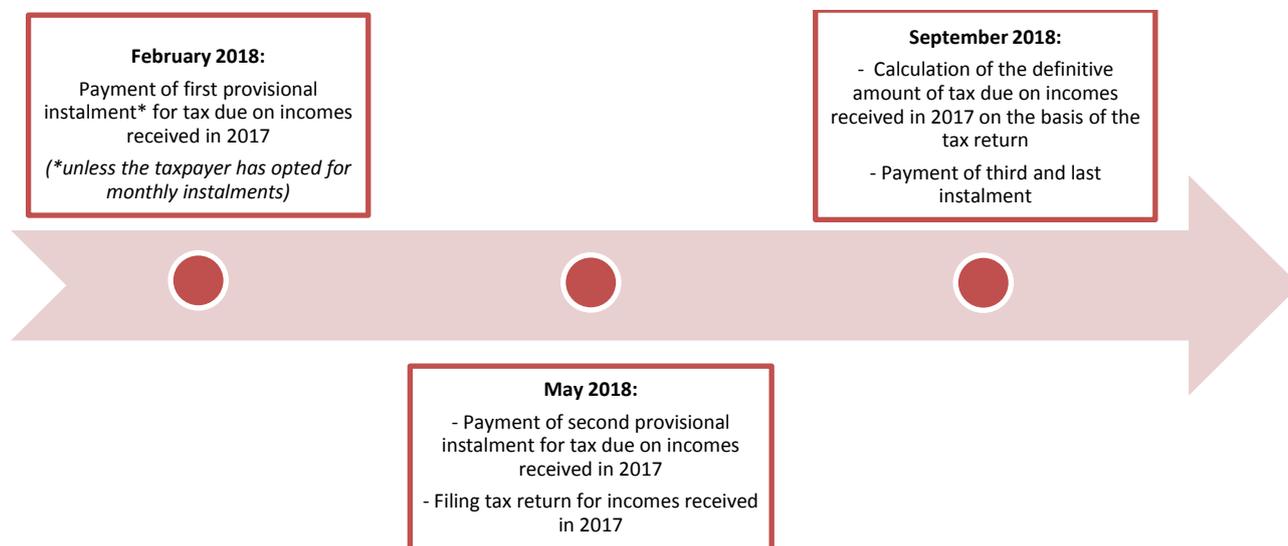
After 60 years of fierce debate, France has eventually decided to reform its income tax system and shift the burden of income tax collection from the State to employers, thus aligning itself with all other EU Member States and most Western countries. As of 1 January 2019, employers will thus be under an obligation to collect income tax by deducting it from their employees' salaries and paying it to the French Tax Department.

This major development in France comes with a number of new obligations for employers and raises several practical and legal issues. It is thus important to anticipate and be prepared for this substantial change.

The French Income Tax Reform in a Nutshell

To date, employers only deduct social security contributions from employees' gross salary. What we call net salary is thus the amount of salary after deduction of social security contributions. However, employees still have to pay income tax on this net salary, which implies that they save a sufficient amount of money in doing so.

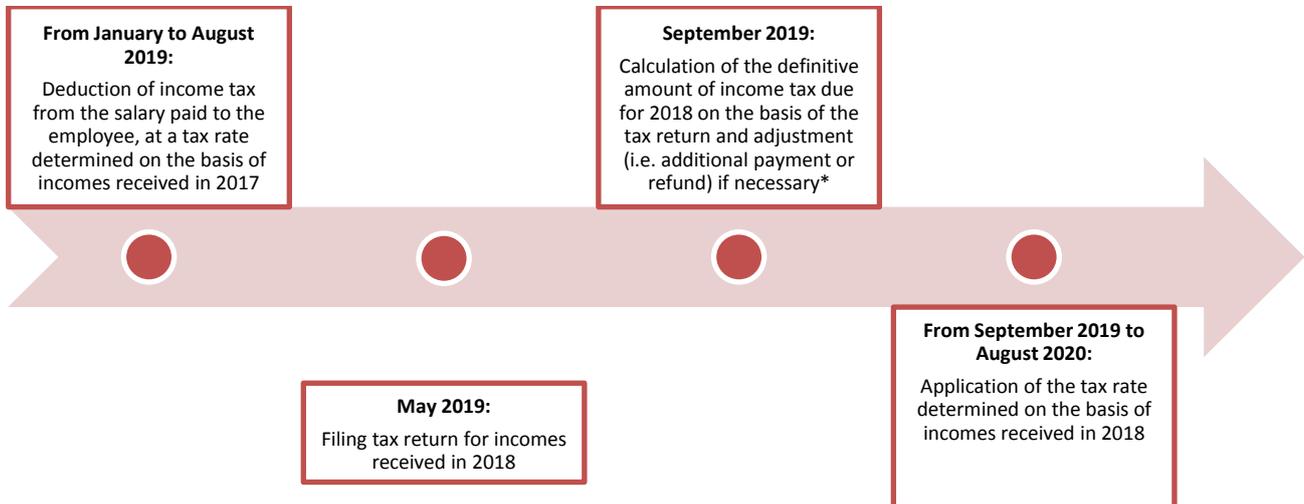
In addition, tax due on incomes received during a year Y is not calculated and paid until Y + 1, according to the following calendar:



The main downside of the existing system is that it does not take into account the current situation of the taxpayer. For example, as income tax to be paid in 2018 is based on income received in 2017, an individual who lost his job at the beginning of 2018 would still have to pay a substantial amount of income tax in 2018, while his incomes are likely to have significantly decreased by then.

As a result of the reform, and starting from 1 January 2019, income tax will be deducted by employers from their employees' salaries at a rate determined by the Tax Department or at a non-individualised rate, applicable if selected by the employee and also in some specific situations such as short fixed-term contracts. Income tax due on incomes

received in 2019 will thus be paid throughout 2019, with a possible readjustment (i.e. an additional payment or a refund) in September 2020.



* *As an exception and to avoid double taxation in 2019, only exceptional incomes received in 2018 will be taxed.*

As pointed out by the French government, this reform will allow consideration of a taxpayer's current situation. Indeed, as the income tax will be deducted from a taxpayer's salary at a determined rate, it will become proportional to the amount of the salary received, which means that if the taxpayer's salary decreases, the amount of his income tax will automatically decrease too. Furthermore, in the event of a significant change to their financial or family situation, taxpayers may request amendment of their tax rate to take this change into account.

However, the main consequence of this reform is that the burden – and the associated costs – of collecting income tax will therefore shift from the State to employers.

What Companies Fall within the Scope of this New System?

The obligation for employers to collect income tax on behalf of the French State applies to the following companies:

- French companies paying salaries to French tax residents, whether they perform their duties in France or abroad;
- Foreign companies paying salaries to French tax residents as remuneration for work performed in France. In this case, if the company does not have any registered office in France, and depending on the country where it is registered, it may be under an obligation to appoint a tax representative for this purpose. If the company has already appointed a tax representative for the payment of VAT, it should be the same person.

For the sake of clarity, foreign companies paying salaries to French tax residents as remuneration for work performed abroad are not subject to these new obligations. This does not apply to payments made to independent contractors either.

What Obligations exist for Employers as Income Tax Collectors?

As of 1 January 2019, all companies falling into this scope will be in charge of collecting income tax on behalf of the French State. More specifically, they will be obliged to:

- calculate the amount of the income tax that will be deducted from each employee’s monthly salary by applying the tax rate provided by the Tax Department to the salary (after deduction of social security contributions);
- deduct this amount from salaries paid to employees;
- pay the amount of income tax thus collected to the French State; and
- declare the amount of income tax thus collected through DSN reporting (“*déclaration sociale nominative*” – this reporting system is already used in order to follow up payment of social security contributions) or, should the company not be subject to DSN reporting, by filing the PASRAU declaration.

The law provides for severe penalties in the event of breach of one of these obligations, with a minimum fine equivalent to €250 per irregular declaration:

- in the event of failure to pay the collected income tax to the State within the prescribed time period: late payment penalty equivalent to **5%** of the tax which should have been paid;
- in the event of unintentional omissions or inaccuracies in the collection of income tax (e.g. where the employer did not apply the right tax rate or applied it on an inaccurate basis): fine equivalent to **5%** of the tax which should have been deducted or declared;
- in the event of failure to send the declaration within the prescribed time period: fine equivalent to **10%** of the tax which should have been deducted or declared;
- in the event of failure to send the tax statement within 30 days following a formal notice, or submitting it with deliberate omissions or inaccuracies: fine equivalent to **40%** of the tax which should have been deducted or declared;
- in the event of collection of the income tax but deliberate failure to pay this tax to the State: fine equivalent to **80%** of the amount of tax that was collected but not paid to the State.

Non-compliance with these new obligations, whether deliberate or not, may thus turn out to be very costly for the company.

Data Protection Issues: Protecting and Retaining this New Personal Data

One of the main causes for concern triggered by this reform is that it will provide employers with new personal data about their employees, such as their effective income tax rate and the amount of income tax they pay. Such data is rather sensitive as it might provide indications as to an employee’s financial and family situation. However, as stressed by the Tax Department, the same tax rate may correspond to many different financial and family situations. Moreover, any employee may elect to be taxed at a non-individualised rate, based on his sole salary received from this employer and regardless of his family situation or other incomes, so as to prevent his employer from gaining knowledge of his effective tax rate. In this case, the definitive amount of income tax will eventually be adjusted by the Tax Department.

In addition, all persons who gain access to this personal data while carrying out their professional duties are subject to a strict obligation of confidentiality. Any breach of this obligation of confidentiality may be regarded as an offence punishable by a year’s imprisonment and a fine amounting to €15,000 for individuals and €75,000 for companies. It may be wise to remind all those HR and payroll employees who are likely to gain access to other employees’ personal data of their obligations and the potential penalties for breaching them.

Finally, it should be noted that employers must retain all income tax declarations, which should specify the tax rate applied and the amount of income tax deducted, for six years, to be extended to ten years where this data is computerised.

What Changes for Payroll?

The role of the payroll department in the implementation of this reform of income tax at the company-level is central.

First, it is essential to ensure that the payroll software used by the company or its payroll service provider is up-to-date and adapted to new French legislation. Publishers of payroll software should have taken part in the trials carried out by the Tax Department since 2017.

Furthermore, as a result of this reform, employers will be required to amend their payslip template so that it states:

- the income tax basis, which is basically the amount of the employee's monthly salary after deduction of social security contributions;
- the tax rate applied by the employer;
- the amount of income tax deducted from the salary; and
- the net amount of salary after deduction of income tax.

Payroll departments and service providers may be willing to seize this opportunity to ensure that their payslips are fully compliant and include all mandatory mentions stipulated by the French Labour Code. Failure to include all mandatory mentions on a payslip is indeed punishable by a fine amounting to €450 per irregular payslip for legal representatives and up to €2,250 per irregular payslip for the company itself.

What Information for Employees?

The law does not place employers under any specific obligation to provide information as regards this income tax reform. However, as this reform will primarily be visible on employees' payslips and result in a significantly reduced net salary at the end of the month, employers are likely to be the first point of call for employees for all queries they might have regarding this new income tax system.

Employers are thus advised to communicate extensively in order to inform and prepare impacted employees for this major change. With that in mind, HR departments may find useful documentation that they may circulate within the company on the French Tax Department's website. It is also important to point out to employees that their employer will be powerless as regards determination of their income tax rate or of the quantum of income tax deducted from their salary, and that all specific queries and claims they might have should be directed to the Tax Department, which legally remains the sole point of reference for all tax matters.

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