

Tax Withholding at Source (*Prélèvement à la Source*) – an overview

Starting 1 January 2019, France is bringing in tax withholding at source (*prélèvement à la source*) or tax on a current year basis, similar to the system of PAYE which operates in the United Kingdom. This article gives an overview of the mechanics of this new system and the transitional year – 2018 – known as the *année blanche* (“blank year”).

This represents a significant overhaul in the current system, under which French residents pay their tax one year in arrears. Whilst the incoming system may not necessarily be a simplification on the outgoing one - the need for annual tax returns not being eliminated - it will at least avoid certain cash flow problems brought about by the timing delay such as having to pay tax on prior year earnings whilst being unemployed. Under the new system, tax paid in the year will correspond to one's resources in that same year, and taxpayers will typically no longer have to put money aside for future years' tax.

How it will work in practice

Taxpayers will continue to submit a tax return each year.

Based on these tax returns, the tax office will calculate a single tax rate for each taxable household. Tax will be deducted at this rate: either “at source” at or directly from the taxpayer's bank account.

This tax rate is based on the income of two years ago (N-2) for the months January through August of the year concerned (N), and on the income of the prior year (N-1) for September through December.

The total tax deducted at source in any year (N) will be imputed onto the actual tax calculated for that year when the return is submitted in N+1.

Any excess deducted over tax due for N will be reimbursed to the taxpayer in N+1. If tax has been underpaid, amounts under €300 will be taken directly by the tax authorities, and amounts in excess of €300 will be recovered in equal, monthly equal instalments in the last part of the year N+1.

Employees, unemployed and the retired

Employees, the unemployed and pensioners' tax will be deducted at source by the organisation that pays it to them e.g. their employer, *pôle emploi* or their retirement fund. These are the parties who are legally responsible for the settlement of the tax. The tax authorities will communicate the relevant tax rates to them directly.

Self-employed and property owners

Tax will be taken monthly or quarterly by direct debit from the taxpayer's bank account, as it is not possible to deduct this money “at source”. These amounts will be calculated according to the prior year income.

Other types of income

Other types of income such as investment income and capital gains will not have tax deducted at source. Rather they will continue to be assessed and settled in the following year.

Change of the tax rate at the taxpayer's own request

A taxpayer may request that their tax rate be increased (for example, if they anticipate that their monthly deductions will be insufficient to cover the tax which will fall due in respect of that year). There are no conditions to obtain the change which is granted on demand.

Meanwhile a taxpayer wishing to decrease their monthly deductions may do so only if they anticipate a difference of at least 10% and €200 between their own estimate of their liability and the amount that will be deducted by the tax office. If the taxpayer incorrectly leads the tax office to “undercharge” them by more than 10% they will be subject to fines.

Individual and neutral tax rates

A married couple or a couple in a civil partnership with significant disparities in their income may request individual rates of tax, such that the lower earner's tax rate is lowered and the higher earner's is increased. This might be desirable in order to protect privacy (as a high rate of tax on a modest salary – or vice versa - may reveal information about the other partner's salary) or may simply be the preferred arrangement of the couple. As with the tax rate increase, there are no conditions for benefitting from these personalised rates of tax.

It is also possible to opt for a default rate (for example, an employee with other sources of income may not wish these to be exposed to their employer). This default rate is calculated in accordance with the progressive tax scale and any additional tax due is paid from the taxpayer's bank account each month.

All of these preferences will be able to be managed via taxpayers' online accounts at www.impots.gouv.fr under the new tab “Gérer mon prélèvement à la source” once their 2017 declarations have been submitted.

The *année blanche*

Income earned in 2018 will theoretically not be taxed – this is why 2018 is referred to as an *année blanche* or “blank year”.

The French tax authorities are keen to point out that this does not mean that taxpayers will be exempted from paying tax for one year. Rather, in 2018 they will pay tax on 2017 income, and in 2019 they will pay tax on 2019. 2018 effectively slips by untaxed.

So that taxpayers do not pay tax on both 2018 and 2019 in 2019, tax relief will be delivered via a one-off tax credit known as the *Credit d'Impôt Modernisation du Recouvrement (CIMR)* or “tax credit for the modernisation of tax collection”. Its effect will be to neutralise the taxation of **non-exceptional** income received in 2018.

Arrivers/leavers

The good news for arrivers and leavers in France around the time of the *année blanche* is that they are not excluded from benefiting from the CIMR tax credit, so long as their income is not classified as “exceptional” (see “anti-avoidance” below).

For example, a person moving to France to take up French employment in the first part of 2018, who lives here for at least 6 months and fulfils all of the criteria to become French resident, could technically benefit from one tax-free year, so long as their remuneration is in line with their employment contract and does not consist of e.g. exceptional bonuses. It is expected that the tax authorities will carry out checks of employment contracts, beginning around the end of 2019.

Arrivers in France from 2019 onwards with no history of French income and taxes in the past three years upon which their tax rate can be calculated, will have the default tax rate applied, calculated as described above according to the tax bands in place.

Anti-avoidance

Exceptional income which will **not** benefit from the CIMR tax credit includes severance pay, exceptional bonuses and other income sources which are not earned annually.

As for business owners and the self-employed, income earned in 2018 will be compared to earnings for the period 2015–2017 to determine how much of it is exceptional when calculating the CIMR 2019. An additional tax credit may be granted in 2020 when the years 2015–2019 are taken into consideration.

The tax office have anticipated that landlords may in 2018 attempt to receive rent in arrears for 2017 or in advance for 2019 in order not to pay tax thereupon. However this is one of the specifically-named examples of exceptional income for which a tax credit will **not** be available.

The tax office’s intervention period during which it can rectify omissions and errors – usually three years for any given tax year – is extended to four years for the year 2018.

Tax credits for home-based employment, charitable donations etc.

French residents are entitled to tax credits of 50% for home-based employment and 66% (and sometimes up to 75%) for charitable donations.

Such tax credits arising from salaries and donations in 2018 will not be lost. Rather, they will be reimbursed to the taxpayer in two tranches.

On 1 March 2019 (N+1) the taxpayer will be reimbursed 30% of the tax credit to which they were entitled in respect of 2017 (N-1). In April 2019 they will declare actual salaries of home-based employees and charitable donations in 2018. The tax credit will be calculated thereupon and the remaining amount due reimbursed to them at the end of August 2019.

Likewise, if they were paid money to which they were not actually entitled (e.g. because their employee’s last year of service was in N-1), this will need to be set aside and repaid to the tax authorities at the end of August N+1.

The cycle will continue to function year on year in the same fashion.

Changes in family situation

As French residents are taxed as a “household”, events such as marriage, conclusion of a civil union, divorce or death of a partner, birth or adoption of a child may affect the amount of tax paid. Such events must be reported to the tax authorities within sixty days and will normally be incorporated into one’s tax rate within three months of the declaration.

Conclusion

Practically speaking, the new system of deduction of tax at source should not present any new difficulties for most taxpayers. They will still continue to complete an annual tax return each year. Whilst there will no doubt be teething problems in the initial stages and in particular during the transitional phase, the burden of setting aside enough money for tax due in the future will finally be lifted and people will have the peace of mind which comes from knowing that the money in their bank account is essentially all theirs to keep.

Jennifer Hooper, April 2018