France’s Reform Agenda: Overview of Key Announcements

July 25, 2017

Following the election of 39-year-old Emmanuel Macron as the new President of the French Republic, his one-year-old centrist party *La République En Marche* (REM) – *The Republic on the Move* – won a landslide victory in French parliamentary elections, giving it an absolute majority of seats in the National Assembly. With such a large parliamentary majority, the newly constituted Government holds all the cards to carry out in the coming months the reforms that were promised during Macron’s campaign.

Among the measures that have been announced, particularly since the new Government took office, increasing France’s attractiveness to foreign investors stands as a priority, especially to those based in the US. In this sense, it is particularly significant that both the newly appointed Finance Minister and Digital Affairs Minister headed to New York to present France’s reform agenda. In the race between continental Europe’s financial centres ahead of Brexit, French authorities are doing their utmost to make France a leading reference in the European market.

Macron’s ambitious reform agenda – that also embraces major institutional reforms, including at the European level – will however have to cope with strong hard left and far right political oppositions, a complex geopolitical context and deteriorated public finances, all factors which have already contributed to the new Government’s hesitation to implement some of the promised tax cuts and which could affect in the medium-term its room to manoeuvre.

That being said, the very first signals that have been sent demonstrate Macron’s commitment to pursue his reform agenda. The following brief discussion focuses on the key economic measures that are currently being considered.

1. Promoting Flexible Employment Relationships

Reforming France’s employment market has been identified as a key and urgent priority by the Government, which decided to fast-track the reform process by using ordinances – which avoid the potential of lengthy parliamentary debate – with the objective of seeing the reform enacted by the end of this summer.

In summary, the aim of such reform is to reshape and simplify French labour laws in order to boost competitiveness and reduce France’s high and persistent unemployment rate. Even though the precise scope of the reform will only be known once the ordinances are disclosed, the following key objectives of the reform already stand out:

- decentralizing collective bargaining negotiations to the company level by promoting company collective bargaining agreements over branch-level ones, thus bringing France's labour relations closer to the German model,
- simplifying employee representative bodies by merging current structures into a single employee representative body, and
- making economic dismissal procedures more certain - notably vis-à-vis the employer - and labour litigation more predictable by setting upper and lower limits to the damages that can be awarded.

While discussions about such reform are progressing smoothly, hardline unions have called for countrywide strikes in mid-September that will undoubtedly test the Government’s ability and commitment to implement not only these measures but also the other expected labour reforms relating to unemployment benefits and the pension system.

2. A More Attractive Taxation System

With one of the highest public spending ratios among advanced countries and high levels of public debt, reforming the French tax system could be the Government's toughest task, thus explaining why some of the tax cuts promised during the presidential campaign will be implemented progressively.

Turning first to the corporate income tax rate, the Government aims at going a step further than the previous Government – which had already agreed a phased reduction of the rate from 33.33% to 28% by 2020 – by setting a new target rate of 25% by 2020. Against a backdrop of the European Commission pushing for the adoption of a Common Consolidated Corporate Tax Base (CCCTB), it has become even more necessary to align the French corporate income tax rate with those of other EU countries.

Another area where the Government has announced an important change is on the taxation of investment income (dividends and interest) and capital gains, that would be subject to a flat tax rate of 30% instead of being subject to the current progressive income tax (with the maximum marginal tax rate at 45%) and social contributions (15.5%). It is an eagerly awaited measure by both investors and entrepreneurs, with a rate that would move France closer to the European standard.

The divisive ISF wealth tax should also be amended to cover only real estate property and to exclude securities, which should contribute to boost private investments in French companies.

While this tax reform plan – including the other tax-related changes announced to make Paris more attractive to financial institutions (see below) – has been met positively by the business community, many questions remain to be clarified and several commentators have warned against hasty changes to ensure that economic operators have stable and predictable tax policies.

3. Making Paris a Key European Financial & Digital Centre

With Brexit on everyone's mind, a multipronged strategy is being pursued by French authorities – both at local and national levels – to make Paris a key European hot spot for financial affairs.

Building on the steps already taken in this regard (e.g. modernization of the French bond issuance legal framework[1] as well as investment funds regulations[2], tailored measures taken to simplify and speed up licensing procedures for UK-based institutions, improvement of the "impatriate" tax regime, etc.), the new Finance Minister has notably endorsed the proposal made by the Legal High Committee for Financial Markets of Paris – a committee established by the French Financial Markets Authority (AMF) and the French Central Bank – to set up a special court dedicated to handling international disputes with English as the working language of proceedings and that would be able to apply UK law. With such a proposal, Paris would position itself as a possible place of reference for financial litigation in the event that UK court decisions are no longer automatically recognized and enforced in EU countries following Brexit.

Further and more targeted measures – including tax related-ones – have also been announced, such as the removal of the higher rate of 20% for the top band of payroll tax, or the exclusion of deferred bonuses of some finance employees – e.g. traders – in the calculation of their severance indemnity. France's seduction efforts vis-à-vis financial institutions and their employees even extend to developing additional education capacity with the opening of new international schools in the Paris region.

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[1] Providing in particular greater flexibility in the relationship between the issuer and bondholders and removing in certain cases the need to have a nominated representative of bondholders.

[2] See in particular the measures resulting from the working group set-up by the AMF and the French Asset Management Association (AFG) and called – not without humor – the "FROG" (*French Routes and Opportunities Garden*) group, available on the AMF's website (www.amf-france.org).

The finance industry is not the sole industry concerned by this modernization trend and promoting France as a major European start-up hub is also one of the Government's key priorities. In this respect, the opening last June of Station F, the world's biggest tech start-up campus which is backed by French telecoms tycoon Xavier Niel, demonstrates the dynamics of France's digital scene. Amongst the flagship measures announced are the creation of a specifically designed visa to attract high-tech talent and the spread of very-high-speed broadband internet access nationally by 2022.

4. Prospect of Reduction in French State's Shareholding Portfolio

Holding interests in more than 70 companies – including around 10 that are listed –, the French State – acting through the State Investment Agency (APE) – manages an extensive portfolio of diversified investments, both in terms of the sectors concerned (aerospace and defense, energy, transport, etc.) as well as the percentage of ownership interest involved. In this regard, the Government has already announced that it is considering the divesture of some of its non-strategic assets to fund a new €10 billion innovation investment fund.

Although details of such divestures are still to be provided, the Government's announcements to date do not suggest a new wave of privatizations similar to those completed in the 80's or 90's, but rather sales of listed minority interests through accelerated book building processes. In a situation where historically the French State has been entitled to double voting rights[3], the advantage of such an approach is clearly that it affects only partially its voting power.

Larger transactions and privatizations cannot however be excluded, in particular in the infrastructure sector.

[3] Following the Florange bill enacted in 2014, any shareholder holding registered shares in a French listed company for at least two years is entitled to double voting rights on those shares unless two-thirds of the shareholders have voted against the granting of such double voting rights.

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

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