

France: Taxing Capital Gains

The special rules for long-term capital gains applicable to assignments and to the granting of exclusive licenses

BY FRANCOIS LASRY*

The profits of French companies are normally taxed at 50%, while long-term capital gains are only taxed at 15%. Some of the revenue stemming from industrial property rights may, however, under certain conditions, benefit from the rules which were created for long-term capital gains. That is to say, such revenue may be taxable at 15% instead of 50%.

The revenue covered by the terms of those rules are the proceeds resulting from patent assignments, the proceeds resulting from a transfer of processes or techniques, the proceeds from granting exclusive licenses, and the proceeds from certain partially exclusive licenses, namely licenses which the licensor grants only for a determined geographical area or for a particular field of use. Therefore, these rules cover a large range of revenues.

FUNDAMENTAL REQUIREMENTS

Obviously, a certain number of requirements must be met with regard to these special rules.

First requirements

The rights must be of the character of fixed assets for the company: these rights should not be considered as stock from an accounting point of view. Rights which are held by companies whose purpose is to trade in the rights, are considered as stock items. However, this rule has been broadly interpreted by the administration in the favor of the taxpayer.

The administration considers that if rights are bought with a view to resale, this first requirement is not complied with since the buying and selling is the company's activity. On the other hand, a company whose object is to assign patents or processes or techniques which it has discovered or developed itself satisfies this first requirement and may therefore benefit from the special rules.

Second requirement

The rights should not have been acquired for valuable consideration within the preceding two years, that

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is to say, that if the invention was developed by the company itself, the requirement is met, and if the right were acquired for valuable consideration more than two years previously, the requirement is also met. The same applies if the rights were acquired free of charge, even if the acquisition was within the preceding two years.

APPLICATION TO PATENT ASSIGNMENTS AND TO PATENT LICENSES

It would seem normal that the legislature intended to favor the sale of patents — which are well-defined rights and company assets — and that these rights are covered by the special rules for long-term capital gains.

But these special rules have been extended to cover the granting of exclusive licenses.

What requirements must be met so the granting of licenses may be covered by these rules? We have already said that the license must be exclusive. This is an absolute requirement. A note from the administration in 1962 states that "a license must be considered as exclusive when the licensor gives up his personal operating right." A nonexclusive license is not covered by these rules, nor is a so-called "sole" license which is exclusive with the exception of the licensor. But a partially-exclusive license may be covered; this is an exclusive license given for one or several special fields of use of the rights in question, or which includes a limitation to a determined geographical area.

The administration considers that such an area must be an extensive geographical area, with an administrative and political individuality, especially within federal states. In other words, the license must be for a whole country or, if one considers the case of the United States, for a certain number of states.

Duration

Another extremely important point is that the license should be granted for the whole duration of the patent or, of course, the whole of the remaining time counting from the date that the license is granted.

It is obvious that in a contract, this is a problem since any licensor has a natural tendency to try to impose restrictions on the rights which he is granting, under forms of controls or limitations, while the need to grant a license for the duration of the rights goes against this tendency. If, in order to benefit from a particular set of fiscal rules, all rights must be given up definitively, there is a risk of finding oneself in difficulty vis-a-vis an inefficient licensee.

But the administration has permitted the inclusion in contracts of what are called safeguard clauses, designed to safeguard the rights of the licensor. Minimum production figures or minimum royalty figures have been accepted as valid safeguard clauses, on condition, of course, that they are reasonable.

In the same way, termination conditions designed to guarantee the rights of the licensor in case of violation of the main conditions of the contract have been accepted as presenting no obstacle to being covered by the rules for long-term capital gains. In other words, rights may be granted in a definitive manner, but the licensor is not totally disarmed.

APPLICATION TO THE TRANSFER OF PROCESSES OR TECHNIQUES

The rules for long-term capital gains have been extended to cover the transfer of processes and techniques which are not covered by the law, that is to say, what is known as know-how. This has been carried out gradually.

First of all, in 1969 the rules were extended to cover the know-how ancillary to a patent license. Very often a patent is associated with certain know-how and the license covers both. Then, in 1972 a second more significant extension was made in favor of the transfer of know-how, even if there is no connection with a patent. Of course, with regard to nonlegally-protected rights, the license must be granted definitively, since there is no determined duration as for the patent.

This measure is extremely important and highly favorable to companies since the know-how accumulated by companies represents a considerable asset.

Know-how, which by definition is secret, has extremely vague limits and this is an area in which disputes are possible. Faced with this difficulty, the tendency should be to concretize as much as possible the know-how which is the subject of a transfer, for example, by the constitution of dossiers, written documents which may be submitted materially and which certify to the existence and concreteness of the transferred know-how.

THE PROBLEM OF TECHNICAL ASSISTANCE

A transfer of technology, generally, is not simply a legal operation. Materially, it is necessary to give technical assistance and, very often, there are mixed contracts which organize the transfer of patent rights, the transfer of know-how and the technical assistance for the utilization of the two.

Is the remuneration from this technical assistance subject to the same tax rules? The reply must draw a fine distinction: The principle is that technical assistance, immediately and obviously necessary for the actual transfer of rights and for their application, may be part of the contract and, in a limited way, may be covered by the same rules. Even that may give rise to a certain number of disputes. But technical assistance which is organized in many contracts and which is complementary technical assistance, i.e. technical assistance which is not the actual object of the transfer of technology is normally covered by the usual tax rules, that is to say, it is subject to taxation at a rate of 50% on taxable income.

TRANSFERS AND LICENSES WITHIN A GROUP

It is obvious that between several companies belonging to the same group, one may actually or fictitiously transfer the technology of one company to another, and in the accounts of the company receiving these rights, deduct the royalties paid from income taxable at 50%, and then only be taxable in the other company at 15%. This is why it is not possible to be covered by the special rules in such a case.

However, if the company which is covered by the transfer and which pays the royalties is abroad, this rate is applicable since there will not have been a deduction of sums taxable at 50% in France, and this company is hypothetically subject to foreign taxes.

It is important to say that the amount of revenue benefiting from the reduced rate of 15% is not the net amount of sums received, but the difference between the sums received and the expenses and costs relating to the operation, for example, design and research costs.