



## New measures of interest to foreign companies or legal entities owning French real estate

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The Finance Amendment Act of 30 December 2009 (ie "Loi de finances rectificative pour 2009") contains various important provisions which are highly relevant to foreign companies (or other legal entities) owning French real estate.

The new legislation clarifies two points which were otherwise unclear due to a difference of opinion between the French Tax Authorities ("FTA") and the courts. In addition, in the context of the new measures concerning the fight against international tax evasion (see French Tax News December 2009), the new Act seriously tightens the rules regarding real estate capital gains generated in France by companies or entities established in "uncooperative" States or territories.

### Clarification of territorial limits of French Corporation Tax

The territorial limits of French Corporation Tax ("CT") are given by Article 209-I of the French Tax Code ("FTC"). Under this Article foreign companies or entities can be liable to French CT in two situations: if they have an activity (an "exploitation") in France (French domestic test); or where a Double Tax Treaty ("DTT") gives France the right to tax the French source profits of a foreign company or entity (eg permanent establishment or taxation of real estate income in the State where the property is situated).

Under French law the simple passive ownership of property in France is not, in principle, sufficient to characterise either the existence of an activity in France (an "exploitation") or a permanent establishment (within the meaning of DTTs). Therefore, the strict application of

Article 209-I in the case of simple passive ownership of French real estate gives the following results: in the presence of a DTT, French CT is due if the DTT gives France the right to tax (which is usually the case if the DTT is drafted in accordance with the OECD model). However, in the absence of a DTT, French CT should not be payable since the property does not, in principle, constitute an activity (ie "exploitation") in France and there is no DTT to give France the right to tax. Application of Article 209-I to passive real estate income results in a paradox: CT is due in the presence of a DTT and not due in the absence of such a Treaty.

In reality the Courts have never strictly applied Article 209-I to passive real estate income. In fact, in order to tax, they (and the FTA) have invoked another Article of the FTC: Article 206-1 which describes companies and other forms of legal entity which are liable to French CT.

It should be noted here that this Article has been invoked on various occasions to justify the application of CT to foreign companies and entities owning French real estate which they make available, free of charge, to their shareholders or to third parties. Simply put, a company or entity liable to CT is supposed, in principle, to make profits. If real estate is made available to shareholders or third parties rent free, this could be contrary to the commercial interests of the company and constitute what in French law is known as an abnormal act of management. The abnormal act of management theory enables the FTA to apply CT to the rent that the company or entity would have earned if the property had been rented out normally.

This approach of only referring to Article 206-1 was not strictly correct because this provision serves merely to determine the types of legal entity which are subject to French CT and not to determine the territorial scope of this tax. In the recent case of "Sté Overseas Thoroughbred Racing Stud Farms" of 31 July 2009, the Supreme Administrative Court appears to have called into question this approach by referring to Article 209-I along with Article 206-1 to justify the fact that the company in question was potentially subject to French CT. Some commentators saw this case as creating a precedent.

The new law has put an end to any further ambiguity. Article 209-I provides that CT is payable in France on income from French sited immovable property and capital gains made on the sale of French real estate and rights on French real estate (unless otherwise stated by a DTT provided there is one applicable). In the absence of a DTT, there is no need to ask whether or not there is an "exploitation" in France. This of course is mainly of interest to companies or entities located in a State which has not signed a DTT with France because where such a treaty exists, France almost always has the right to impose tax. However, in principle, in order for CT to apply, it must be shown that the foreign company or entity is subject to that tax under the provisions of Article 206-1 (ie because of its form or the "lucrative" nature of its activity) as French CT does not apply to all forms of foreign entity (as it does not apply to all forms of French entities). The new law interprets the existing tax legislation and therefore applies immediately to any litigation underway.

## Stamp duty on sale of French real estate or rights over French real estate

Until now there has been an issue as to whether or not stamp duty at the rate of 5% should be due on a sale made outside France of shares in a foreign company whose assets mainly consist of French real estate (ie a French real estate company).

This was because the FTA and the Courts did not have the same view on this matter. The FTA considered the sale of shares of a foreign real estate company to be subject to stamp duty. But in two low court cases (TGI Nice 27 September 2007 and TGI Grasse 4 September 2008), it was held that, provided the sale is not made in France, there is no requirement to register it and therefore

pay stamp duty. Not surprisingly, the new law upholds the position of the FTA.

Therefore, since 1 January 2010, stamp duty at 5% is due on the sale of the shares of a foreign company made outside France, provided it can be considered to be a French real estate company under French tax legislation. The new law also provides for a tax credit deductible against French stamp duty corresponding to any stamp duty effectively paid abroad.

## Situation of companies or entities established in an uncooperative state or territory

In the context of the new measures concerning the fight against international tax evasion, the new law introduces a new concept into French tax legislation, that of "an uncooperative state or territory" and provides for a more severe tax regime in respect of operations effected with such a state or territory.

Under the new law, real estate gains made by companies (or individuals) established in an uncooperative state or territory will be subject to 50% tax on the gain irrespective of whether it is made on a habitual or an occasional basis. The normal rate for other foreign companies or entities remains at 33.33%.

Therefore the law changes the way the capital gain is computed depending on where the company or entity is located and whether the gain is made on a habitual or occasional basis. More distinction must be made when determining the tax liability in these respects. This regime also applies to the sale of shares of a French real estate company (ie a company whose assets mainly consist of French real estate) and to other habitual profit made from French real estate. The new rules regarding habitual gains have been in application since 1 January 2010 and the rules regarding occasional gains will come into force on 1 March 2010.

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