



Tax Shield and Multi-based life insurance policies

February 2010

In a very important case dated 13 January 2010, the French Supreme Court ("Conseil d'Etat") revoked some provisions of a Tax Guideline (Instruction) including within the definition of income realised by the taxpayer for the purposes of the tax shield ("Bouclier Fiscal") legislation, interest paid from the euro support of multi-based life insurance policies principally invested in euros. This decision is very significant for those living in France who benefit from the tax shield legislation.

The context

In terms of assets invested in a life insurance policy, two different types of policy can be distinguished:

- Policies invested in units of account (eg shares, funds etc) where there is no income when the policy is cashed in. If no part of the policy is surrendered (partially or totally), no income is taxable and there is no tax on the accumulated income.
- Policies invested in the general fund in euros of the insurance company (essentially bonds) where any income generated is taken into account and deemed to be realised on its inscription date on the account, even if the income is not effectively paid out to the policyholder. Such a policy does not allow the capitalisation of income generated within the policy, since income is taxed as soon as it is generated even where it is not paid out.

Most of the policies currently on the market are multi-based which give access both to the general Euro Fund and to

units of account, as opposed to mono-based policies which only give access to the general Euro Fund.

This distinction is very significant when considering tax planning strategy in respect of the tax shield which involves, in particular, the use of capitalisation products to reduce the taxpayer's income as much as possible.

The origins of the above case lie in a contested interpretation of an article of the French Tax Code by the French tax authorities. Article 1649-0 A, 6 of the French Tax Code provides that income derived from capitalisation bonds and contracts and similar investments (such as life insurance policies), except those invested in units of account, is deemed to be generated on its inscription date on the account (even if it is not effectively received). This article does not refer to multi-based policies and seems only to concern mono-based euro policies.

Generally speaking, multi-based policies are, in principle, assimilated to policies in units of account. However, in a contested Tax Guideline dated 26 August 2008 (Inst. 13 A-1-08, n° 34) the tax authorities required that at least 20% of a multi-based policy be considered as comprising units of account and be taxed accordingly. Therefore, the tax authorities only considered policies in units of account to be multi-based if they were not mainly invested in Euros. In their Guideline, the tax authorities considered that, if the threshold of 20% in units of account was not respected, the interest paid on the funds invested in Euros should be taken into account from the date of inscription, even if it had not been paid out to the policyholder.

It was this interpretation by the tax authorities that went before the Supreme Court and was overturned.

What the judges said

In order to cancel the contested provisions of the above Tax Guideline, the Court invoked Parliament's intention, as shown in the Parliamentary debates, when the tax shield legislation was introduced.

Article 1649-0 A, 6 of the French Tax Code only concerns mono based policies exclusively invested in Euros and not multi-based policies. The Court considered the tax authorities' analysis of multi based contracts to be misguided as regards the concept of income definitively acquired or generated, as Euro Fund products contained in multi-based policies are not definitively acquired: they can be reinvested by the policyholder into units of account and be subject to the corresponding fluctuations.

The Court considered that by imposing a minimum of 20%, the tax authorities had added a condition to the law which only Parliament had power to do.

The terms of the Guideline were revoked both for the past and for the future.

Consequences

In the future, holders of multi based policies are not required to include in their income, for the purposes of the tax shield computation, income from Euro Funds contained in such policies, irrespective of the proportion of the amount invested in Euros.

Those taxpayers who have contested the tax authorities' position should therefore win their case, as the authorities no longer have an argument, as the provisions of the Tax Guideline have now been revoked. However it is not clear that those who have not already contested the situation can still make a claim, as the time limit in which to do so may now have passed, and advice should be take on that.

For further information, please contact:

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