



Draft French Finance Bill for 2011 Measures concerning non French tax residents owning real estate in France

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In early May the French Government submitted a draft Finance Bill proposing tax reforms which include the abolition of the tax shield "Bouclier fiscal" and the introduction of an exit tax for French tax residents. The draft bill includes in particular several proposals concerning non French tax residents owning real estate in France and this issue of French Tax News presents these proposals.

Wealth tax (ISF)

The Government acknowledges that wealth tax is often considered as an "exception française" and it is pernicious to France's fiscal attractiveness. However, the abolition of this tax is not viable in the present economic climate and therefore the proposal is that:

- As of 1 January 2011, the wealth tax threshold will be raised from €800,000 to €1,300,000. French sited assets of a net value exceeding €1,300,000 will be taxed in 2011 in accordance with the current progressive tax rates;
- As of 1 January 2012, French sited assets of a net value of between €1,300,000 and €3,000,000 will be taxed at a flat rate of 0.25% and assets of a net value exceeding or equal to €3,000,000 will be taxed at a flat rate of 0.50%. In both cases tax is payable as of the first euro (not as of the first euro above the threshold). For example, wealth tax paid today of about €40,000 on assets worth about €5,000,000 would be €25,000 as of 1 January 2012.

In addition, to alleviate the effects of tax being applicable once the threshold has been exceeded by one euro, a scale of deductibility will be introduced.

Given that there will be a delay before the proposals can be voted and introduced, the deadline for the wealth tax declaration for 2011 will be extended to 30 September 2011. The proposals do not mention whether there will be an additional extension to this deadline for non French tax residents, as is usually the case.

Inheritance and gift taxes

There is a proposed increase of the two top tax rates applicable in direct lines and gifts between spouses by 5% ie from 35% to 40% for the band exceeding €902,838 and from 40% to 45% for the band in excess of €1,805,677.

In addition, the French inheritance tax due on the deceased's death is in principle calculated by clawing back into the deceased's estate lifetime gifts he has made. This is called the "rapport fiscal". However, at present it does not apply to gifts made more than 6 years before the death of the deceased. The proposal is to extend this to 10 years.

Finally, it is proposed that existing tax deductions or credits of 35% or 50% applicable to gifts according to the age of the donor and the nature of the gift will be abolished.

These three measures would be applicable to estates opened and gifts made as of the date the draft law comes into force ie June/July 2011, as the law should be voted by then.

Tax liability on assets or interests held in Trusts in respect of wealth tax and inheritance and gift taxes

This is, without doubt, the most complex and ambitious proposal.

The Law will be harder to apply and to interpret and will no doubt be more controversial and less acceptable to Trust professionals.

The Government confirms that there is no equivalent to a Trust in French law, therefore there is no established tax regime in relation to Trusts. This situation creates a lack of legal security for the settlors or beneficiaries of Trusts. In order to improve on this situation and to fight against all types of tax evasion, the Government proposes to redefine the tax regime relating to transfers on death and gifts made through a trust and the wealth tax rules applicable on assets held in Trusts.

We set out below the general policy of the proposals which, if voted, will require interpretation and completion through a Tax Instruction (this will be much awaited).

1/ Inheritance tax and Gift tax

Transfers carried out through a trust which may be qualified, for tax purposes, as gifts or transfers on death (in accordance with French law) would be subject to gift tax or inheritance tax as usual according to the relationship between the settlor and the relevant beneficiary.

However, when the transfer cannot be qualified as a gift or a transfer on death (where French civil law concepts do not provide for such a qualification) and taxation under the normal regime is not therefore possible, the draft law proposes the introduction of a "sui generis" tax applicable on the death of the settlor regardless of whether the assets are transferred at the date of death or at a later date.

If, at the date of death, the value of a beneficiary's share is known, it will be taxed according to the relationship between the deceased settlor and the beneficiary under the normal regime. However, if the value is not known or cannot be calculated, the trust assets could then be heavily taxed (45% to 60%).

These taxes would be due when the deceased is either tax resident and/or the trust assets are situated in France.

If the assets and interests remain in trust for several generations, the proposals suggest that tax would apply as above between the successive beneficiaries.

Furthermore, where trusts are set up under the law of an "uncooperative" State or territory, the tax rate applicable to gifts and transfers on death would be 60%. This tax rate would also apply if the settlor was domiciled in France when the trust was set up.

These draft proposals would apply to gifts made and deaths occurring from the date the draft law comes into force (ie June/July 2011).

2/ Wealth tax

A "sui generis" tax will arise, applicable to all assets, rights, capitalised products comprising the trust fund when the settlor and/or the beneficiaries are French tax residents, and in respect of French sited assets and interests if the settlor and/or the beneficiaries are not French tax residents.

The tax would be levied at a flat rate of 0.50% irrespective of the value of the assets. It would be due by the beneficiaries and the settlor but paid by the trustees.

The tax would not be due where the trust assets have been included as assets of the settlor or beneficiary for wealth tax purposes, where the settlor or beneficiary is liable to wealth tax.

These new provisions would come into force as of 1 January 2012. If the project is adopted the situation of trusts holding French sited assets should then be assessed before the end of the current year.

Shareholders' loans held by non French tax residents no longer deductible when assessing shares in French real estate holding companies

This proposal appears to have gone unnoticed.

Shareholders' loans held by non French tax resident shareholders in French companies are not presently liable to wealth tax. Therefore, companies (not

necessarily French) financed by loans from their shareholders have been used for a number of years to avoid exposure to wealth tax.

Shareholders' loans constitute debts for companies in order to diminish the value of the shares but, furthermore, they are not taxable in the hands of the shareholders either because they are considered as non-taxable financial investments in respect of French companies (notably SCIs) or because they are not considered to be French sited assets for foreign companies.

The Government clearly proposes abolishing these tax planning advantages.

If the draft law is adopted, shareholders' loans held by non French tax residents will no longer be taken into account to reduce the value when assessing the value of the shares in the company for wealth tax purposes.

The draft proposals are aimed at real estate holding companies regardless of their nationality. It will clearly affect SCIs (French or Monegasque) which are commonly used to hold French real estate.

These provisions would come into force as of 1 January 2012.

Tax on second homes owned by non French tax residents

An additional tax on second homes in France owned by non French tax residents is proposed. This tax would be due to the French State rather than the local authorities (as this is the case for the current local "council" taxes).

It would be an annual tax at the rate of 20% of the cadastral letting value of the property or properties concerned (the cadastral letting value is determined by the cadastral authorities). This new tax would have the same basis as the current "Taxe d'habitation".

Taxpayers who have been resident in France for tax purposes for over three consecutive years over the ten years preceding the transfer of their residence abroad would enjoy a temporary exemption from this tax for a six year period.

But, and this will come as a welcome relief to a number of people pretty concerned by the controversial "three times letting value" arising under Article

164 C of the French Tax Code, as a quid pro quo for the introduction of the 20% cadastral letting value tax, will be pleased to learn of the proposal that this form of income tax would simply be abolished.

The news of the abolition of this tax will be especially well received in Monaco, as this tax raises many issues in respect of foreigners resident in Monaco who have secondary residences available to them in France and where, in some cases, liability to this income tax arises. It is expected this will be helpful to the local French property market.

The 20% tax would come into force as of 1 January 2012.

If the proposed draft is adopted, the new law might affect many non French tax residents owning French properties, notably if the shareholder's loan exemption for wealth tax purposes is abolished as of 1 January 2012 and that such a loan were used for the purpose of avoiding French wealth tax. Furthermore, the new law might have important tax consequences in respect of French sited assets currently held in Trusts.

Depending on the circumstances and the potential tax exposure under the new law, a review of the ownership structure of the property should be envisaged as soon as the law is adopted and before the end of this year.

Should you require any information in this respect and French taxation in general do not hesitate to contact us.

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