



# Tax Planning International **European Tax Service**

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# France: Important tax changes

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The French government has recently proposed several tax amendments which will impact non French residents. Most of these changes are tied to properties, trusts and inheritance. These amendments and their impact, if passed by the parliament, are highlighted in the article below.

A series of tax changes which will affect non French residents and will be brought in during 2011 has been proposed by the French government. If passed by parliament the amendments will form a second 2011 Finance Act in France. The main points are:-

## I. Wealth tax

- From January 2012, the threshold at which Wealth Tax becomes payable is increased from a net value (i.e. after deduction of debt) of EUR 800,000 to EUR 1,300,000.
- Between EUR 1,300,000 and EUR 3 million the rate will be 0.25 percent on the entire net wealth. If the household's wealth exceeds EUR 3 million the rate will be 0.5 percent on the entire net wealth.
- There will be a form of progressive taxation between EUR 1.3 million and EUR 1.4 million and EUR 3 million and EUR 3.2 million
- If your net wealth is below EUR 3 million you will no longer file a Wealth Tax return but will declare your wealth on your income tax return.

## Comment

- Moderately wealthy French people will be pleased by this change as many will now fall out of Wealth Tax.
- Payment at the higher rate of 0.5 percent on all wealth if you are worth over EUR 3 million means the banding system has gone.

## I. Wealth tax – current accounts

- At the moment it is possible for non residents to quite simply avoid Wealth Tax using a company

such as an SCI or a foreign company typically a Monegasque or Luxemburg company. This has become wide spread at the top end of the property market typically with villas and chalets worth from EUR 10 million to EUR 70 million. In recent years it has become more noticeable in properties worth under EUR 10 million and this may be why action is being taken.

- As an example an SCI buys a property for EUR 30 million which is financed by a EUR 30 million loan from the shareholder. It is not necessary for the company to borrow any money from a bank. The shareholder, an individual, is taxed to Wealth Tax on the value of the shares in the SCI. The value of the shares in the SCI is however zero because although it owns a property worth EUR 30 million the SCI has a debt of EUR 30 million due to the shareholder. The debt of EUR 30 million is owed to a non resident and is classed as a financial investment and as such is exempt from Wealth Tax in France.
- It is proposed to end this exemption from January 1, 2012.

## Comment

- This will come as very bad news to owners of very expensive French properties.
- The devil will be in the detail of the draft legislation to see whether lending can be structured via trust arrangements or offshore companies to reduce the value of SCI shares.
- The route to avoid Wealth Tax which remains open to non residents is to borrow from a bank thereby reducing their taxable equity in the property. This route has not been affected. However for the very

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wealthy this is tiresome as they have to pay the banks margin on the loan. On mortgages running into tens of millions they will almost certainly have to pledge collateral in the form of shares or cash, as the security of a mortgage on the property will usually be insufficient.

- The winners here are likely to be banks in Monaco, Geneva and Luxemburg who will find the very wealthy are now forced to take mortgages to reduce their net wealth in France. We anticipate a fair amount of offshore mortgaging before January 1, 2012. Other Wealth Tax exemptions apply which we expect will be explored more vigorously.

### III. Wealth tax – trusts

- Trusts have been useful planning vehicles in France because the French legal system does not recognise them as legal entities and so their tax status is usually ambiguous.
- From 2012 a new annual tax is to be levied on trusts of 0.5 percent of all their assets if the settlor and beneficiary are French resident and on French assets only if the settlor and beneficiary are not French resident.
- The tax will not be levied if the assets in the trust are declared for Wealth Tax by the settlor or beneficiary as their assets.

#### Comment

- This is going to be problematic for trustees who will have to decide whether assets they hold in trusts have to be disclosed to the French Revenue.

### IV. Non residents - holiday homes

- A new tax will be levied on non residents who own a holiday home in France which is freely available to them. This will be equal to 20 percent of the *valeur locative cadastrale* "VLC". This is based on a theoretic rental value for the property. The calculation of the VLC is carried out as part of the rating process and is set by the local tax office. It depends on the size of the property. There is information on [www.cadastre.gouv.fr](http://www.cadastre.gouv.fr)
- If you have been French resident for three years in the previous 10 years before you leave France you are exempt from this tax for six years.
- This tax will apply from January 1, 2012.

#### Comment

- The tax will apply to "residences" so commercial and agricultural property will not be affected. Building sites should also be exempt.
- If the property is rented and so not freely available to the owner the tax will not apply. This means leasebacks will not be affected.
- The tax applies to all residences so you pay on all properties in France.
- There is a current version of this tax in force in France but it does not apply to residents of EU countries or residents of countries which have a double tax treaty in France.
- Questions will be asked whether this rule breaches EU law on free movement of capital. French residents may think twice before leaving to work abroad.

- Double tax treaties may be applicable and afford protection.
- This may be the "last straw" for people who use their holiday home rarely and find it a financial drain.

### V. Inheritance tax – trusts

- The position on gifts made within a trust is unclear in France. The new law will change this by taxing lifetime and death gifts on the basis of the relationship between the settlor and the beneficiary. In France the rate of tax varies according to the relationship between donor and recipient.
- If you cannot establish whether a gift has been made within the trust a tax charge will still arise on the death of the settlor. This charge will generally be at 60 percent.
- If the trust is in a "non cooperative state" i.e. a tax haven with no treaty (or Tax Information Exchange Agreement) with France the tax rate will be a flat 60 percent.
- The tax arises if the deceased was French resident or the trusts assets are in France.

#### Comment

- This is going to be difficult to administer. It ties in with the 0.5 percent declarations for Wealth Tax which trustees will now be required to make. This means that if assets are appointed out of a trust to beneficiaries the French Revenue will become aware of the same.

### VI. Gifts – 10 years instead of 6 years

- Currently gifts made to the same person after six years are not taken into account when calculating French Inheritance tax. The slate is "wiped clean" after six years. This will change and the new period will be 10 years.
- This means that if a father makes a gift in 2004 to his son and dies in 2011 the gift of 2004 which was previously ignored for inheritance tax is now taken into account.

### VII. Exit tax

- French residents may seek to avoid tax by going non resident. This is to be clamped down on by charging individuals capital gains tax on their latent gains on the date they leave France.

#### Conclusion

These proposals are populist and will please many French voters in the run up to the presidential elections. They are however unhelpful in attracting foreign capital into France. It is to be hoped that the French parliament will see sense and review the proposals.

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