

New Rules on taxation of trusts in France

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Please note that tax and trust law are complex subjects and you should not rely on this article without professional advice on the facts of your case.

1. Article 14 of the French Finance Amending Law of 2011 makes major changes to the way foreign trusts are taxed in France. It is unfavourable to trusts and its full implications including its interaction with double tax treaties will take some time to be understood. This article sets out the basic new French rules but does not deal with the effect of double tax treaties. Its reach is much wider than many people would expect and it is likely to catch unsuspecting trustees out. It imposes a new onerous disclosure requirement on trustees with criminal sanctions.

Summary of the main changes

2. The changes cover Wealth Tax, income tax and Inheritance tax. In summary income retained within a trust is not taxed until distributed to a beneficiary, a new disclosure regime is introduced for trustees who hold French assets or if the settlor or any beneficiary is French resident, Wealth Tax is extended to trusts if the settlor or beneficiaries do not declare the same.

Definition of a trust

3. The legislation defines a “*constituant*” (settlor) of a trust as the individual (not a company) who has set up the trust. The new legislation does not extend to trusts set up by corporate settlors. It does however extend to individuals who have provided the assets and used a professional individual trustee or a corporate settlor as a vehicle¹. The intention is to look behind any professional person and identify any individual who has provided the money.
4. In most cases trusts will have been set up by individuals. Corporate settlors are quite rare but arise in charitable trusts and trusts for the benefit of employees.
5. If the original constituent has died then the beneficiary is deemed to be the constituent². This will be difficult to apply in the case of a discretionary trust if there is no specified beneficiary.
6. A trust is defined³ as the legal rights created under the law of a country other than France by a *constituant* either inter vivos or on death who transfers assets to an administrator (a trustee) in the interests of one or more beneficiaries or for a defined objective. This wording is wide and is likely to cover fixed and

¹ Art 792-0 bis I.2

² Art 790-0 bis 3

³ Art 792-0 bis I.1

discretionary trusts. It only applies to non French trusts, as France does not have a trust law as such.

Disclosure requirements on trustees

7. A new provision⁴ puts an obligation on trustees to declare the creation, modification and revocation of any trust if the constituent or at least one of the beneficiaries is a French resident or if any trust asset is situated in France. The trustees are also obliged to disclose the terms of the trust. The specific requirements will be detailed in a separate decree.
8. There is no specific provision defining what a trust asset in France is. This is likely to come under scrutiny as the main connecting factor for trustees. The precise French wording in Article 1649 AB is “...*un bien ou un droit qui y est situé...*” If for instance a trust owns a property in France via a Luxembourg SCI does the trust own Luxembourg shares or is it deemed to own the French property? For the moment the former is more likely and the trust would not come within the disclosure requirement. Purchasers using trust vehicles are best advised to use non French SCIs for property investments. Monegasque vehicles will be suitable.
9. If a trustee has lent money to an individual beneficiary or to his French SCI to buy a French property is the debt owed to the trust a French situs asset of the trust? Does it make any difference if the debt is secured by a mortgage over the French asset? A mortgage is enforceable against successors in title of the property according to French laws of registration and as such is most likely in this context to be a French situs asset. If there is no mortgage secured on the property it may be thought there is no French situs asset. However in most cases the beneficiary who owns the property will have declared the existence of the debt to the French Revenue to obtain a deduction for Wealth Tax. To be deductible for Wealth Tax an unsecured loan must relate directly to the French property which is of concern. If the owner of the property is a French SCI then the debt will be enforceable through the French courts and as such it will be a right in France and so probably caught by the new provisions. If the loan is to a Monegasque or Luxembourg SCI then the right is probably not a French asset and should be outside the scope of the new provisions.
10. The obligation is now put on the trustees by the new law to consider what declaration should be made regardless of whether any tax may be due. As such the new provision is unusual and indicates that the French Revenue may be building a database of trusts which have a French connecting factor. This may be used to expand the tax base in the future. Trustees may decide it is best before the first assessment date of 1st

⁴ Art 1649 AB

11. The trustees are obliged to declare the market value of the trust assets as at 1st January each year. This obligation to declare the assets does not require the assets to be taxable. The wording is difficult to follow⁵ but it seems for French settlors and beneficiaries it requires all assets worldwide to be disclosed not just the French assets. For non French resident settlors and beneficiaries it requires French assets to be declared. This provision is extremely wide and will work in an arbitrary way. A settlor who many years after establishing a trust moves to France will result in his trustees having to make the declaration.
12. Failure by a trustee to make the return will result in a fine of the higher of €10,000 or 5% of the assets placed into trust including capitalised income⁶. This fine surprisingly appears to cover all trust assets worldwide and not just French situs assets. It does not seem to matter that the settlor and beneficiary are not French resident; the whole trust fund is fined 5%. The French Revenue can proceed against the French assets to secure the fine. The constituent and the beneficiaries are jointly liable with the trustees for this fine. It seems likely that a failure to pay the fine will be a criminal matter which could lead to the trustee's imprisonment in France.
13. The declaration has to be made even though there may be no liability to pay any tax. This will enable the French tax authorities to build a register of trusts with French interests.

Wealth Tax ("ISF") assessed on settlors of trusts with French assets or with French resident settlors or beneficiaries

14. Assets placed into a trust are deemed to be the assets of the settlor for Wealth Tax purposes⁷. If the settlor is deceased the beneficiaries are deemed to be the settlors⁸. This imposes an obligation on the settlor to include the trust assets in his Wealth Tax return. If the settlor is a corporate entity the law cannot apply as only individuals can be assessed to ISF.
15. If the trustees are subject to the law of a country which has signed a tax treaty with France to prevent tax evasion the charge does not apply to irrevocable trusts if all the beneficiaries come within Article 795, broadly charities.

New provision taxes capital in trusts at 0.5%

16. A new provision⁹ taxes capital in trusts at a flat rate of 0.5%. This is aimed at taxing assets in a trust which have not been taxed as an asset of the settlor. The tax is due from individual settlors (and beneficiaries) of a trust but not corporate entities. The trustees will in effect be liable because they have to file a disclosure

⁵ Art 990J III 1 and 2

⁶ Art 1736 IV bis

⁷ Art 885 G ter

⁸ Art 792 – O bis 3

⁹ Art 990 J

and have to make payment by 15th June in each year. The first payment will be due on 15th June 2012.

17. There is a similar provision as for settlors exempting trusts which are irrevocable and come within article 795 (broadly charitable) but also including pension schemes set up by employers. It does not extend to self administered schemes not set up by employers.
18. The provisions are similar to the ones for settlors. If the settlor or a beneficiary is French resident the tax is assessed on the worldwide assets of the trust. If not then only on the French assets¹⁰.
19. The tax is not payable if the assets in the trust have been declared as part of the estate of the settlor or beneficiary under Article 885G ter. It is also not taxable if it has been duly declared by the trustees as part of the estate (under Article 1649 AB) of the settlor or beneficiary and the settlor or beneficiary is not taxable because the individual's total estate including the trust assets is below the threshold. This puts an important obligation on the trustees to declare the trust assets. Failure to declare the trust assets makes them taxable.
20. In almost all cases it will be in everyone's interests for the trust assets to be declared by the settlor rather than assessed on the trust. If the tax is not paid the settlor and the beneficiaries as well as their heirs are jointly liable for the tax.

Income Tax

21. Trust income is not taxed on the beneficiaries. Article 120 – 9 has been amended to provide that only the distributed “products” of a trust are to be considered taxable income.

Tax on death of settlor – Gift and inheritance tax

22. The position of gifts from a trust has been clarified. The event which generates a tax charge is either a gift by the trustees or the death of the settlor. The tax is assessed according to the family relationship between the settlor and the beneficiary. The tax is assessed on the net value of assets gifted to a beneficiary¹¹. This is straight forward if there is a gift out of a trust to a specified beneficiary. This would be the case if trustees exercise a power to appoint assets to a beneficiary or if a fixed trust comes to an end and assets are distributed to named beneficiaries. The beneficiary should include all other assets received from the settlor apart from the trust assets and is assessed on the total amount and is liable for the tax.

¹⁰ Art 990 J III 1 & 2

¹¹ Art 790-bis II 1

23. In the event that the assets do not leave the trust on the settlor's death because say they are held on further default trusts, if a determinable part of the trust assets passes to a beneficiary, tax is levied according to the above family link.
24. If on the settlor's death trust assets are "globally" due to the descendants of the settlor they are taxed at 45 %. This would be the case if there was a discretionary trust and at the date of death it was impossible to know what share each beneficiary would receive. The beneficiaries must be descendants of the settlor to benefit from this provision. It is unclear what the rate will be if the beneficiaries were not all descendants of the settlor.
25. The trustees are required to pay the tax. If they do not and the trustee is subject to the law of a non cooperating state¹² or a state which has not signed an exchange of information treaty with France the beneficiaries are jointly liable for the tax.
26. If the trustee is subject to the laws of a non cooperating state, i.e. one with which France does not have an exchange of information treaty then all gifts whether inter vivos or on death are taxed at 60%. The French provisions do not apply the test of the law where the trust is resident. Rather they apply the law to which the trust is subject. In other words a trust resident in a tax cooperating jurisdiction but which is stated to be governed by the law of a tax non cooperating jurisdiction will fall foul of the French provisions. Non cooperative states¹³ are listed as at 29th April 2011 as, Anguilla, Belize, Brunei, Costa Rica, Dominique, Grenada, Guatemala, Cook Islands, Marshall Islands, Liberia, Montserrat, Nauru, Niue, Panama, Philippines, Oman, Turks and Caicos and Saint Vincent and the Grenadines.
27. The usual rules of territoriality¹⁴ will apply so broadly if the settlor and beneficiary is not French resident the tax will only apply to French assets. Article 750 ter has been changed so that if the settlor is French domiciled the Inheritance/gift tax is assessed on the world wide assets in the trust. If the settlor is not French domiciled the tax is assessed only on French situs assets. If however the beneficiary is French resident at the date of the death or gift and has been so for at least 6 out of the last 10 years then the tax is assessed on a world wide basis.
28. The provisions in the new French provisions are drafted in general terms and there are glaring loopholes to an Anglo Saxon lawyer's eye. The question is to what extent the French courts would be sympathetic to technical points of construction on English trust law. It must also be born in mind that the French legislator has in mind other jurisdictions with trust law in particular the United States.

¹² Art 238-0 A

¹³ Art 238-O A

¹⁴ Art 750 ter

29. For all trusts set up after 11th May 2011 with a French resident settlor the rate will be 60%. In short French residents should not set up trusts.

30. The new rules apply from 31st July 2011.

Steps for trustees to take before 1st January 2012

31. Trustees who have any French connection should consider the following before 1st January 2012:- (1) notify settlors and beneficiaries of the disclosure requirements (2) consider moving assets into Monegasque or Luxembourg SCIs so they are no longer French “assets or rights” (3) advise settlors and beneficiaries of the implications should they become French residents (4) consider whether they have any double taxation treaty protection (5) dispose of any peripheral French assets (6) resettle French assets into a separate sub trust if the settlor or any beneficiary is or may become French resident so that disclosure of assets does not have to extend to non French assets (7) consider changing the law which governs the trust if it is currently the law of a country which has no tax treaty with France (8) if loans have been advanced consider releasing any mortgage or French security taken.

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