

## 2011 French Tax Reforms



### 2011 FRENCH TAX REFORMS

Usually the French parliament discusses and votes the Budget (*Loi de Finances*) annually at the end of the year, with a series of decisions affecting the next calendar year onwards and another series of decisions which potentially have a retroactive effect. In recent years the French parliament has taken the habit of introducing further interim tax legislation in the summer (*Lois de Finances rectificatives*). This year, because of the crisis France has had not one but two interim *Lois de Finances rectificatives*,

the first one published on 29 July 2011 and the second one published on 20 September 2011. Both laws, which we will refer to as The French Tax Reforms, impact businesses and individuals. The scope of this technical update is to summarise the main tax changes affecting individuals.

It is worth noting that some uncertainties remain as to the application of some of the tax changes. The government indicated that they would issue guidelines in the form of *Decrees* and/or *Instructions Administratives*. The additional documentation will no doubt raise new questions.

#### New wealth tax rates and wealth tax threshold

The new wealth tax threshold is €1,300,000 from 1 January 2011. Wealth tax applies to worldwide net assets for French residents and net French situs assets for non residents. The new tax rates, applicable from 1 January 2012, are as follows:

- 0.25% on the total net assets if net assets are between €1,300,000 and €3,000,000.
- 0.50% on the total net assets if net assets are above €3,000,000.

#### The highlights

	Out	In	Modified
Wealth tax rates/wealth tax threshold			x
Gift/inheritance tax rates			x
Tax shield	x		
SCI shareholder loans deductible for wealth tax	x		
Assurance-vie IHT exempt contracts	x		
Assurance-vie IHT rate			x
Exit tax		x	
Trusts			
- Inheritance tax		x	
- Wealth tax/trustee tax		x	
- Trustee disclosures/penalty regime		x	
Capital gains taper relief on property			x

#### Gift/inheritance tax rates

Rates have been increased by 5% for taxable amounts in excess of €902,838:

- for direct descendants: on succession and gifts;
- for spouses or partners in a PACS: on gifts only, as successions are not taxable.

Also, the reductions applicable to gift duty for donors younger than 70 or 80 years old have been abolished.

Previously, after 6 years new nil rate bands were available – this will now be after 10 years.

## The tax shield

The tax shield, originally created in 2007 when Nicolas Sarkozy was elected President, and which was only available to French residents, will apply for the last time in 2012, with reference to 2010 income.

## SCI shareholder loans deductible for wealth tax

This change will affect only non French residents. Hitherto non residents could claim the benefit of the deduction of shareholders loans in the valuation of their SCIs for wealth tax purposes. For French residents, the deduction of the SCI shareholder loan has no net impact, because although the SCI valuation is reduced, they have to declare the amount of their shareholder loan owed by the SCI as a separate asset on their wealth tax return. For non residents, there has been a debate amongst tax advisers as to whether the shareholder loan had to be declared. The reason for the debate is that non residents benefit from a general exemption on French investments, aimed at encouraging them to invest in France. The question was then to determine whether a shareholder loan account could be defined as a French investment.

The new legislation has clarified the position by disallowing the deduction of non residents' shareholders loan accounts in the valuation of SCIs for wealth tax purposes, so that residents and non residents are now treated in the same way. This change will be effective from 1 January 2012. Non residents who did not file a return in previous years may therefore fall within the scope of wealth tax in 2012, unless they restructure their investment by the end of 2011.

When considering restructuring they should ask themselves whether such restructuring is cost effective, as it is sometimes cheaper to pay the wealth tax.

## Assurance-vie IHT exempt contracts

Assurance-vie contracts which comply with French legislation benefit from a favourable tax regime. The amounts paid to beneficiaries are exempt from succession duty but subject to a 20% flat rate contribution, for taxable amounts in excess of €152,500 (see also below for the rate update). Before the 2011 tax reform, assurance-vie contracts which had been subscribed by non French residents at the time of subscription were exempt from the flat rate contribution even when the subscriber moved permanently to France. This is no longer the case, and the change applies retrospectively to contracts which were subscribed before the change in law.

The contribution will therefore be due in the following circumstances:

- at time of death, the beneficiary is French resident, or was a French resident for at least 6 years in the 10 years preceding death;
- the subscriber was a French resident at the time of death.

## Assurance-vie IHT rate

The French tax reform introduced a higher contribution rate for taxable amounts in excess of €902,838:

- between €152,500 and €902,838 per beneficiary: 20%
- above €902,838 per beneficiary: 25%

Note that French residents are also subject to the social surcharge at 13.5%.

## Exit tax

Since 3 March 2011, French residents moving from France are potentially liable to an exit tax on latent gains, with the possibility of claiming deferral. This will be automatic for EU residents. There are provisions in order to avoid double taxation. A future decree is expected to give more details on the application of the exit tax.

## Trusts

### Quick assessment: are you likely to be affected by the new rules?

The answer is yes if:

- you are French resident and you are the settlor, or the deemed settlor (see definitions below). You might be affected if you are the beneficiary/potential beneficiary of a trust;
- you are not French resident but are settlor, or the deemed settlor, of a trust which owns French real estate;
- you are a trustee of a trust with settlor/deemed settlor/beneficiaries in France, or with French assets held in trust.

## Definitions and taxes involved

The new legislation starts by giving a definition of trusts and similar structures under French law. This definition is largely based on the definition which had been given in the context of the 3% tax potentially due by companies and trusts owning French real estate.

Trusts are potentially brought into the ambit of wealth tax (with effect from 1 January 2012) and succession duty (applicable since the publication of the law this

summer). The law also creates annual reporting obligations for trustees, with heavy fines in case of non compliance, with effect from 2012. There is scope for restructuring trusts in the light of this new legislation, but action needs to be taken before the end of 2011, which does not leave much time.

Amongst the definitions, France creates the concept of deemed settlors in order to be able to tax trusts even when settlors are deceased. A deemed settlor may be:

- the actual person who placed the assets in trust in case of nominee arrangements;
- following the death of the original settlor, the beneficiary/ beneficiaries to whom the assets or beneficial interests are attributed.

## Inheritance tax

The devolution of assets held in trust is now potentially taxable in France.

Taxation applies to:

- all trust assets if the settlor was French resident at the time of death,
- all trust assets received by a French resident beneficiary (or by beneficiaries who were French resident for 6 out of the 10 years preceding death),
- all French situs assets held in trust.

The event which triggers French inheritance tax is the death of the settlor.

The level of taxation will be determined by circumstances at the time of death:

- if the devolution of assets qualifies as an event similar to inheritance or gift, then the usual tax bands and rates applicable to succession duty/gift duty apply;
- in other cases:
  - if a determined share is passed to a defined beneficiary: the tax rates and band depend on the family relationship with the deceased. Normal succession duty rates apply.
  - if a determined share is passed to a defined class of beneficiaries who are all descendants of the deceased: the applicable rate is 45%.
  - otherwise the tax rate is 60%. This rate also applies to trusts created after 11 May 2011 by a French resident settlor, and to trusts for which the applicable law is in a blacklisted jurisdiction.

## Wealth tax/trustee tax

Trust assets potentially liable to wealth tax are:

- French situs assets such as properties (financial assets are exempt);
- All trust assets if the settlor or the deemed settlor (as defined above) is French resident.

Exemptions exist for charitable trusts and pensions. The pension exemption is written such that it may apply to occupational pension trusts only.

Once the taxable assets have been identified, there are two possibilities:

- Either the settlor/deemed settlor files a wealth tax return each year and includes the assets in the return, in addition to the other taxable assets he may have. In that case, normal wealth tax

rates and exemptions apply. For example, if the total net assets are below €3,000,000 the tax rate is 0.25% per annum, and exemption can be claimed in respect of antiques and works of art.

- Or the trustees file a special tax return in lieu of the wealth tax return. In that case the tax rate will always be 0.5% per annum, even if the total value is below €3,000,000, with no exemption for antiques or works of art.

The implication of the above is that many trustees throughout the world are potentially liable to pay and file the trust tax. The law applies with effect from 1 January 2012.

Wealth tax/trustee tax is not due if the total value of the settlor's assets is below the €1,300,000 wealth tax threshold. However trustees will still have disclosure requirements as explained below.

## Trustee disclosures/penalty regime

In order to have access to information which may evidence the tax liability, the tax authorities have introduced an annual declaration to be made by the trustees in the following cases:

- The settlor/deemed settlor is French resident;
- At least one of the beneficiaries is French resident;
- There are French situs assets owned by the trust.

Trustees will have to report:

- The creation, modification or cessation of the trust;
- The principal terms of the trust Deed;

- The description and valuation of assets which are in the scope of the trust tax, including potentially exempt assets, for example assets which have been declared by the settlor in his wealth tax return.

The sanction if trustees fail to file the annual report is a fine of 5% of the trust assets, with a minimum of €10,000. This is ten times the trust tax rate, and is clearly intended at incentivising trustees to comply.

### Expected decree

There are many aspects which are uncertain in the law as drafted. The decree should provide more details in due course.

### Capital gains taper relief on property – change with effect from February 2012

#### Rules before the change

Under the existing rules, the French property gain is tapered by 10% for each complete year of ownership after 5 years of ownership, in other words the gain is fully tapered after 15 years.

Example: for a property owned for 6 complete years, the gain is tapered by 10% for French CGT purposes.

There is a window of a few months to benefit from the current rules.

#### Future rules

With effect from February 2012, the taper relief will be less favourable and full exemption will only be available after 30 complete years of ownership. For French residents, the sale of their main residence remains exempt.

The new taper relief rates will be as follows:

- First 5 years: no taper relief;
- Next 12 years: 2% per annum;
- Next 7 years: 4% per annum;
- Final 6 years: 8% per annum.

Note that a UK resident domiciled in the UK is also subject to UK Capital Gains Tax (CGT) on the sale, with a tax credit for tax paid in France. Non UK domiciled UK residents claiming the remittance basis should seek advice to work out what the outcome would be in the event of a sale.

### What's next?

At the time of writing the parliament is in its more traditional process of discussing the 2012 *Loi de Finances*. One of the expected changes is the introduction of a higher marginal rate of income tax, but the level of increase has not yet been decided.



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