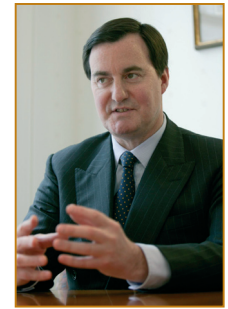


# French civil companies

## What are they? How can they benefit United Kingdom residents?



Author James Howes.

### The idea of a “civil” company

French law makes an important distinction between corporate bodies with commercial objects (*sociétés commerciales*) and those with so-called “civil” objects (*sociétés civiles*). In essence, a company with a civil objects clause is precluded from carrying on business with a view to a profit. If a civil company starts to carry on a trade (except for the types of business mentioned below) it loses its civil status for tax purposes and becomes liable to French corporation tax.

*Sociétés civiles* have no direct equivalent in English law. They are proper companies, with statutes, a capital, a manager, a name and a registered office; they have their own legal personality and must be registered with the local companies registry. But they differ from ordinary limited liability commercial companies, such as the English limited company or a French SA, in that their capital is much more closely identified with the persons who own it. Whereas shares in a commercial company may be more or less freely exchanged, with no impact upon the company itself, the so-called *parts* in a civil company can only change hands through a deed which has to be stamped and notice of the change of owner given both to the registry of companies and to the company itself. Nor do they usually have a board of directors: the manager or *gérant* has very wide powers under the statutes and can commit the civil company to practically anything providing it is in the company’s own interest.

Civil companies do not confer limited liability on their owners. Shareholders have unlimited liability in proportion to their respective percentage ownership of the *parts*.

Civil companies do not pay income tax or corporation tax, except in special circumstances. Income and gains arising to such companies are pro-rated between the shareholders and taxed on them through the mechanism of their respective tax returns.

### Uses of *sociétés civiles*

The attraction of the *société civile* is that it provides a convenient vehicle in which to hold assets without submitting them to the rigours of the commercial tax régime. In practice in France there are six categories of endeavour for which civil companies are widely used: farming (including vineyards); mining; literary, musical and artistic work; the liberal professions; mutual societies and co-operatives; and the ownership of real property. Of these it is the use of the civil company to own French land which is most commonly encountered by non-French residents. A French civil company which owns predominantly land and buildings is called a *société civile immobilière* or “SCI”.

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## Sociétés civiles in the context of private family wealth

The civil company offers strategic advantages over direct personal ownership of assets, such as, for example, the family home, shares in the family company, a portfolio of quoted stocks and shares, royalty rights or farm land.

- Transmission of family wealth to the next generation

Placing assets into a *société civile* permits the parent to make regular gifts of *parts* to the children without having either to sell the assets and convert them into cash or to endure ownership in indivision (see below).

The parents stay in effective control of the company, as *gérants*, even while the value has been hived down to the children.

The parent can conveniently give just sufficient parts to utilise the succession duty exemption of €151,950 per parent per child every six years. For French tax purposes a discount of up to 15% will be allowed in valuing the *parts*.

UK residents will need to bear in mind the possible application of the UK pre-owned assets charge to these sorts of situation.

- Avoiding indivision

A French indivision, or joint ownership of assets, is intrinsically unstable. Any one of the joint owners may require the termination of the indivision at any time: this may mean the forced sale of a family château or of shares at a time when the market is depressed. In contrast, a family civil company has a life of its own and no one shareholder may require its dissolution unless he is the majority shareholder. Whilst an indivision will typically be brought to an end by family pressures upon the death of one of the joint owners, a company continues in being, keeping the family fortune intact.

- An SCI offers stability for unmarried couples

Owning their house through an SCI allows unmarried partners to avoid an indivision between the survivor of them and the successors of the deceased.

Through the use of crossover shareholdings in an SCI, i.e. where one partner holds 50% of the shares in usufruct and his partner the bare ownership, and vice versa for the other 50%, allows the survivor to retain control of the SCI and stops the house from being sold. This arrangement also avoids French succession duty on the first death, which might otherwise be payable at up to 60% in the absence of a “Pacs” (French civil partnership). Note, however, that there should be equality of contributions to the SCI by the partners and no unnatural disparity in their ages. An apparently artificial arrangement would be open to attack if it looked like a device merely designed to avoid tax.

The ancient *tontine* arrangement treats a house owned jointly as if it had always belonged to the surviving partner; but succession duty will be payable at 60% on the first death (on one half of the value) if the *tontine* clause is incorporated in the property title deeds. If the *tontine* clause is built into the statutes of an SCI which owns the house then there will be no succession duty, only the 5% duty applicable to a sale of real property. Again, there must be an underlying rationale to the arrangement if it is to pass scrutiny as a potential abuse of law.

## Use of SCIs by United Kingdom residents

Draft legislation published at the time of the March 2007 Budget aims to remove any possibility of a taxable benefit in kind arising to a UK resident who owns a foreign holiday home through a company. The proposed key conditions for the exemption to apply are that:

- The company must be owned by individuals;
- The property should be the company's main or only asset;
- The only activities undertaken by the company should be ones that are incidental to its ownership of the property.

It is proposed that the exemption shall have retrospective effect.

If this exemption passes into law it will remove a significant perceived obstacle to the use of SCIs by UK residents to own French holiday homes.

A UK domiciled person who owns shares in an SCI owns personal property, as opposed to real property. He is therefore free to leave the shares under the terms of his English will. French forced heirship rules will not apply if the shareholder dies domiciled outside France. Note, however, that French succession duty will still be in point at the time of his death (see below).

## Income tax

SCIs are free to let the bare walls of their properties as this is considered to be a civil activity. Furnished letting, however, is commercial and can only be carried on by the owner or other third party who leases the property unfurnished from the SCI. French income tax is payable at the minimum rate of 20% applicable to non-residents and double tax relief given against the UK liability arising on the same income, calculated under UK rules.

## Capital gains tax

A French holiday home which has been owned either directly or by an SCI for fifteen years or more is exempt from French capital gains tax. It must be fifteen years in the same ownership: transferring the house into an SCI from personal ownership restarts the clock for this purpose.

The capital gain is equal to the net sale price, less original purchase price, plus the cost of subsequent capital improvements. From this is deducted 10% for each year of ownership after the fifth year. Note that if it is the shares in the SCI which are sold (as opposed to the SCI selling the property), relief for capital improvement expenses will only be available if the SCI was funded by a matching increase in its issued capital. In other words it is the actual total cost of the shares which is taken into account. French tax at 16% is due by non-French residents who are resident in EU countries. Double tax relief is again available under the UK-France treaty against the UK capital gains tax payable as a result of the gains being looked through to the UK resident owner of the SCI.

## Wealth tax

A United Kingdom resident who owns shares in a French SCI is liable to wealth tax if the value of his *parts* exceeds the exempt threshold, currently €770,000. The tax rate starts at 0.55% and rises to 1.80% on wealth above €16,020,000. It is an annual tax, based on values at 1 January. Only French resident taxpayers may take advantage of the so-called "tax shield" which limits a person's overall liability to French taxes to 50% of his income.

### Succession duty and inheritance tax

The estate duty treaty of 1963 between England and France deems shares in an SCI to be French situs real property for tax purposes. Relief against UK inheritance tax is given for French duties paid. Since August 2007 there has been no French duty payable upon transfers on death between spouses or between partners in a French Pacs; (lifetime gifts are still taxable events and are not the subject of the 1963 treaty). But where the SCI shares are left to children, siblings or even third parties (e.g. trustees) normal rates of French death duties apply and these go up to 60%. As the top IHT rate in the UK is 40% care must be taken not to incur the full French rate, against which no relief will be available.

### Valuation of SCI shares

For both English and French tax purposes normal valuation principles apply to parts in an SCI. The value will be basically the market value of the properties owned less debts due by the company, less discounts for a private company and minority shareholdings. Debts can include properly evidenced shareholder loans as well as bank loans, whether secured on the property or not.

### Running an SCI or other civil company

Civil companies are not required to file annual accounts at a public registry and their internal affairs are largely private. Nevertheless, changes in the statutes, the identities of the owners and the *gérant*, the registered office and the like all have to be filed publicly. Only one tax return is required each year: it has the dual purpose of apportioning any rental or investment income between the shareholders and of securing exemption from the annual tax at 3% levied on property holding companies. This relatively relaxed regime frequently lulls SCI owners into a false sense of security, believing, for example, that proper books of account and the calling of annual meetings can be dispensed with. This is most unwise. Civil companies which do not keep proper accounting records and prepare financial statements for approval by the shareholders at a properly convened AGM are quite likely nowadays to be declared to be "fictitious companies" by the French tax authorities. This generally leads to unforeseen and unwanted tax consequences, for example where a valuation of shares is under discussion for wealth tax or succession duty purposes.

Nevertheless, providing a sensible attitude is taken to the administration of an SCI, it is a vehicle which has much to recommend it in appropriate circumstances.

This update is for information only and does not constitute professional advice. For advice on your particular circumstances or for further information, advice or assistance in relation to any matters raised above, please contact the author or your usual Dixon Wilson partner.

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