

TIRARD, NAUDIN
International Tax Newsletter

LEADER

Following the First Amendment to the Finance Law of 2011, which had a significant impact on estate planning for both French residents and non residents (see our Tax Letter of July 2011), additional measures were introduced by the Second Amendment to the Finance Law of 2011 (passed in September 2011), the Fourth Amendment to the Finance Law of 2011 and the Finance Law of 2012 (passed in December 2011). These include, in particular, increasingly adverse provisions for the taxation of real estate and participations in France. Certain significant corporation tax measures were also introduced, such as an increase in the taxable fraction of capital gains under the participation exemption regime, a capping of the carry forward and carry back of tax losses, and a temporary increase in the standard rate of corporation tax for large companies.

REAL ESTATE TAXATION

CAPITAL GAINS TAX ON FRENCH REAL ESTATE

Current rules. The sale of a French property by an individual triggers capital gains tax at a 19% flat rate, assessed on the net capital gain after the application of a yearly 10% fixed allowance as from the 6th year of ownership. As a result, the sale of a French property held for more than 15 years was tax exempt.

New rules. For sales made on or after 1st February 2012, a yearly allowance applies as from the 6th year of ownership, at reduced progressive rates: 2% per year as from the 6th year of ownership, 4% per year as from the 18th year and 8% per year as from the 25th year. The full tax exemption will therefore apply to the sale of French properties held for more than 30 years. In order to prevent any avoidance scheme involving the contribution of real estate to a company held by the property owner before 1st February 2012, the Law provides that any such contribution made on or after 25th August 2011 is also subject to the new rules.

Example. Mr. A, a non French tax resident, bought a property in France on 1st December 2000 for € 1 million. Mr. A is thinking of selling his property for € 1.5 million.

If Mr. A sold the property on 15th December 2011, the 19% capital gains tax rate applied to 40% of the net gain, i.e. $19\% \times (\text{€ } 1.5\text{m} - \text{€ } 1\text{m}) \times 40\% = \text{€ } 38.000$.

If Mr. A sells the property on 15th February 2012, i.e. under the new regime, the 19% capital gains tax rate will apply to 88% of the net gain, i.e. $19\% \times (\text{€ } 1.5\text{m} - \text{€ } 1\text{m}) \times 88\% = \text{€ } 83.600$.

SALE OF SHARES IN A PROPERTY INVESTMENT COMPANY

Reminder. Since 1st January 2010, the sale by a deed executed outside France of shares in a French or foreign company whose assets predominantly consist of French properties (property investment companies) is subject to registration duties in France at the rate of 5%, and the deed of sale has to be registered in France within one month of the sale.

Additional notarial formalities. Since 1st November 2011, the sale by a deed executed outside France of shares in a property investment company requires the execution of a notarial deed in France within one month of the sale, and the registration of the notarial deed with the tax administration within one month of its date.

New tax base rules for registration duties. As from 1st January 2012, the tax base of the registration duties on the sale of shares in a property investment company is the sale price of the shares, after deducting debts relating only to their acquisition. The aim of these restrictive deduction rules is to prevent schemes which involve reducing the share value before sale by granting a loan to the company.

This measure echoes the anti-avoidance rules introduced for wealth tax purposes by Parliament in its First Amendment to the Finance Law of 2011, under which from 1st January 2012 the valuation of the shares in a property investment company may not be reduced by any loan owed to its non resident shareholders (see our Tax Letter of July 2011).

RECENT CASE LAW

Non-residents' capital gains. In three decisions of 25th February 2011, the Administrative Court of Montreuil held that the taxation of non-residents' capital gains on property sales at a higher rate (33%) than that applicable to French residents (now 19%) was discriminatory for the purposes of the EU Treaty. These decisions echo a judgement of the Administrative Court of Paris dated 20th May 2010, in which the taxation of Swiss residents' real estate capital gains at a higher rate than that applicable to French residents was held to be contrary to the capital gains provisions of the Double Tax Treaty between France and Switzerland. The French tax authorities have also appealed against these decisions. The Administrative Court of Pau, however, held (in a decision of 29th October 2010 based on a more or less identical factual background) that the application of different real estate capital gains tax rates to French and Swiss residents was not contrary to the non-discrimination provisions of the Double Tax Treaty between France and Switzerland.

Share contributions followed by immediate disposal. In two decisions dated 24th August 2011, the French Administrative Supreme Court (*Conseil d'Etat*) confirmed that the contribution of shares under a tax deferral regime to a company controlled by the contributor, followed by their immediate disposal by the company, constitutes an abuse of law only where the transaction's sole purpose is to obtain liquidity from the disposal and remain the shareholder of the company, unless the liquidity is reinvested by the company in an economic activity.

SOCIAL CONTRIBUTIONS

The social surtax on investment income has been raised from 2.2% to 3.4%. The overall flat rate of the aggregate social contributions applicable to French residents has therefore been increased from 12.3% to 13.5%. This rate applies to income from capital assets arising on or after 1st January 2011 and to savings income accrued on or after 1st October 2011.

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TAXATION OF TRUSTS

Further to the introduction of a specific tax regime applicable to trusts (see our Tax Letter of July 2011), no implementing decree or administrative guidelines have been issued to date, although the new regime is fully effective since 1st January 2012. However, the French tax authorities released a ruling on 28th December 2011 according to which the trustees' reporting requirements apply to the terms of trusts existing as at 31st July 2011 and to the modification or termination of trusts occurring on or after this date. In our opinion this only applies in respect of trusts which have connecting factors with France on 1st January 2012. Such requirements should not apply also to trusts involving only non French tax resident settlors and beneficiaries and whose French assets exclusively consist of "financial investments".

TAXATION OF PARTICIPATIONS

INDIVIDUALS

New contributions on individuals

The Finance Law of 2012 introduced a new contribution on high annual income for individuals, at a rate of 3% for the fraction of income between €250,000 and €500,000 for single taxpayers (between €500,000 and €1,000,000 for couples subject to joint taxation), and 4% for the fraction of income over €500,000 for single taxpayers (over €1,000,000 for couples subject to joint taxation). The contribution is assessed on the individuals' reference tax income ("*revenu fiscal de référence*"), corresponding to the net annual amount of all income and capital gains, including capital gains on the sale of real estate and exceptional income. This contribution notably applies to non-residents whose French reference tax income exceeds the above thresholds.

New increase of the withholding tax rates on dividends and interest

Dividends. As a reminder, since 1st January 2011 a 19% tax rate (instead of 18%) has applied to dividends received by taxpayers who have elected for the final levy on dividends, and a 19% withholding tax (instead of 18%) has applied to dividends paid by French companies to non resident individuals within the EEA (EU, Iceland, Norway, Liechtenstein).

As from 1st January 2012, this 19% rate has been increased to 21%, and the withholding tax rate applicable to dividends paid to non-EEA residents in the absence of Double Tax Treaty has been increased to 30%.

Interest. The withholding tax rate applicable to interest payments on certain fixed rate investment products paid by a French paying establishment (whether or not the actual debtor, provided that the latter is established in the EEA) to French and non French residents has also been increased, from 19% to 24%.

Capital gains tax on participations

Removal of the tax exemption applicable to net capital gains in respect of the ownership period. As from 1st January 2012, a capital gains tax deferral regime applies instead provided that the seller (i) has held at least 10% of the financial or voting rights in the company for 8 years before the disposal, (ii) reinvests at least 80% of the gain within 36 months of the disposal in an operating company (*a contrario*, not in a holding company) in which he has no participations or executive functions, and (iii) acquires at least 5% of the share capital of the operating company.

Under this new regime, a full capital gains exemption will apply upon disposal of the new shares after 5 years of ownership.

CORPORATION TAX

Increase in the taxable fraction under the participation exemption regime

Long-term capital gains realized upon the sale of shares which qualify for the French participation exemption regime will now trigger taxation at the standard corporation tax rate (33.33%) on a fixed "fraction of costs and expenses", which has been increased from 5% to 10% of the gain. This new measure applies to fiscal years beginning as from 1st January 2011.

REGISTRATION DUTIES

Former regime. The disposal of shares in an unlisted French joint stock company such as an SA or SAS, which does not qualify as a property investment company, used to trigger registration duties on the sale price at a flat rate of 3%, capped at €5,000 per transfer.

New regime. For transfers of shares made on or after 1st January 2012, the €5,000 cap is abolished and the 3% flat rate is replaced by the following progressive rates: 3% for the fraction of the sale price below €200,000, 0.5% for the fraction between €200,000 and €500,000,000 and 0.25% for the fraction exceeding €500,000,000. However, the acquisition by a company of its own shares (notably in the context of an increase of capital) will be exempt.

REGULARISING TAX SITUATIONS

Regularisation Unit. The French Budget Ministry's Regularisation Unit, whose aim was to allow taxpayers who had undeclared assets outside France to regularise their tax situation spontaneously, closed on 31st December 2009. Since then, many regularisation files have been addressed to the Budget Ministry with a view to benefiting from similar arrangements, but with no apparent follow-up. The tax administration recently declared that the opening of a new Regularisation Unit may be contemplated, with new voluntary disclosure opportunities.

Global extension of the statute of limitation for undeclared assets outside France. The Fourth Amendment to the Finance Law of 2011 extends from 3 to 10 years the time period under which the tax authorities are allowed to initiate income tax or corporation tax reassessments in respect of undeclared assets held by French taxpayers outside France, irrespective of whether or not the country in which the assets are located is deemed non cooperative or qualifies as a tax haven. This global 10-year limitation period will also apply in case of non-compliance by a trustee with its new reporting requirements (see above).