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Global mobility: Boom or Bust?

GLOBAL MOBILITY: IMPACTS ON TAXATION IN FRANCE

Introduction

Last year has taught us that global mobility is a key issue for our clients. But more than a temporary phenomenon due to COVID-19 pandemic, global mobility has been a growing trend for several decades now. Our firm is aware of the tax issues related to relocation and has advised many individuals wishing to settle in France or return there, particularly because of Brexit or the economic and political crisis in Lebanon.

To the question: "Where should individuals move?", we would answer without hesitation: "Definitely in France!". Whether it is at the time of their arrival on French soil or at the time of their departure, individuals benefit from favorable tax conditions in France; contrary to received ideas. In a few examples, we will try to convince you that even before the next epidemic, France is a domicile of choice. Not only for its gastronomy, its landscapes, its inhabitants and the "French art de vivre", but especially for its advantageous tax system (notably since the introduction of a flat tax of 30% on dividends, interests and capital gains on shares and securities and the suppression of wealth tax on movable assets).

Nevertheless, to be accurate, we will nuance our remarks on one point: gift and inheritance taxes, which are among the highest in the world, but which can be reduced by anticipating the transmission of one's estate.

I. Moving to France

1. Taxation of individuals

1.1. Determination of tax domicile

1.1.1. How to be a tax resident in France

The question is essential insofar as a tax domicile in France entails an unlimited tax liability.

Subject to double tax treaties, for a taxpayer to be domiciled in France, regardless of nationality, it is sufficient that one of the following criteria be met (article 4 B of the CGI):

- Personal criterion: having his/her home or main place of residence in France;
- Professional criterion: having a professional activity in France, whether salaried or not, unless this activity is carried out on an accessory basis;
- Economic criterion: having his/her center of his economic interests in France (principal investments, seat of his business, center of his professional activities, or the place from which he derives most of his income).

As a consequence, in terms of income tax, individuals domiciled in France are taxed on all their income from French or foreign sources (subject to double tax treaties).

On the other hand, in terms of gift and inheritance taxes, under French domestic law (article 750 ter of the FTC) the extent of France's taxing power depends on the domicile of the deceased or donor, that of the beneficiary and the location of the transferred assets on the day of death or donation:

- If the deceased or donor is domiciled in France, all movable and immovable property is taxable in France, regardless of its nature or location (even foreign debts and securities or foreign assets or rights that make up a trust and the proceeds that are capitalized there);
- If the deceased or donor is domiciled outside France, but the beneficiary has been domiciled in France for at least six years during the last ten years: all movable or immovable property located wherever situated is taxable in France;
- If both the deceased or donor and the beneficiary are domiciled outside of France: only the assets located in France are taxable in France (including French trust assets).

There are very few obstacles to the extensive application of French estate tax. Indeed, while France has signed more than 130 tax treaties with respect to income tax, it has signed only 35 treaties with respect to inheritance tax and only 8 with respect to gift tax (these are the treaties signed with Germany, Austria, the United States, Guinea, Italy, New Caledonia, Saint-Pierre-et-Miquelon and Sweden).

1.1.2. *Impact of Covid-19 on tax residency*

The Covid-19 pandemic has raised concerns about the transfer of tax residence. In accordance with the recommendations issued by the OECD in April 2020, the French tax authorities have clarified that a temporary stay in France due to lockdown in France, or travel restrictions ("travel ban"), is not likely to have an impact on the assessment of the criteria for tax residence in France. In fact, with regard to international conventions, it appears that the fact that a person is temporarily detained in France due to *force majeure* is not such as to consider, for this reason alone, that he or she has established a permanent home or has the center of his or her vital interests in France.

1.2. Taxation of new French residents

1.2.1. *Settling down for a temporary period*

A temporary residence in France allows individuals to benefit from a favorable tax regime. Individuals who reside in France for less than five years benefit from advantages which should be taken into account:

- No wealth tax (IFI) on real estate properties located abroad (article 964 of the FTC): individuals who have been non-French residents during the five preceding years are only subject to IFI on their French-located real estate properties and rights. Beyond that period, these people are taxable under normal conditions on their worldwide real estate properties and rights (provided that their private real estate wealth exceeds €1.3 million after deduction of debts). When the real estate wealth exceeds the tax threshold, it is taxed according to the scale ranging from 0.5% to 1.5% above €10 million.

- No gift or inheritance tax on assets located outside France when the donor/deceased is not a resident of France;

- No capital gains tax on the sale of the main residence located in France within two years of leaving France;

- No exit tax on unrealized capital gains, claims arising from an earn-out clause, and tax-deferred capital gains, for income tax and social security contributions (article 167 bis of the FTC).

In other respects, temporary residents are subject to the same rules as ordinary residents. Thus, temporary residents (unlike long-term residents) may be subject a flat tax on investment income capped at 30%. Even better, American citizens may benefit from more favorable tax provisions and plan to settle in France for more than 5 years. Under the tax treaties signed between France and the United States:

- French income tax only applies to non-US source income (i.e., derived from France or other countries);
- IFI only applies to assets located outside the US (i.e., located in France or other countries);
- Certain assets located in the United States are fully exempt from gift and inheritance taxes.

1.2.2. Settling down to retire

If an individual is considering settling permanently in France, there is one thing he should not overlook: inheritance tax.

- High inheritance tax rates

In France, the marginal tax rate on inheritance in direct line, i.e., between parents and children, is 45%, which is the highest rate in the European Union (EU). The taxation is even more confiscatory for the other heirs since they can be taxed up to 55% if they are part of the family and even up to 60%, without deduction, if not.

In contrast, the tax system is favorable to spouses: the surviving spouse and the partner bound to the deceased by a civil solidarity pact (Pacs) are totally exempt from inheritance tax (the exemption does not extend to gift taxes: for donations between spouses or Pacs partners, only an allowance of €80,724 is applicable.).

- Extended right to tax inheritance

As mentioned above, subject to double tax treaties, France taxes the worldwide assets of the deceased if he/she was domiciled in France on the day of death.

This being said, it is essential to have a well-organized and flexible estate before arriving in France. Keyword is anticipation. For example, "non-domiciled" UK residents who wish to return to France may take advantage of their specific status by making lifetime gifts to their children that would have been subject to inheritance tax upon their death in France.

- “Forced heirship” rules

France applies rules restricting testamentary freedom. Under the “forced heirship” rules, the children of a deceased person who was habitually resident in France at the time of death are entitled to a minimum proportion of the estate calculated according to the number of children (article 913 of the Civil code). However, since 2015 with the EU Succession Regulation (Regulation (EU) No. 650/2012 also known as Brussels IV), it is possible to choose the law of one’s nationality as the law governing one’s succession and therefore override these “forced heirship” rules provided that the heirs are not minors or in financial difficulty.

To avoid the application of the “forced heirship”, it is therefore essential to plan one's succession by adapting one's will and/or creating a trust before becoming a French tax resident.

However, the implementation of estate planning may be challenged by a recent law of 24 August 2021, applicable to international successions opened as from 1 November 2021. This law introduces a new right of compensatory levy on property located in France for heirs who would be disinherited under the foreign law applicable to the succession where the deceased or at least one of his children is, at the time of death, a national of a Member State of the EU or habitually resident there. The conformity of the text with the aforementioned European "successions" regulation seems doubtful, to say the least, and exposes this new compensatory levy to censure by the Court of Justice of the European Union.

- Change of matrimonial regime

Incidentally, a transfer of domicile may automatically modify the law applicable to the matrimonial regime and, by implication, the matrimonial regime itself (for example, a change from a foreign matrimonial regime similar to a separation of property to a French community regime). Indeed, under the Hague Convention of March 14, 1978, in the absence of a designation of the applicable law by the spouses or of a prenuptial agreement, the spouses risk being confronted with the automatic mutability of their matrimonial regime. This automatic change of law occurs in 3 cases:

- When the spouses take up residence in the State of their common nationality;
- If they reside more than 10 years in a State after the marriage;
- For spouses who did not have a common residence in the same State after the marriage, when they establish their residence in the same State.

However, it should be noted that this mutability of the applicable law only concerns spouses married between September 1, 1992 and January 29, 2019. For spouses married before 1992, the applicable law remains that of the country of first domicile. For spouses married since 29 January 2019, the EU Regulation of 24 June 2016 excludes automatic mutability.

In an international context, it is therefore advisable for the spouses to proceed to the designation of the applicable law or to conclude a prenuptial agreement.

- Law applicable to divorce

When the spouses divorce in France, the French judge applies the European Regulation n°2201/2003 called "Rome III" to determine the applicable law. The spouses may choose by the law applicable to their divorce, provided that this law corresponds to the law:

- of the State of the spouses' habitual residence;
- of the State of the last habitual residence of the spouses, if one of them still resides there;
- of the State of nationality of one of the spouses;
- of the court seised.

The field of the law applicable to divorce is rather limited. Indeed, it only concerns the pronouncement of the divorce and the different cases of divorce and does not include its financial consequences.

- Law applicable to the compensatory allowance

According to the Hague Protocol of 27 November 2007, applicable by reference to Article 15 of European Regulation n°4/2009 (the so-called "Maintenance Regulation"), the spouses may also choose the law applicable to their maintenance obligations, provided that this law corresponds to:

- the national law of one of the spouses;
- the law of the habitual residence of one of the spouses;
- the law designated by the spouses to govern their property relations or the law actually applied to those relations;
- the law designated by the spouses to govern their divorce or the law actually applied to that divorce.

In choosing the law applicable to maintenance obligations, it is possible to choose a foreign law which allows to fix in advance the amount of the maintenance obligations between spouses.

However, there are some safeguards:

- It is the law of the State of the habitual residence of the maintenance creditor, at the time of the designation, which determines whether he/she can waive his/her right to maintenance. Under French law, at the time of concluding the marriage contract, it is impossible to determine the financial consequences of the divorce. Thus, a waiver of the compensatory allowance by a spouse habitually resident in France at the date of the contract is hardly conceivable.
- Unless it is waived knowingly, the designated law must be set aside where its application would lead to manifestly unfair or unreasonable consequences for one of the parties. Thus, it seems that if the agreement made by the spouses is balanced and respectful of each other's rights, French judges will accept to apply it.

While prenuptial agreements are now useful planning tools, the full effectiveness of these agreements is yet uncertain.

2. Impacts on business taxation

It is important to keep in mind that the relocation of individuals may have corporate tax consequences for businesses.

2.1. Concerns related to the creation of permanent establishments

Companies may be concerned that having their employees relocate to countries other than those in which they regularly work could lead to the creation of a permanent establishment (PE) in those countries, which would impose new tax and reporting obligations.

In its April 2020 recommendations, the OECD has stated that the exceptional and temporary change of location where employees exercise their employment because of the COVID-19 pandemic should not create new PEs for the employer. Similarly, the temporary conclusion of contracts in the home of employees or agents because of the pandemic should not create PEs for the businesses.

However, with the continuation of telecommuting and the decrease in business travel, what was temporary and non-routine yesterday has finally become the norm. In January 2021, the OECD clarified the implications of continued telecommuting after the pandemic.

On the one hand, with regard to the creation of a fixed place of business, the OECD specifies that extensive telecommuting could reflect a certain degree of permanence, but that this element is not sufficient to characterize a permanent establishment. An examination of the facts and circumstances is necessary to determine whether the home office is at the disposal of the enterprise.

On the other hand, with regard to the creation of a dependent agent, the OECD clarifies that if the employee continues to telework on a regular basis after the pandemic, while continuing to contract on behalf of his or her company, the employee will be considered as a permanent establishment of that company.

As the existence of a permanent establishment in France may be difficult to determine, non-resident companies may ask the French tax authorities to provide assurance that they do not have a permanent establishment or a fixed base in France within the meaning of the tax treaty between France and the State in which the company is resident (article L 80 B 6° of the French Tax Procedure Code (FTPC)). This possibility is restricted to companies who are residents of a State bound to France by a double tax treaty.

Finally, in the event of the creation of a permanent establishment in France, companies may benefit from a specific tax regime provided for the "headquarters" of multinational companies established in France (i.e. any company or permanent establishment located in France) which performs for the sole benefit of its group the functions of direction, management, coordination or control. Under this regime, these "headquarters" can obtain *a priori* guarantee from the French tax authorities that the amount of their profits subject to corporate income tax will not be challenged if they determine it on the basis of a profit margin for all activities that fall within the scope of the "headquarters" functions, calculated by applying a given percentage to the amount of current operating expenses.

2.2. Concerns related to change of residence

Companies may be concerned about a potential change in the "place of effective management" of a company due to a relocation, or inability to travel, of board members or other senior executives, resulting in a change in the company's residence.

In that case, the OECD recommends that all relevant facts and circumstances be examined to determine the "usual" and "ordinary" place of effective management, not just those that relating to an exceptional period such as the COVID-19 pandemic.

Securing the tax residence of companies will therefore require reconciling the general principles based essentially on the physical location of management activities with the new remote working methods.

II. Leaving France

Leaving France does not mean cutting all ties with it. If its landscapes are now only a distant memory for the former resident, France does not forget him and will continue to tax non-residents keeping interests in France.

1. Taxation of former French residents

1.1. At the time of departure: liability to « Exit tax »

Since 2011, transfer of tax residence outside France leads to the taxation of unrealized capital gains and capital gains subject to deferred taxation at the rate of 12.8% for income tax and of 17.8% for social security contributions (article 167 bis of the FTC). The tax is applicable when the following conditions are met:

- the taxpayer has been domiciled in France for tax purposes for at least six of the ten years preceding the transfer of their residence abroad;
- these corporate rights, securities or rights represent at least 50% of the corporate profits of a company, or their total value exceeds €800,000.

However, the taxpayer may benefit from an automatic deferral when he moves to a Member State of the EU or to another State or territory that has concluded with France an assistance agreement to combat tax evasion and avoidance as well as an assistance agreement for tax collection, and this State or territory is not uncooperative. Otherwise, the deferral is granted upon express request and subject to providing financial guarantees to the tax authorities (as a general rule, 12.8% of the total amount of capital gains).

Moreover, the taxpayer may benefit from automatic tax relief:

- on the date on which the taxpayer transfers his tax residence back to France;
- in the event of a gift of the securities;
- in the event of the taxpayer's death;

- after a period of two years or five years for taxpayers whose total value of securities exceeds €2.57 million on the date of transfer (for transfers of domicile occurring before 2019, the reduction applied only to income tax after a period of 8 years, and then applied to income tax and social security contributions after a period of 15 years).

1.2. Once abroad

1.2.1. Liability to withholding taxes

Subject to double tax treaties, non-resident individuals are still likely to be subject to French tax if they receive French-source income. Indeed, certain income received by non-resident individuals is generally subject to a withholding tax or a specific levy at the time it is earned or paid.

The income covered by the withholding tax includes notably income from French movable capital (such as distributed profits and directors' fees). The withholding tax rates on dividends tax vary according to the status of the beneficiary:

- For individuals: the withholding tax rate is set at 12.8%;
- For companies: the rate is set at 26.5% and 25% as of 2022 (15% for dividends paid to non-profit organizations based in the European Economic Area (EEA)).

However, most of the double tax treaties signed by France provide for a reduced rate of withholding tax (generally 15%, 10% or 5%) on income distributed by a French company to residents of the other contracting state, or sometimes even the elimination of this tax.

Dividends paid in a non-cooperative State or territory (whose list varies each year) are subject to a withholding tax at an increased rate of 75% unless the debtor proves that the distributions of these products have neither the purpose nor the effect of allowing them to be located in such a State or territory for the purpose of tax evasion.

French tax may also be withheld on capital gains from real estate located in France or from rights relating to such real estate (such as undivided rights, usufruct, shares in real estate companies, etc.). French real estate income (rental income or capital gains) realized by non-residents may also trigger French social contributions (at the rate of 7.5% for individuals affiliated to a compulsory social security scheme of an EEA country (other than France) or Switzerland; 17.2% in other cases).

The choice of the destination country must therefore be carefully considered in order to benefit from a reduced taxation once France is left.

1.2.2. Liability to inheritance tax

After their departure, former French residents may be subject to French inheritance tax if they keep assets in France or if their heirs are domiciled in France. Indeed, as mentioned above, subject to double tax treaties, France retains the right to tax the assets of the deceased even if he/she was not domiciled in France on the time of death, in two cases:

- If the beneficiary has been domiciled in France for at least six years during the last ten years: all movable or immovable property located wherever situated is taxable in France;
- If the beneficiary is domiciled outside of France: only the assets located in France are taxable in France (including French trust assets).

There are very few obstacles to the application of this inheritance tax, as France is bound by tax treaties with only 35 countries in this area. Where this is the case, France is deprived of the right to tax assets transferred by a non-resident deceased or donor to a beneficiary resident in France if they are located outside France or are not taxable under the treaty.

Nevertheless, most of these tax treaties allow France to apply the so-called "effective average rate" rule: all assets taxable under French domestic law are taken into account for the calculation of the applicable tax rate even when the deceased is domiciled in the contracting country (this is the case of the treaty signed with the United States).

2. Impacts on business taxation

For the same reasons exposed in § I.2.1. above, the relocation of a board member or a senior executive of a French company may lead to the creation of a permanent establishment or a change of residence of the company and result in the taxation of the company's profits in that other country.

2.1. Creation of a permanent establishment

In general, the tax treaties define a "permanent establishment" as a fixed place of business through which an enterprise carries on all or part of its business. This definition is therefore based on the following criteria:

- the existence of a place of business (i.e., items such as premises, equipment, tools, location, etc., which are at the disposal of the enterprise);
- the business facility must be fixed (i.e., established in a specific place with a certain degree of permanence);
- the business facility must have its own activity, which normally implies the presence on the spot of the company's personnel.

In the absence of a genuine fixed place of business, the enterprise may have a permanent establishment where it is represented by a dependent agent empowered to negotiate contracts on behalf of the company. As mentioned above, in January 2021, the OECD has clarified that if an employee works on a regular basis in a country and enters into contracts on behalf of his/her company, the employee will be considered as a permanent establishment of that company. These conclusions should be applicable to board members or other senior executives.

2.2. Change of company's residence

Where two States jointly claim the right to treat a company as a resident under their domestic laws, tax treaties settle the residence dispute generally by attributing the right to tax to the State where the company has its place of effective management. The place of effective management is the place where the management, administration and control organs of the legal person are principally located.

While the relocation of a board member or other senior executive should not result in the transfer of the tax residence of a large company, greater care should be taken in the case of smaller companies where the manager has significant decision-making power.

Conclusion

In a nutshell, if you had to remember only one thing: if it is true that it is nice to live in France, it is better not to die there. With extensive inheritance tax scope and high inheritance tax rates, France is not a popular destination to end one's days in. However, French pleasures can last until the last breath, provided that one's estate has been organized.