

## Wealth Tax Panel - France

ACTEC Boca Raton, Florida  
Tax Policy Study Committee  
March 6, 2020

Paris  
France

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### 1. Introduction

Democrat candidates for the upcoming presidential elections made various proposals in order to increase taxation of the wealthier part of the US population. Most of them suggest rising the tax rates applicable to the highest brackets in the tax scale, at different levels, and brought new proposals for tougher taxation of capital gains<sup>1</sup>. Two of them - Sen. Elisabeth Warren and Sen. Bernie Sanders – also propose setting up a new annual tax on wealth.

Sen. Elisabeth Warren’s “multi-millionaire tax on wealth” will consist of a 2% annual tax on household net worth between \$50 million and \$1 billion, increasing to 6% on net worth above \$1 billion. The proposal does not provide for any exemptions, all assets should therefore be covered by the tax. It is also suggested to set up a 40% exit tax on net worths above \$50 million for any U.S. citizen who renounces their citizenship<sup>2</sup>.

Sen. Bernie Sanders is willing to set up a “tax on extreme wealth” that would be a progressive tax (from 1% to 8%) on net worth above \$32 million for a married couple. The 8% marginal tax rate will apply to assets valued above \$10 billion<sup>3</sup>.

Lots of discussions have already taken place in France about the principle and the functioning of wealth tax. It might be interesting to analyze the Democrats’ proposal for the new annual tax on wealth in light of these debates.

### 2. Overview of the French wealth taxes

After reviewing the history of the French wealth taxes, which can enlighten us on the purposes and the political context surrounding this specific tax (1), we will describe its main characteristics in order to give an overview of how the French wealth tax works (2).

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<sup>1</sup> For a summary of these proposals, see T. LAJOIE (Tax Foundation), “Comparing Capital Gains Tax Proposals by 2020 Presidential Candidates”, December 4, 2019, available at: <https://taxfoundation.org/2020-capital-gains-proposals/>.

<sup>2</sup> See the dedicated article available on Sen. Elisabeth Warren’s campaign website, available at: <https://elisabethwarren.com/plans/ultra-millionaire-tax>.

<sup>3</sup> See the dedicated article available on Sen. Bernie Sanders’ campaign website, available at: <https://berniesanders.com/issues/tax-extreme-wealth/>; commented by T. LAJOIE (TAX Foundation), “Senator Sanders proposes a Tax on “Extreme” Wealth”, September 25, 2019, available at: <https://taxfoundation.org/bernie-sanders-wealth-tax/>.

## 2.1 A short history of the French wealth tax

Even though the French wealth tax was only introduced in the French tax code at the beginning of the eighties, the idea of such a tax has been the subject of recurrent proposals since the Second World War. Furthermore, a temporary and exceptional tax “of national solidarity” on wealth was set up in 1945 by the French post WWII government. The wealth tax we knew for decades in the French tax system was introduced for the first time in 1982 by a socialist President, the late François Mitterrand, under the name “impôt sur les grandes fortunes” [tax on great fortunes]. Every French household with a net worth exceeding \$541,890<sup>4</sup> was concerned by this tax<sup>5</sup>. At that time, three main justifications were put forward in support of this new tax. It was supposed to affect assets that provided their holders with an additional contributory capacity, it was intended to respond to the criticism of insufficient taxation of capital in France, and, most importantly, it was designated as a redistribution tool aimed at reducing inequalities<sup>6</sup>.

The new wealth tax faced a lot of criticism<sup>7</sup>, and was finally dropped in 1986 with the arrival of the right-wing political majority to power<sup>8</sup>. However, as soon as the left-wing majority returned to power (1988), the wealth tax was reinstated on the same basis as the previous one with a slightly different name: “l’impôt de solidarité sur la fortune”, literally, the solidarity tax on wealth<sup>9</sup>. The minimum tax threshold was increased from \$541,89<sup>10</sup> to \$668,943<sup>11</sup> and the marginal tax rate was decreased from 1.5% to 1.1%<sup>12</sup>. This time the only justification officially put forward by the government for setting up this tax was the need to fund the “*revenu minimum d’insertion*”<sup>13</sup> [the minimum insertion income], a social benefit designed to guarantee everyone a minimum level of resources<sup>14</sup>. This definitely is one of the reasons why the French wealth tax is mainly perceived as a redistribution tool and an additional effort by the wealthiest in favor of the most underprivileged. The very name given to this tax speaks for itself.

The French wealth tax underwent a significant modification two years ago: the Finance Act for 2018<sup>15</sup> replaced the solidarity tax on wealth, known as the ISF [*l’impôt de solidarité sur la fortune*] with a tax on real estate, called the IFI [*l’impôt sur la fortune immobilière*]. The mechanism of this new tax is almost entirely identical to the one it replaces, but its basis of assessment is a lot weaker since it is limited to real estate properties. The scope has thus been significantly reduced but the tax scale and the minimum tax threshold have remained the same. It is interesting to note that the government tried to separate this new wealth tax from the political purposes of redistribution and solidarity.

<sup>4</sup>French Francs 3 million (€457,347). This amount seemed curiously low to constitute the threshold of a wealth tax. As a French deputy said ironically during the course of the debates before the Parliament: “three million assets, so that is the great fortune” (Records of the debates before the Assemblée Nationale, Oct. 28, 1981, 3rd session).

<sup>5</sup> Loi n° 81-1160, Dec. 30, 1981, *Loi de finances pour 1982* [Finance Act for 1982], art. 2 to 11.

<sup>6</sup> Finance Bill for 1982, n° 450, explanatory statement under article 2, *Dr. fisc.*, Oct. 1981, n° 44, 100044.

<sup>7</sup> Two important reports, the 8<sup>th</sup> report of the *Conseil des impôts* (a French institution responsible for assessing all compulsory levies and making recommendations on all matters related to such levies, renamed the *Conseil des prélèvements obligatoires* in 2005) published in September 1986 and the report of the *Acairdi Commission* (commissioned by the minister of the Economy and Finance to assess the French rules on assets taxation) released in April 1988, were both highly critical toward the wealth tax set up in 1982.

<sup>8</sup> Loi n° 86-824, July 11, 1986, *Loi de finances rectificatives pour 1986* [Amending Finance Act for 1986], art. 24.

<sup>9</sup> Loi n° 89-1159, Dec. 23, 1988, *Loi de finances pour 1989* [Finance Act for 1989], art. 26.

<sup>10</sup> French Francs 3 million (€457,347).

<sup>11</sup> French Francs 4 million (€609,796).

<sup>12</sup> This marginal rate concerned households whose assets were valued at more than French Francs 10 million, *i.e.* €1.53 million and \$1.68 million.

<sup>13</sup> Which became the “*revenu de solidarité active*” [Solidarity Income] in 2011.

<sup>14</sup> Finance Bill for 1989, n° 160, explanatory statement under article 18, in accordance with the promise made by late President François Mitterrand in his *Lettre à tous les Français* [Letter to all French], published April 7, 1988.

<sup>15</sup> Loi n° 2017-1837, Dec 30, 2017, *Loi de finances pour 2018* [Finance Act for 2018].

Indeed, the only ground exposed to parliament in the draft bill to support this reform was a financial one: “This tax is instituted for budgetary purposes, so as to create a specific tax on the real estate properties of taxpayers with the most valuable real estate properties”<sup>16</sup>. According to the current French President, Emmanuel Macron, the replacement of the ISF by a tax limited to the real estate properties is supposed to encourage the wealthier taxpayers to invest in productive corporations rather than in real properties. It is difficult to say if this purpose will be achieved<sup>17</sup>, however, this reform has significantly reduced the number of households liable to wealth tax<sup>18</sup>.

In addition to the taxation on capital gains and ordinary income on investments, French taxpayers face no less than three main taxes on capital: inheritance tax, local taxes on real estate properties and wealth tax. In addition to these, a *sui generis* tax is due by trustees of French connected trusts when the grantors (or the beneficiaries “deemed grantors”) are liable to wealth tax but did not comply with their reporting and payments requirements in this respect. We must also mention the 3% tax on properties held by corporations, which was set up in order to prevent taxpayers reluctant to the wealth tax from interposing corporations between them and their real properties<sup>19</sup>. Capital taxation is therefore particularly high in France, reaching 11% of the GDP which is 2.2% higher than the average for European countries<sup>20</sup>.

## 2.2. The main characteristics of the French wealth taxes (ISF and IFI)

Even if the ISF was repealed by the Finance Act for 2018, it is of particular interest to describe its main characteristics as it is closer to the wealth tax proposals made by the democrat candidates than the new tax set up in 2018 (the IFI). Thus, we will describe the functioning of both the ISF and the IFI. By the expression “wealth taxes”, we refer to both taxes.

### 2.2.1. Scope

The ISF concerned households whose net worth exceeded the threshold of \$1.42 million<sup>21</sup> on January 1<sup>st</sup> of each year. All assets belonging to members of the tax household were included in the scope of the ISF as long as they did not fall under a specific exemption.

The IFI concerns households whose real estate properties are valued at more than \$1.42 million on 1<sup>st</sup> January of each year. As it was already the case with the ISF, all real estate properties belonging to members of the tax household are taken into account.

<sup>16</sup> Finance Bill for 2018, n° 235 explanatory statement under article 12.

<sup>17</sup> According to a major study, if the reform of capital taxation that has occurred in France in 2018 should encourage investment in corporations, especially in equity, the most recent data available regarding French households’ financial investment are not relevant to identify the impact of the reform. France Stratégie, *1<sup>er</sup> rapport du Comité d’évaluation des réformes de la fiscalité du capital* [Committee for the evaluation of capital taxation reforms], Oct. 2019, p. 172-174. Available at: <https://www.strategie.gouv.fr/publications/comite-devaluation-reformes-de-fiscalite-capital-premier-rapport>.

<sup>18</sup> According to the most recent report, the wealth tax reform has reduced the number of households subject to the wealth tax from 358,198 to 132,722, *i.e.* about 2/3<sup>rd</sup> of the taxpayers. V. EBLE, A. DE MONTGOLFIER, *Rapport d’information n° 42 (Sénat) fait au nom de la commission des finances sur l’évaluation de la transformation de l’impôt sur la fortune (ISF) en impôt sur la fortune immobilière (IFI) et de la création du prélèvement forfaitaire unique (PFU), Tome 1* [Information report n° 42 made on behalf of the Senate’s Finance Commission on the evaluation of the replacement of the wealth tax estate assets by the wealth tax on real estate properties and the creation of the flat tax], Oct. 2019, p.87, available at : <https://www.senat.fr/notice-rapport/2019/r19-042-1-notice.html>.

<sup>19</sup> French Tax Code (CGI), art. 990 D to G, created by the Finance Act for 1983 (at the same time as the wealth tax), Loi n° 82-1126, Dec. 29, 1982, *Loi de finances pour 1983* [Finance Act for 1983].

<sup>20</sup> France Stratégie, *Comité d’évaluation des réformes de la fiscalité du capital* [...] prev. footnote n° 17, p. 14.

<sup>21</sup> €1.3 million.

The territoriality rule is the same for the ISF and for the IFI: French tax residents are liable to the wealth taxes on their worldwide taxable assets, regardless their location, whereas non-French tax residents' liability is limited to their taxable assets located in the French territory<sup>22</sup>, unless otherwise stated by the relevant tax treaty. The French-US tax treaty does not, however, have any consequences on wealth tax matters. It should be remembered that in France, tax liability is only determined by the tax residency, regardless the citizenship of the taxpayer. A favorable measure has been set up for the benefit of persons transferring their tax residence to France: they will only be concerned by the wealth tax on their real estate properties located outside of France after a five-year period following their transfer of tax residence.

### 2.2.2. *Taxable assets and exemptions*

All assets, regardless of their nature, as a general rule, fell within the scope of the ISF. Some specific assets, however, could benefit from an exemption. This was notably the case for antiques, art or collector's items<sup>23</sup>, intellectual property rights<sup>24</sup>, or annuities, pensions and allowances<sup>25</sup>. Certain categories of shares were also not concerned by the ISF, such as shares belonging to employees or executive officers if they exercise their main activity in this corporation (up to three quarters of the shares' value)<sup>26</sup>.

The most notable exception, and the one that caused most issues, concerns business assets<sup>27</sup>. Two main categories of assets are indeed excluded from the scope of the wealth tax: first, assets needed for the taxpayer's main professional activity; secondly, assets belonging to the taxpayer and assigned to the activity of a corporation in which the taxpayer is an executive director or in which he exercises his main professional activity.

The IFI only concerns real estate properties. All real estate properties and real property rights are included in the tax base<sup>28</sup>. In the case of indirect holding (through a corporation French or foreign), shares are also included in the tax base in proportion to the value of properties held by the corporation, unless these properties are allocated to an operational activity<sup>29</sup> of the corporation that holds them.

A class exemption has been set up in favor of business assets<sup>30</sup>. Real estate properties benefit from an exemption from the IFI as long as they are assigned to the tax payer's main activity or to the operational activity of the corporation in which he is an executive director / exercises his main activity. In case of indirect holdings, the exemption may apply to the value of shares in proportion to the value of properties held by the corporation. This exemption is however of strict interpretation, and cannot for instance benefit properties assigned to the subsidiary or the sub-subsidiary of the corporation in which the taxpayer is an executive director / exercises his main activity.

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<sup>22</sup> French Tax Code (CGI), art. 964.

<sup>23</sup> French Tax Code (CGI), anc. art. 885 I paragraph 1 and 2.

<sup>24</sup> French Tax Code (CGI), anc. art. 885 I paragraph 3 and 4.

<sup>25</sup> French Tax Code (CGI), art. 885 J.

<sup>26</sup> French Tax Code (CGI), anc. art. 885 I quarter.

<sup>27</sup> French Tax Code (CGI), anc. art. 885 N to 885 R.

<sup>28</sup> However, are not concerned by the wealth tax minority shareholdings, *ie* shareholdings representing less than 10 % of the capital.

<sup>29</sup> For the purpose of this measure, an activity is considered operational if it is an industrial, commercial or artisanal activity. Real estate property management is thus not considered an operational activity.

<sup>30</sup> French Tax Code (CGI), art. 975.

A specific rule regarding assets held in a trust in respect of the ISF was added in the French Tax Code in 2011, and was also implemented in the rules governing the IFI. According to this rule, assets held in a trust, regardless its characteristics, are considered as part of the grantor's estate assets for their current value as established on January 1<sup>st</sup><sup>31</sup>. It is crucial to determine the grantor's tax residency on January 1<sup>st</sup> in order to determine which assets are concerned by the wealth taxes. If the grantor is a French tax resident; all assets put in the trust are concerned by the wealth taxes, regardless of their location; otherwise, the wealth taxes only concern assets located in France.

### 2.2.3. Tax base and calculation of the tax

The basis of the wealth taxes – the rule is the same for the ISF and for the IFI – consists of the taxable assets' net worth as it is valued January 1<sup>st</sup> of each year. The taxpayer must carry out the valuation of the taxable assets at their current value, subject to possible verification by the French Tax Administration (the FTA)<sup>32</sup>. An allowance of 30% applies to the value of the principal residence<sup>33</sup>.

For the calculation of the ISF basis, it was allowed to deduct all debts incurred for covering purchasing price and works related to a real estate asset in the scope of the wealth tax, as long as they were supported by the concerned taxpayer.

The rules governing the deduction of debts for the determination of the IFI tax base are very restrictive<sup>34</sup>. Deduction is limited to debts incurred in respect of purchase price items, which are listed exhaustively in the French Tax Code, to a maximum extent of 50% of the value exceeding €5 million (\$5.48 million) in the event that the amount of debts exceeds 60% of the taxable properties' value.

The progressive scale rate is the same for the ISF and for the IFI. The marginal 1.5% rate concerns households whose assets are valued at more than \$10,97 million<sup>35</sup>.

<b>Fraction of the net value of taxable assets</b>	<b>Tax rate (%)</b>
Under €800,000 <sup>36</sup> (\$877,596)	0
From €800,001 to €1,300,000 (\$877,597 to \$1,426,094)	0.50
From €1,300,001 to €2,570,000 (\$1,426,095 to \$2,819,277)	0.70
From €2,570,001 to €5,000,000 (\$2,819,278 to \$5,484,975)	1
From €5,000,001 to €10,000,000 (\$5,484,976 to \$10,969,950)	1.25
Over €10,000,000 (\$10,969,950)	1.50

<sup>31</sup> French Tax Code (CGI), anc art. 885 G; art. 970. Charitable trusts and retirement trusts are however not concerned by the wealth tax.

<sup>32</sup> French Tax Code (CGI), art. 885 S, 1<sup>st</sup> paragraph, by reference to the rules of property valuation for inheritance tax purposes.

<sup>33</sup> French Tax Code (CGI), art. 885 S, 2<sup>nd</sup> paragraph.

<sup>34</sup> French Tax Code (CGI), art. 974.

<sup>35</sup> €10 million, representing approximately French Francs 65,6 million. In 1986, the marginal tax rate was reached at French Francs 10 million.

<sup>36</sup> The first bracket of the wealth tax scale concerns assets with a value between €800,0001 (\$877,597) and €1,300,000 (\$1,426,94). However, we remind you that households with real estate properties valued at less than €1,300,000 are not concerned by the wealth tax.

Various tax reductions could reduce the amount of ISF due. The first one was set up in 2007<sup>37</sup> with the aim of encouraging investments in small and medium enterprises (SMEs) and consisted of a tax reduction equivalent to 50% of capital increases in favor of SMEs<sup>38</sup>, within a limit of \$49,364<sup>39</sup>. To benefit from this reduction, the taxpayer was subject to holding the securities received in return for a five-year period<sup>40</sup>.

The second exemption concerned taxpayers who made gifts to charities, exhaustively listed by the French Tax Code, located in France or in the EU. These organizations included: research or higher education establishments, charitable foundations, academic foundations or some employer associations. 75% of the amount of eligible gifts were deductible from the wealth tax due, within an annual limit of €50,000<sup>41</sup> (\$54,850). This specific tax cut has been implemented in the rules governing the IFI.

Moreover, in order to prevent the wealth tax from being confiscatory, the French Legislator set up a tax cap: the total amount of the wealth tax due, added to the amount of the other taxes on the income, could not exceed 75 % of the previous year's income, taking into account the worldwide income of all the household's members<sup>42</sup>. This capping only concerned French tax residents. Foreign taxpayers cannot benefit from it. The author considers this measure as discriminatory.

### **3. The contrasted balance sheet of the French wealth tax**

France has almost forty years of experience of wealth taxes, which is very instructive. We now have the necessary hindsight to account for the technical issues that have been raised by the wealth tax (1). Numerous assessments of this tax have been made over the past decade and the majority of them put forward its lack of fairness (2) and its economical inefficiency (3).

#### ***3.1. The significant technical issues raised by the French wealth taxes***

We will focus on three main technical issues.

##### *3.1.1. Asset valuation issues*

Wealth taxes are based on the market value of the taxable assets on January 1<sup>st</sup> of each year. The taxpayer is responsible for the valuation of his/her assets.<sup>43</sup> The taxpayer is exposed to possible adjustments (and the related penalties) by the FTA if the valuation is challenged. The valuation of property on January 1<sup>st</sup> of each year outside of any sales, is necessarily difficult and theoretical. Furthermore, taxpayers are not allowed to deduct the amount of taxes on capital gains, which will be bored when the assets are sold. The risk is double for the taxpayers, if the assets are undervalued, they run the risk of an adjustment by the FTA. If the assets are overvalued, they will pay more taxes

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<sup>37</sup> Loi n° 2007-1223, August 21, 2007, *Loi en faveur du travail, de l'emploi et du pouvoir d'achat*, [Act in favor of labour, employment and purchasing power], known as "*Loi TEPA*".

<sup>38</sup> For the purpose of this measure, SMEs are defined in accordance with the European definition of a SME, *i.e* enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding €50 million (\$54.8 million), and/or an annual balance sheet total not exceeding €43 million (\$47.1 million).

<sup>39</sup> €45,000.

<sup>40</sup> The shares so received had to be held until the 31<sup>th</sup> December of the fifth year following the subscription.

<sup>41</sup> French Tax Code (CGI), art. 978.

<sup>42</sup> French Tax Code (CGI), art. 979.

<sup>43</sup> The notion of current value has been defined as "the price that could be obtained by the interplay of supply and demand in an actual market". Cass. com., Oct .23, 1984, n° 82-17054. This definition has also been adopted by the Tax Administration, BOI-ENR-DMTOI-10-10-20-40 n°1, 12-09-2012.

than they should. Moreover, the risk of fraud is real and requires the FTA to commit additional resources in order to limit it, which makes the cost of the wealth tax collection even higher.

### 3.1.2. *The numerous uncertainties about the concept of business assets*

As explained before, business assets benefit from a wealth tax exemption. This exemption is the most difficult to apply and is the source of significant disputes.

Shares qualify as business assets if the corporation exercises an operational activity. The concept of a leading corporation is however very ambiguous, as it is mainly based on a factual assessment, and has given rise to numerous discussions with the tax administration and many disputes, despite the introduction of a definition of a leading holding corporation in the French Tax Code<sup>44</sup>. The legal uncertainty related to the concept of business assets contributes to make the wealth tax more complex, which is all the more harmful since the amounts involved are often very large.

The question of whether the shares of holding corporations (French or foreign) can be regarded as business assets is crucial. Even if the stakes may be lower since the 2018 reform, the issue is still important toward real estate properties owned directly or indirectly by a corporation, the FTA can, in certain cases, challenge the qualification of business assets over a ten-year period<sup>45</sup>.

### 3.1.3. *The burden of the reporting obligations*

In addition to other reporting obligations, there is a specific wealth tax return to file. Thus, the taxpayers have to annually declare the gross and the net taxable value of all the assets concerned by the wealth tax. Fortunately, reporting obligations have been lightened for households with a real estate asset valued at less than \$3.29 million<sup>46</sup>.

Regarding assets held through a trust, one should mention the annual reporting obligations of the trustee<sup>47</sup>. If the trust has a French connection<sup>48</sup>, the trustee should declare the current value of the worldwide assets held through the trust. If neither the grantor nor the beneficiaries are French taxpayers, the trustee should report the current value of the assets located in France. Assets held through a trust must appear on the wealth tax's specific return, otherwise, the trustee will face a 1.5% tax on the current value of the assets that should have been reported for wealth tax purposes by the grantor.

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<sup>44</sup> French Tax Code (CGI), art. 966 (created by the Finance Act for 2018): "The activities of corporations which, in addition to managing a portfolio of shareholdings, take an active part in the conduct of the policy of their group and the control of their subsidiaries and provide, where appropriate and on a purely internal basis, specific administrative, legal, accounting, financial and real estate services are also considered as commercial activities".

<sup>45</sup> C. cass. 17 janv. 2002, n° 10-28.599, commented by D. BARBUS and J. BEGUIER, "Le délai de reprise de l'administration fiscale en cas de contrôle de la qualification des biens professionnels en matière d'ISF" ; *Revue de droit fiscal*, May 2012, n° 18-19, proc. 288.

<sup>46</sup> €3 million. Since 2012, they can indeed declare the total value of their assets concerned by the wealth tax without establishing the specific declaration. Loi n° 2011-900, July 29, 2011, *Loi de finances rectificative pour 2011* [Amending Finance Act for 2011].

<sup>47</sup> For a more detailed presentation of the trustee's reporting obligation, see our precedent paper "Everything You Always Wanted to Know About Trusts with a French connection (But Were Afraid to Ask)", ACTEC Philadelphia; Oct. 18, 2019.

<sup>48</sup> A trust is regarded as having a connecting factor with France if either: the grantor is a French resident for tax purposes; at least one of the beneficiaries is a French resident for tax purposes; the trust holds French located assets; the trustee is a French tax resident.

### 3.2. *The lack of fairness of the French wealth taxes*

One of the objectives of the wealth taxes was to take greater account of contributory capacities of the wealthiest taxpayers. However, this objective seems to be no longer achieved and the taxpayers who are the most affected by the wealth tax are not necessarily the wealthiest.

A parliamentary report released in October 2019<sup>49</sup> shows that numerous households are liable to the wealth tax without necessarily having high incomes. In 2017 for instance, 10 % of the households liable to the wealth tax had an annual tax revenue of less than \$34,913<sup>50</sup>, for an average amount of wealth tax paid of \$7,643<sup>51</sup>, and 20% of them had a tax revenue of less than \$52,414<sup>52</sup>. This situation can partly be explained by strong inflation, especially of the property prices that European countries and France have known for the past three decades<sup>53</sup>, which has moreover not led to any modification of the wealth tax scale since 2013. The report emphasized the fact that some households became liable to the wealth tax solely because of the value increase of their real estate properties, without being particularly wealthy<sup>54</sup>. Moreover, the capping mechanism turned out to be almost totally inefficient for these households, as it mainly benefits the wealthiest taxpayers<sup>55</sup> and excludes foreign taxpayers. Besides being very expensive for French public finances<sup>56</sup>, this measure does not fulfill the very purpose it was set up for.

This seems all the more unfair that the wealth tax, as a tax on capital, is not due on income but on capital: there is therefore no certainty that its contributors will have enough resources to pay the amount of tax due, and sometimes forces taxpayers to dispose of their assets or to transfer their residence outside of France. The paradox of a tax that is supposed to provide a better understanding of the contributory capacities of its taxpayers then becomes apparent, as it is based on a contributory capacity which appears to be merely theoretical. Inquiring on this specific point, the French Constitutional Council however considered that “the apprehension of the contributory capacity does not imply that only income-productive assets should be included in the wealth tax’s basis”<sup>57</sup>. The only flexibility admitted concerns trusts: if the grantor manages to demonstrate that the assets he placed into a trust do not provide him any contributory capacity, he may avoid the general rule stating that assets held in trusts are part of the grantor’s real estate assets<sup>58</sup>. This proof is however very difficult to provide since it is often possible for the grantor to request a distribution from the trustee for the legitimate reason of paying taxes.

Moreover, some assessment reports<sup>59</sup> have shown that taxpayers the most affected by the wealth taxes were not necessarily the wealthiest, especially now that the French wealth tax is limited to real

<sup>49</sup> V. EBLE, A. DE MONTGOLFIER, *Rapport d’information n° 42* [...] prev. footnote n° 18.

<sup>50</sup> €32,000.

<sup>51</sup> €7,000.

<sup>52</sup> €48,000. V. EBLE, A. DE MONTGOLFIER, *Rapport d’information n° 42* [...] prev. footnote n° 18., p. 35.

<sup>53</sup> According to the report just mentioned, the real estate property prices have risen by 75 % in France from 2000 to 2018. *Ibid.* p. 34.

<sup>54</sup> *Ibid.*, p. 35.

<sup>55</sup> *Ibid.*, p. 36-37. According to the report, in 2017 taxpayers in the first bracket of the scale represented only 13 % of the beneficiaries of the capping mechanism and 0.5% of its cost.

<sup>56</sup> The report measures the cost of the capping at €1.326 million (\$1.47 million) in 2017 and at €92 million (\$100.7 million) in 2018, *Ibid.* p. 94.

<sup>57</sup> Cons. constit., Sept. 29, 2010, n° 2010-44 QPC, *Epoux Mathieu* ; commented by O. FOUQUET, “L’assiette de l’ISF est-elle constitutionnelle ?”, *Revue de droit fiscal*, Oct. 2019, n° 43, act. 398.

<sup>58</sup> This rule results from a decision of the French Constitutional Council, Cons. constit., Dec. 15, 2017, n° 2017-679 QPC.

<sup>59</sup> Notably, C. DHERBECOURT, C. FREPPEL, *rapport particulier sur les prélèvements obligatoires des ménages n° 3 (Conseil des prélèvements obligatoires), Les prélèvements obligatoires sur le capital permettent-ils d’appréhender la capacité contributive des ménages ?*,

estate properties. Indeed, economic studies<sup>60</sup> have demonstrated that the wealthier households are, the less significant the part of real estate properties in the total estate will be. As a result, if the rate of the wealth tax is generally progressive, the average tax rate is decreasing once the threshold of \$15.6 million<sup>61</sup> of assets is exceeded<sup>62</sup>. It has furthermore been established that the 2018 reform reducing the tax base to real estate properties has led to a significant part of the wealthier taxpayers being exempted from the wealth tax<sup>63</sup>.

Another source of unfairness is the lack of consideration for family situation. For the calculation of income tax, households can benefit from a family quotient whose purpose is to adjust the amount of tax in consideration of the family situation<sup>64</sup>. This measure was however never extended to wealth taxes. As a result, married couples and families are *de facto* more affected by wealth taxes than a single person: the tax basis will be constituted by their total assets and the marginal tax rate will therefore be higher than if the taxpayers were taxed alone. This situation is hardly understandable, knowing that in matter of inheritance rights, another form of capital taxation, each taxpayer is taxed on his own assets, and clearly results in discrimination<sup>65</sup>.

All these elements show that the French wealth taxes present some significant issues that allow us to discuss its fairness. Its incapability to efficiently tax the wealthiest households also puts in question its effectiveness toward its redistribution purpose.

### 3.3. *A tax that might cost more than it brings in*

If the French wealth tax is subject to lots of discussions, it is because its economic efficiency is very questionable and has indeed been proven very low whereas its cost for the French economy is significant.

#### 3.3.1. *The low economic efficiency of the French wealth tax*

In 2017, the wealth tax generated \$4.58 billion<sup>66</sup> and represented approximately 5 % of the total amount of tax on capital<sup>67</sup> and less than 0.5% of taxes and social security contributions borne by French households<sup>68</sup>. The official purpose of the wealth tax announced in 1988, *i.e.* financing the

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[specific report of the *Conseil des prélèvements obligatoires* about capital taxation, Are taxes on wealth appropriate to understand the households' contributory capacity?], May 2017, p. 53-54, available at :

<https://www.ccomptes.fr/fr/publications/les-prelevements-obligatoires-sur-le-capital-des-menages>.

<sup>60</sup> V. EBLE, A. DE MONTGOLFIER, *Rapport d'information n° 42 (Sénat)* [...] prev. footnote n°18, p. 86.

<sup>61</sup> €14.3 million.

<sup>62</sup> France Stratégie, *Comité d'évaluation des réformes de la fiscalité du capital* [...] prev. footnote n° 17, p. 192.

<sup>63</sup> *Ibid.*, p. 87 and following.

<sup>64</sup> The basis subject to the tax on incomes is divided by the numbers of family quotient shares – which depends on different factors (number of children, possible disabilities ...) – that benefits the household, before the application of the tax rate. The result thus obtained after this calculation is multiplied by the number of family quotient shares.

<sup>65</sup> The French Constitutional Council however refused to sanction this discrimination, stating that there is not any constitutional requirement for the Legislator to take into account family situations by the implementation of a quotient mechanism, as the subject does not concern income taxation. Cons. constit, Dec. 29, 2010, n° 2010-44 QPC. For a critical opinion about this decision, see Y. GAUDEMET, “Heurs et malheurs du quotient familial », *Revue juridique de l'économie politique*”, April 2013, n° 707, 4.

<sup>66</sup> €4,2 billion

<sup>67</sup> *I.e.* taxes on capital gains, transfer rights, local taxes on property and inheritance tax. The figure of 5% is obtained from the Eurostat data base for 2017.

<sup>68</sup> B. LANCAR, J. MARCHAL, *rapport particulier sur les prélèvements obligatoires des ménages n° 1 (Conseil des prélèvements obligatoires), Les prélèvements sur le capital : un panorama général* [specific report of the *Conseil des prélèvements obligatoires* about capital taxation, Overall view], Feb 2017, p. 43, available at : <https://www.ccomptes.fr/fr/publications/les-prelevements-obligatoires-sur-le-capital-des-menages>.

*revenu minimum d'insertion*<sup>69</sup>, was in fact never achieved, the cost of the social measure outweighing by far the income generated by the wealth tax<sup>70</sup>. In 2018, the net output of the new tax on real estate properties has been measured at approximately \$1.43 billion<sup>71</sup>.

Several reasons may explain this low efficiency. Reports have often denounced the numerous exemptions which have considerably reduced the wealth taxes basis. In the course of the parliamentary debates in 1981, an important exemption in favor of antiques, art or collector's items and agricultural property was added to the draft. An exemption was also quickly created for business assets<sup>72</sup>, then for some categories of shares, and a 20% base reduction for primary residences was added in 1999 (increased to 30 % in 2007). Wealth tax reductions in favor of donors and taxpayers who invest in SMEs have also significantly helped French households to reduce the amount of wealth tax incurred. Without discussing the merits of all these exemptions and reductions, we can criticize the significant cost they imply for our public finances. A study published in 2017<sup>73</sup> established that the shortfall related to these exemptions, without taking into account the exemption in favor of business assets, is approximately \$1.21 billion<sup>74</sup>, while the cost of the wealth tax capping is a bit more than \$1.1 billion<sup>75</sup>.

### 3.3.2. *The significant cost of the French wealth taxes*

The first cost incurred by the wealth taxes is related to the tax exile it provokes. The subject might be more sensitive in France, as it is not the citizenship that determines the application of the French taxation rules (like in the US), but the tax residency: it is easier to change French residency than to change French citizenship.

It is difficult to establish with certainty the link between wealth taxes and the departure of taxpayers. However, in the context of tax competition enhanced by the great EU freedoms that benefit its citizens, it is more than likely that the French wealth tax, knowing that most European countries have dropped their wealth tax<sup>76</sup>, has played a sizable role in the decision of French taxpayers to move their tax residence out of France. Data published by the FTA shows an increase in the number of departures of French taxpayers liable to the wealth tax since 2011, 2014 excepted<sup>77</sup>. We are still expecting data to analyze the effect of the wealth tax's reform on tax exile, but professionals agree that this reform, if it has not induced returns in France, has at least contributed to slowing down departures<sup>78</sup>. In 2017, *i.e.* the year during which President Emmanuel Macron announced the removal of the ISF, departures have fallen to their lowest level since 2003<sup>79</sup>.

<sup>69</sup> Cf. *supra* p. 1.

<sup>70</sup> The cost of the *revenu de solidarité active*, which has replaced the *revenue minimum d'insertion* since 2011 is estimated at €10 billion (\$10.96 billion) by the French public finances.

<sup>71</sup> €1.3 billion. V. EBLE, A. DE MONTGOLFIER, *Rapport d'information n° 42 (Sénat)* [...] prev. footnote n°18, p. 80.

<sup>72</sup> The exemption is the result of the Finance Act for 1984. Loi n° 83-1179, Dec. 29, 1983, *Loi de finances pour 1984* [finance act for 1984], art. 19.

<sup>73</sup> B. LANCAR, J. MARCHAL, *Rapport particulier sur les prélèvements obligatoires des ménages n° 1* [...] prev. footnotes n° 68, p. 39-40.

<sup>74</sup> €1.1 billion.

<sup>75</sup> €1 billion. See prev. footnote n° 56.

<sup>76</sup> V. EBLE, A. DE MONTGOLFIER, *Rapport d'information n° 42 (Sénat)* [...] prev. footnote n°18, p. 48.

<sup>77</sup> Direction Générale des Finances Publiques, *rapport 2018 relatif aux contribuables quittant le territoire national* [2018 report about taxpayers leaving the French territory], Feb. 2019, See Annex 1, p. 85.

<sup>78</sup> M<sup>e</sup> Luc Jaillais, French Tax Lawyer and co-president of the *Institut des avocats conseils fiscaux* [Institute of French Tax Lawyers] declared during his parliamentary hearing that even if he did not notice any return of tax exiles, some of his clients did renounce leaving France thanks to the wealth tax reform. Report of the hearing before the Senate about the wealth tax reform and the creation of the flat tax, April 10, 2019.

<sup>79</sup> France Stratégie, *Comité d'évaluation des réformes de la fiscalité du capital* [...] prev. footnote n° 17, p. 204.

Tax exile represents two main costs. First, it is a shortfall for our public finances; in addition to avoiding the wealth tax, tax exiles will also pay a lot less taxes in France (if any at all)<sup>80</sup>. Secondly, it induces some significant losses for the economy which will suffer from all the investments that will not be made in France due to an excessive taxation on capital. These losses are impossible to evaluate, but some specialists are deeply convinced that the French wealth tax costs more to the French economy than it brings in<sup>81</sup>.

By limiting the scope of the wealth tax to real estate properties, Emmanuel Macron has contributed to a great reduction of the wealth tax burden for the concerned taxpayers. However, as it has been explained before, this reform has also contributed to making the wealth tax more unfair and significantly limited its initial role of reallocation. In light of the numerous issues we mentioned, we may think that the more rational solution to the French wealth tax problem consists in its complete removal. Though, the political cost of such a decision seems too high regarding the very symbolic nature of this tax. The removal of the wealth tax by the late Jacques Chirac has been seen by many commentators as the measure that cost him his loss at the presidential election. The replacement of the ISF by the IFI has provoked great anger among a significant part of the French population: one of the *gilets jaunes*' main requests was the reinstatement of the wealth tax.

## Conclusion

The French experience of wealth taxes brings a great paradox to light: while the wealth tax is, to a certain extent, inefficient and costly for the economy, it seems nearly impossible to remove. As a consequence, France is now one of the last three European countries to have such a tax on wealth, standing in what seems to be a dead end that should probably just be avoided just by not stepping in.

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<sup>80</sup> It is extremely difficult to estimate the amount of losses thus generated. An author estimated that the induced losses could be estimated around €5.4 billion (\$5.92 billion) in 2015. This figure must be taken carefully but can give an idea. E. PICHET, "Pour une réforme de l'ISF et de la fiscalité patrimoniale française", *Revue fiscale du patrimoine*, April 2016, n°4, 10, p. 4.

<sup>81</sup> *Ibid.*, p.5.

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