

TIRARD, NAUDIN

International Tax Newsletter

LEADER

The Amended Finance Law for 2011 has introduced several measures which go back on the "tax package" introduced in 2007 and may have a significant impact on the estate tax planning of both French residents and non residents. Under the new Law, wealth tax is radically revised, the "tax shield" is abolished, gift and inheritance tax rates are raised, a specific tax regime for trusts is introduced and an "exit tax" is created. However the French Government has dropped its earlier proposal to introduce a new tax on the second homes of non residents.

WEALTH TAX

The new rules aim to simplify and lighten the burden of French wealth tax. As from 2011, individuals are subject to wealth tax if the net value of their assets owned on 1st January 2011 is €1,300,000 or more (instead of €800,000). The wealth tax payable for 2011 is still determined by applying a sliding scale, which varies from 0,55% to 1,80%, to an individual's net assets above €800,000. The deadline for filing wealth tax returns has (only for this year) been extended to 30th September 2011. As from 2012, the same threshold will apply but the wealth tax computation will be based on new rules. Individuals liable to wealth tax will be subject to a flat rate applicable to their whole estate (instead of that part which exceeds €800,000). The rate will depend on the value of their net assets: 0.25% if the assets are worth between €1,300,000 and €2,999,999 and 0.5% if the assets are worth more than that. In order to mitigate the thresholds' effect, the taxpayer whose net assets are just above a threshold is entitled to a specific relief. The administration of wealth tax is also to be simplified for taxpayers who are subject to the 0.25% rate. They will no longer be required to file a wealth tax return but will only need to report the net value of their assets on their income tax return.

Furthermore, the exemption for business assets is to be extended to taxpayers who carry on business activities, and the 25% participation threshold required for a company's shares to be exempt is lowered to 12.5% if this condition is not met because of a capital increase (and provided certain other criteria are fulfilled). Lastly, the qualifying conditions for the relief available to shareholders who undertake a lock-up commitment (Dutheil's relief) are to be loosened slightly with view to stimulating business activity.

WEALTH TAX TREATMENT OF NON RESIDENTS OWNING FRENCH PROPERTY

Reminder

Non residents are subject to wealth tax only on their assets located in France, subject to a number of exemptions including financial investments made in France. New residents are exempt from wealth tax on all their property situated outside France for the five years after they take up residence in France.

New anti-avoidance measure

The French Parliament is introducing a rule for French wealth tax purposes which will particularly affect non residents owning French property through an intermediary company. As from 1st January 2012, the valuation of shares in a property investment company ("société à prépondérance immobilière", such as an SCI) cannot be reduced by any debts owed to its non resident shareholders. This measure purports to counter a widely used scheme which consists of granting a loan to the company (through a shareholder's current account) in order both to reduce the value of its shares and to benefit from the wealth tax exemption applying to financial investment in receivables.

ABOLITION OF THE « TAX SHIELD »

The so-called "tax shield", which allows individuals to claim a tax refund when the total French tax paid is in excess of 50% of their worldwide income, will be abolished as from 2013 (with respect to income incurred in 2011). As from 2012, claims for a refund will be directly offset against the wealth tax due.

TAXATION OF TRUSTS

Reminder of current rules

In accordance with our long-held view, which has been confirmed by case law, the transfer of assets by a resident or non resident settlor to an irrevocable discretionary trust allowed French resident settlors and beneficiaries to avoid wealth tax, to defer the payment of income tax up until the point at which income was distributed to the French resident beneficiaries, and/or to postpone the payment of gift or inheritance tax up until the transfer of assets by the trustee to the beneficiaries.

Creation of a new specific tax regime

Although the income tax treatment is not being modified, a new regime is being introduced in respect of gift and inheritance tax as well as wealth tax. Moreover, several stringent reporting requirements are to be imposed on trustees, with very heavy penalties for non compliance. The scope of this new specific tax regime is clearly extensive, as it applies not only to trusts but also to similar foreign law structures.

Inheritance and gift tax

The new regime officially confirms our analysis whereby the transfer of assets to a trust is not subject to gift tax or inheritance tax, but only upon the distribution of the trust assets to the beneficiaries. As from 31st July 2011, these taxes apply at the time of the transfer of trust assets to the beneficiaries or, if earlier, upon the death of the settlor. The beneficiaries are liable for the payment of tax, which is assessed on the value of the trust assets at the time. The tax rate is determined in accordance with the relationship between the settlor and the beneficiary as though the trust were transparent (assuming that the relationship can be substantiated).

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GIFT TAX AND INHERITANCE TAX

As from 31st July 2011, the two highest tax rates applicable to gifts and inheritances in favour of direct descendants, as well as gifts to a spouse or civil partner, are increased by 5 percentage points. From a practical standpoint, this means that gifts/inheritances worth between €902,838 and €1,805,677 are taxed at 40% and at 45% above the latter value. Moreover, the period during which lifetime transfers form part of the transferee's cumulative total is extended to 10 years instead of 6 (this specific change will have retroactive effect). In addition, the relief for early transfers (which reduces the amount of tax according to the age of the transferor) is abolished. However, the qualifying conditions for Dutreil's relief (described above) are being loosened slightly.

TAXATION OF TRUSTS (continuation)

If however, it is not possible to ascertain the shares of the beneficiaries in the trust fund upon the death of the settlor, the trustee and the beneficiaries are jointly liable for the payment of tax. A 45% rate applies if the class of beneficiaries only contains descendants of the settlor, while a 60% rate otherwise applies. In any event, the 60% rate applies if the trust is governed by the law of an uncooperative jurisdiction or if the trust was settled by a French resident after 11th May 2011. The other provisions apply to any settlement or capital distribution occurring after 31st July 2011.

Wealth tax

The new Law provides that assets held in any kind of trust, including an irrevocable discretionary trust, are taxable on the settlor (or on the beneficiaries following the death of the settlor) for French wealth tax purposes, if the settlor/beneficiary is a French resident or the trust fund contains taxable French assets. However, the assets held by a trust whose beneficiaries are all qualified charitable organisations under article 795 of the French Tax Code (« FTC ») are not subject to wealth tax.

A specific wealth tax for trusts is also being introduced at a rate of 0.5%. Indeed, a catch-all provision specifies that the trustee is liable for this tax jointly with the settlor and the beneficiaries, either if the trust assets are not included in the settlor's or the beneficiaries' estates for wealth tax purposes, or if the trust has not been disclosed to the tax authorities (where the taxpayer was not liable to wealth tax). As a departure from this principle, trusts whose beneficiaries are all qualified charitable organisations and trusts settled by French residents specifically for retirement purposes are not subject to this tax. This provision will come into force in January 2012.

Reporting requirements

If the settlor or one of the beneficiaries is resident in France or if the trust fund

contains French assets, the trustee must disclose to the tax authorities the formation of the trust, any variation of its terms and its termination as well as the market value of the trust assets each year. Failure to comply with the reporting requirements will give rise to a very heavy penalty equal to 5% of the value of the trust fund.

EXIT TAX

The exit tax (abolished in 2005) has been reinstated as from 3rd March 2011. This tax applies to any individual who transfers his tax residence abroad after 6 years of continuous residence in France and who holds, whether directly, indirectly or jointly with the members of their household, either (i) a participation of at least 1% in a company, or (ii) a participation (in such a company) whose value exceeds €1,300,000 at the date of the transfer.

When these conditions are met, the transfer of residence will trigger income tax and social contributions on any unrealised gains calculated at the date of the transfer (i.e. a global tax rate of 31,3%). However, the taxpayer benefits from an automatic deferral if he becomes resident in an EU State or an EEA State which has entered into a tax agreement with the French tax authorities in order to facilitate the exchange of information and the collection of taxes. Otherwise, income tax and social contributions are immediately payable unless the taxpayer requests a deferral and provides an appropriate guarantee for the payment of such taxes (no guarantee is required if the transfer of residence is for professional reasons). In both cases, the deferral will end and tax will become payable when the shares are sold, cancelled, repurchased, reimbursed, transferred by way of gift in certain circumstances or when the taxpayer receives earn out payments within the eight years following the transfer of residence. The crystallised income tax is exempt at the end of the eight year period or if the taxpayer relocates earlier to France (provided he still holds the shares), or upon his earlier death.

If the exit tax is payable, it can either be reduced if the actual gain is eventually lower than the crystallised gain at the time of the transfer of residence, or it can simply be cancelled if the transfer has generated a loss. In order to avoid double taxation, the tax paid abroad in the country of residence upon the disposal of the shares can be credited against the French exit tax.

In spite of the precautions which the French Government has taken (the automatic deferral), the new exit tax may be regarded not only as contrary to the EU's principle of free movement of capital but also to the provisions of the numerous double tax treaties concluded by France. Finally, we believe that adequate restructuring should make it possible to limit the effects of the exit tax.

LIFE INSURANCE POLICIES

As from 31st July 2011, the flat rate levy applicable to the proceeds of life insurance policies which are not subject to inheritance tax is increased and becomes progressive. While the 20% rate still applies to that part of the insurance proceeds which does not exceed €902,838, any proceeds above that threshold are subject to 25%.

In addition, the territorial scope of this levy is also extended and is now applicable if the insured person is a French resident at the moment of his/her death, or if at the same time, the beneficiary has been resident in France for at least 6 out of the 10 years preceding the death of the insured person. This provision specifically relates to insurance policies which were taken out with an insurance company established outside France.

Finally, an anti-avoidance measure provides that when the death benefit of a life insurance policy is subject to a usufruct, both the bare owners and the usufructuary are liable for the payment of this levy in proportion to the value of their shares, as determined in accordance with article 669 of the FTC.