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Private Wealth 2021

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Trends and Developments

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France: Heaven on Earth?

Many of our clients are contemplating transferring their residence to France. The reasons they are moving, or returning, to France are different, but this new development has accelerated since Brexit and may also be explained as an impact of COVID-19.

The impact of COVID-19 and Brexit

After the pandemic crisis, many corporations are contemplating setting up or developing existing businesses in France, which is a very stable country from a political standpoint, located in the middle of continental Europe, with a large, educated workforce.

This new phenomenon is further emphasised by the post-Brexit effect under which multinationals are reinforcing their French teams in order to centralise their operations in continental Europe instead of the UK.

As a consequence, many businesspeople and managers are coming to France, at least for a temporary period.

On the other hand, once lockdown has eased, one may be tempted to live in a country which offers quality of life, gastronomy and many beautiful places to visit.

The introduction of a flat tax on certain sources of income and capital gains, as well as the suppression of wealth tax on movable assets, has contributed to improving the tax burden on new French tax residents.

Living in France is becoming once again a reasonable option for many foreigners who had long sought our "*art de vivre*", but not at any cost.

Despite the poor reputation that France may still suffer as a "tax hell", anticipating a move to France may change it to paradise on earth!

France being a "heaven on earth" is particularly true for American citizens living in France, as we will see below.

How to become a French tax resident

As opposed to the situation in the USA, for example, citizenship is not relevant in determining liability for taxation in France.

Non-French residents are only subject to French taxes on their French-source income and French-located assets. French residents, regardless of their citizenship, are, as a general rule, liable to French taxes on their worldwide income and assets.

It is very easy to become domiciled (*domicilié(e)*) in France. Tax "domicile" is not a question of choice: one either is or is not a French tax domicile. The same criteria apply to all French taxes (income tax, wealth tax, gift and inheritance tax).

When no tax treaty applies, individuals are deemed to be domiciled in France if they meet any one of four tests.

- They have their home or main residence in France (*foyer principal*); the home is the place where the taxpayer and their family (spouse and children) normally live.

- France is their principal place of residence; this means that if they spend more time during the tax year in France than in any other country, they will also become French domiciled.
- They have their main occupation in France.
- France is the country where they are deemed to have the centre of their economic interests; in practice this means the country where they have made their major investments and/or where they receive most of their income.

It is possible that a person qualifies as French domiciled under French domestic law and is also a resident of another country under the law of that country and thus subject to full tax liability in both France and another country simultaneously.

Fortunately, however, as long as France has signed a tax treaty with the other country, if the person is resident both in France under the French rules and in another country according to its own rules, a "tie-breaker" clause in the tax treaty will come into operation and the individual will be deemed to be resident in only one country.

France is a country with a particularly developed network of conventions. More than 120 double tax treaties are applicable to income tax and wealth tax and around 40 double tax treaties are applicable in matters of inheritance tax. Very few treaties apply to gift tax, with the notable exception of the US-France treaty.

Most "tie-breaker clauses" included in the tax treaties signed by France provide that:

- if individuals are resident in both countries, they are deemed to be resident in the country where they have a permanent home available to them;
- if they have a permanent home available in both countries, they are deemed to be resident in the country where they spend the longest period of time; or
- if this country cannot be determined, they are resident in the country where they have their centre of vital interests (ie, the country with which their personal and economic relations are the closest).

If this test is indeterminate, individuals are deemed to be resident in the country of which they are a national.

Treaties' provisions also allow new French tax residents with foreign-source income to avoid double taxation in most cases.

Finally, it is essential to keep in mind that the French tax authorities must respect different sets of rules, including European law and French constitutional law.

Notable taxes payable by French residents

The most notable taxes to take into account before moving to France may be summarised as follows.

Flat tax rate on dividends, interest and capital gains on shares and securities

Since 1 January 2018, investment income (dividends, interest) is subject to a flat tax of 30% (including 12.8% income tax and 17.2% social contributions) unless the taxpayer elects for the application of the progressive income rates. In such cases, a 40% allowance may apply for the calculation of the dividend taxed.

Capital gains on shares and securities of "business companies, including companies subject to corporation tax" are also, as a general rule, subject to a flat tax rate of 30%. When taxpayers' capital gains are taxed under the flat rate, no allowance applies.

However, taxpayers are still allowed to elect for the application of the progressive income tax rates (with a marginal rate of 45%, see below) plus 17.2% in social contributions. In that case, for the purpose of determining the taxable net gain, such gains benefit from annual allowances at the following rates: 50% if the shares are held for a period of two to eight years; and 65% if the shares are held for at least eight years.

"Exit tax" only applies to individuals who have been residents of France for more than six of the last ten years before leaving the country. We are, however, convinced that the so-called "exit tax" does not comply with several constitutional and European fundamental principles.

Income tax on ordinary income

As a general rule, individuals who are residents of France are liable to French income tax in France in respect of their worldwide income (including ordinary income and capital gains). As a general rule, income tax is progressive, with a marginal rate of 45% (for the fraction of taxable income over EUR157,806 for income received during 2020).

In addition to income tax, additional so-called "social contributions" are due in respect of savings income and income from capital assets at an effective flat rate of 17.2%.

A supplementary contribution also applies to an individuals' high annual income, at a rate of 3% for the fraction of income between EUR250,001 and EUR500,000 for single taxpayers (between EUR500,001 and EUR1 million for couples subject to joint taxation), and 4% for the fraction of income over EUR500,001 for single taxpayers (and over EUR1 million for couples subject to joint taxation).

This contribution is assessed on the individual's "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.

Capital gains on real properties

Although France does not levy a separate general capital gains tax as such (such as, for example, in the UK), some specific gains of a capital nature are subject to income tax.

The taxable base and applicable tax rates depend on the nature of the asset which is sold.

As a general rule, French-resident individuals are taxed on realised capital gains upon the sale of real property (regardless of where the property is located) at the global rate of 36.2%, for 2021 (19% plus social contributions at the rate of 17.2%).

Capital gains on the sale of the main residence are tax-exempt.

Capital gains on the sale of other real properties are, however, reduced by yearly allowances leading to an income tax exemption after 22 years and a social contributions exemption after 30 years.

As mentioned above, a supplementary contribution may also apply, at a rate of 3% or 4% depending on the level of income. This contribution is assessed on the individuals' "reference tax income", which includes, in particular, capital gains on the sale of real properties.

The sale of the shares of a company that owns real estate located in France as its main assets (qualified as a *société à prépondérance immobilière*) is subject to a different tax regime depending on whether the company sold is a pass-through entity (such as a *société civile immobilière*, SCI) or a company subject to corporate tax.

Assuming the French resident sells the shares of a pass-through entity, capital gains are taxable at the global rate of 37.2%. The same rebates as those applying to real estate properties apply. Similarly, capital gains on the sale of the main residence held though such an entity would also be tax-exempt.

Finally, an additional tax is assessed on capital gains exceeding EUR50,000 realised upon the sale of real property. This tax applies to the whole amount of the capital gain at a flat rate varying from 2% to 6% (for capital gains exceeding EUR260,000).

Wealth tax

Resident taxpayers who have been domiciled in France at any time during the five preceding years are liable to wealth tax on their worldwide real estate properties and rights, owned directly or indirectly (so-called *impôt sur la fortune immobilière*, or IFI).

On the other hand, individuals who have been non-French domiciled during the five preceding years are only subject to IFI on their French-located real estate properties and rights.

IFI is only payable by individuals whose private real estate wealth, after deduction of debts, exceeds a certain limit on January 1st each year (EUR1.3 million for 2021).

The IFI payable for 2021 is determined by applying the following sliding scale to the individuals' taxable assets over EUR800,000:

- up to EUR800,000 – 0%;
- EUR800,000 to EUR1.3 million – 0.5%;
- EUR1.3 million to EUR2.57 million – 0.7%;
- EUR2.57 million to EUR5 million – 1%;
- EUR5 million to EUR10 million – 1.25%; and
- more than EUR10 million – 1.5%.

The total amount of income tax, IFI and some specific local taxes cannot exceed 75% of the "reference tax income" of the taxpayer.

Inheritance/gift tax

Liability for French gift and inheritance taxes is determined by the donor's and donee's residence (or the deceased's and heir's residence) as well as the location of the assets being transferred.

When the donor (or deceased) is a resident of France, or when the donee (or heir) has been for at least six out of the preceding ten years, all movable and real estate property (wherever it is situated) transferred without valuable consideration is liable to tax in France.

When the donor (or deceased) and the donee (or heir) are both resident outside of France, only movable and real property situated in France (or deemed to be French assets) are liable to French gift or inheritance taxes in these circumstances.

As a consequence, when the donee (or heir) has been a resident of France for less than six of the preceding ten years, only French assets received will be subject to French gift or inheritance tax.

In a nutshell, inheritance tax is imposed upon the recipient and the rates vary according to the relationship between the heir and the deceased.

The rates range from 5% to 45% above EUR1,805,677 for direct descendants (after deduction of an allowance of EUR100,000 for descendants for each 15-year period). Surviving spouses and civil partners are fully exempt from inheritance tax (but not from gift tax).

They increase to 60% in the absence of a family relationship. Inheritance tax is due on any transfer of property upon death, whether it results from the application of intestate succession rules, the provisions of a will, or forced heirship. It is calculated on the net value of the property distributed to each heir.

Gift tax is calculated at the same graduated rates that apply to inheritance tax (with different applicable allowances however).

If the assets are properly structured before moving to France, a new French resident may benefit from favourable tax treatment provided they do not die in France. One may then contemplate spending no more than five years in France.

A temporary residence in France allows individuals to benefit from a favourable tax regime

Individuals who reside in France for less than five years benefit from advantages which should be taken into consideration. They can be summarised as follows:

- no wealth tax (IFI) on real estate properties located abroad;
- no gift or inheritance tax on assets located outside France when the donor or deceased is not a resident of France;
- the sale of the main residence located in France benefits from a total capital gains tax exemption if sold within two years after the seller relocated abroad;
- no exit tax applies; and
- if properly organised, temporary residents may only be subject to the 30% flat tax on investment income.

American citizens can benefit from even more favourable tax treatment in France

As opposed to other countries' nationals, American citizens may benefit from very favourable tax treatment in France, which allows them to stay in France at reasonable cost for more than five years, thanks to the US-French tax treaties applicable to income tax, gift and inheritance tax.

According to these, US-source income and capital gains benefit, as a general rule, from a total exemption from French income tax. Only income derived from France and countries other than the USA are subject to French income tax.

IFI only applies after the first five years of residence in France to assets located outside the USA (including France).

Gifts and inheritance tax on certain assets located in the US benefit from a total exemption for French gifts and inheritance tax.

To conclude, US citizens may contemplate spending the rest of their life as a French resident without paying French taxes, provided their assets are properly structured before becoming French residents.

Do French forced heirship rules apply to French residents?

Individuals wishing to relocate to France must have in mind that France applies rules which restrict testamentary freedom.

In particular, under the French forced heirship rules, a certain portion of the estate (the "hereditary reserve") cannot be disposed of by lifetime gift or will, other than to descendants and, under certain conditions, to the surviving spouse.

Since the entry into force in 2015 of a European Union Regulation on Succession, the law applicable to succession, including of immovable and movable assets, is the law of the country in which the deceased had their habitual residence at the time of death.

However, under this Regulation, it is now possible for a person to choose the law of their state of citizenship at the time of making the choice, or at the time of death, as the law to govern their succession.

It is therefore very easy to circumvent the effect of French forced heirship rules by setting up proper estate planning, which would consist in adapting the will and/or in creating a trust before becoming French tax resident.

Indeed, even though the concept of the trust is alien to the French Civil Code and it is impossible to set up a trust under French law, French courts recognise the effects of common law trusts.

To conclude

Becoming a French tax resident for a limited period (five years) or forever (for a US citizen) may be seen as a suitable solution to benefit from the best France may offer. However, it is essential to have a properly organised estate (in particular through holding companies or trusts) before arriving in France.

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Tirard Naudin is a highly regarded Paris-based boutique law firm co-founded in 1989 by Jean-Marc Tirard and Maryse Naudin, which specialises in international tax and estate planning (including trusts), tax representation and litigation in all aspects of French taxation, with a particular emphasis on international tax issues. The firm is managed by Ouri Belmin. The firm's experience in the trust field is virtually unique in France. Its client base includes corporate clients, who come both for its special expertise in negotiating with the French tax authorities and for its experience of structuring international transactions. It also acts for high net worth private clients and their families who need help in resolving complex tax and inheritance issues. It has considerable expertise in property tax issues and the creation of efficient structures for non-resident investors. Tirard Naudin acts regularly as "lawyer's lawyers", providing specialist support for other firms and their clients.

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Maryse Naudin began her career in the tax department of one of the major accounting firms, where she was in charge of the real estate practice and the South-East Asia clientele, prior to co-founding Tirard Naudin. She now has more than 35 years' experience in advising and defending a varied clientele, from multinational corporations to high net worth individuals, in relation to cross-border tax issues. Maryse Naudin has a particular expertise in advising foreign investors acquiring French real estate as well as advising French clients with foreign interests. She also has a wealth of expertise in matters relating to trust aspects in a civil law environment, European taxation and, in particular, tax litigation with respect to community freedoms. She is the co-founder and former secretary of the French branch of STEP, a member of the International Academy of Estate and Trust Law, a fellow of the American College of Trust and Estate Counsel and a former chairman of the "International Estate Planning" commission of the Union Internationale des Avocats.

Ouri Belmin started his career working on corporate transactional matters and real estate issues for the Paris offices of UK law firms, before joining the financial services department of one of the Big Four audit firms. After more than ten years of practice as a senior lawyer at Tirard Naudin, he is now the firm's managing partner. Ouri Belmin advises corporate clients on all French aspects of international taxation (restructuring, acquisitions, litigation). He also assists high net worth individuals in relation to their estate planning. He has been involved in numerous tax litigations and has an excellent knowledge of all stages and aspects of French tax procedure. Ouri Belmin is a member of the Union Internationale des Avocats (UIA) and the Institut des Avocats Conseils Fiscaux (IACF).

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