BUYING AND OWNING A FRENCH RESIDENTIAL PROPERTY IN 2016.

GOWLING WLG

TAX AND OTHER CONSIDERATIONS FOR NON-FRENCH TAX RESIDENT OWNERS.

For many wealthy individuals and families, an apartment in Paris, a chalet in a ski resort or a villa in the French Riviera are essential elements of their property portfolios. An estate somewhere in the countryside may also be included; a French vineyard or a stud farm for example.

While the search for suitable properties may appear to be the priority, a potential purchaser should also take advice as to how a property should be purchased and owned in order to maximise its tax-efficiency.

As with other types of assets, it is essential to consider the tax efficiency of the acquisition structure at an early stage, and preferably before signing any pre-sale contract (even if the structuring can be implemented later, during the conveyancing process, in order to be in place before completion).

With the low rates of tax in certain countries, one could be excused for not attaching enormous importance to tax planning or thinking that the holding structure for a real estate acquisition can be safely revisited later. Sadly, the French tax environment is not so benign, and failure to adopt the right structure at the outset can have costly tax consequences.

On the French conveyancing side, as part of a French property purchase, a French notary is required to draw up the transfer deed and witness its signature. The notary is also responsible for making the usual standard enquiries, such as checking the vendor has good title to the property, the planning status of the property and for transferring good title to the buyer etc. The notary's role is mainly limited to ensuring that the sale deed is both probative and enforceable (this is also his principal liability). He does not usually give tax advice, and this must be obtained separately from a French tax lawyer.

In this brochure, we look at the tax aspects of buying and owning a property in France in 2016 in line with the most recent tax changes. We also consider some important trusts and French tax residence issues which may be relevant to purchasers.

TAX ASPECTS.

In France, in addition to stamp duty at around 5%, three main capital taxes must be considered when purchasing a residential property:

- Inheritance Tax (IHT)
- Wealth tax
- Capital Gains Tax (CGT).

Other taxes might also need to be addressed, depending on the purchaser's circumstances.

For instance, income tax if the property is intended to be let out, and more importantly, corporation tax when the proposed purchase is to be made through a foreign company (or other entity). In this respect, it should be stressed that specific advice should always be taken before contemplating purchasing a French residential property through a foreign company or through a trust (or similar entity), given the French tax consequences that such structuring might have.

In addition, if the company or the entity in question is situated in a country which has not signed an appropriate Tax Treaty with France, an annual tax of 3% on the market value of the French property becomes payable.

INHERITANCE TAX (IHT)

French IHT normally applies at progressive rates. In the direct line, i.e. transfers to children and parents, the rates rise from 5% to 45% depending on the value of a beneficiary's share of the estate (the rate of 45% applies on a share exceeding €1,805,677).

Death transfers between spouses are not taxed and assets which pass to an unrelated beneficiary are taxed at a flat rate of 60% regardless of value. Broadly speaking, the rates applying to other family members vary between 35% and 55%. As explained below, IHT can also apply on assets passing through a trust at flat rates which can be very high (up to 60% in certain cases).

IHT may of course apply when a French property is owned directly (French sited asset) but the use of a foreign company to own French real estate might not necessarily help to avoid French IHT. Under French tax law, shares of foreign companies owning French real estate can also be regarded as French sited assets potentially subject to French IHT (unless otherwise provided by a relevant Double Tax Treaty).

However, the use of a company properly structured with debt can help to mitigate or avoid French IHT. Other solutions might also be considered: e.g. a Monegasque SCI, lifetime transfers, "Tontine", or a change of matrimonial regime, taking advantage of any applicable Double Estate Treaties depending on the country of residence of the purchaser (e.g. Double Tax Treaties signed by France with certain countries of the Gulf Co-operation Council), but these solutions are guided by the personal circumstances of the purchaser.

Furthermore, movable assets located in France (such as works of art, French financial assets, furniture, French registered cars, etc.) may be subject to French IHT. In certain situations, the use of a foreign company to own them might also be considered.

WEALTH TAX

Non-French tax residents are subject to wealth tax on their French sited assets, if the net value of these assets exceeds €1,300,000, at the following progressive rates:

Net taxable value of the French sited assets	2016 rates
Up to €800,000	NIL
Between €800,000 and €1,310,000	0.50%
Between €1,310,000 and €2,570,000	0.70%
Between €2,570,000 and €5,000,000	1%
Between €5,000,000 and €10,000,000	1.25%
Above €10,000,000	1.50%

Settlors (and beneficiaries regarded as deemed settlors under French tax legislation) of trusts are personally liable to wealth tax on assets held in trust and failure to comply with wealth tax filing requirements and liability gives rise to a penalty of 1.5% on the trust assets.

In broad terms, French sited assets obviously include assets such as shares in a French company (e.g. a French SCI), furniture within a French property, a French registered car or boat etc. Under French tax law, shares of foreign companies owning French real estate may also be treated as French sited assets for wealth tax purposes (unless otherwise provided by a relevant Double Tax Treaty signed by France).

As for IHT, solutions exist to avoid or mitigate wealth tax such as, for instance, using debts or splitting the ownership of the taxable assets between various owners or shareholders. In some cases, when the property has already been purchased and has substantially increased in value, restructuring the ownership and/or the debt may be envisaged to reduce future tax liabilities (wealth tax and IHT liabilities).

CAPITAL GAINS TAX (CGT)

Generally speaking, French CGT applies on a profit made on the sale of French real estate (including the sale of shares of a French or foreign company owning French real estate). Taxation applies on the net gain being determined by the difference between the acquisition price and the sale price after application of a taper relief (at various rates), which depends on the length of ownership of the property. Under the current regime, no tax is due after an extended period of ownership of 30 years. After 22 years of ownership, CGT is not due, but the social contributions remain payable (albeit with a higher taper relief available).

Since 2013, an extra tax applies on net gains (after application of the taper relief) which exceed €50,000. The rates are between 2% and 6% (the higher rate of 6% applies on gains which exceed €260,000).

CGT applies at a rate of 19%. This one single rate applies to all taxpayers regardless of their country of residence (except for sellers residents of one of the few countries seen by France as "uncooperative states or territories").

In addition to CGT, social contributions are due at a rate of 15.5% making a global rate of 34.5%.

This CGT regime only applies when the property is owned directly by individuals or by certain companies (such as a French or Monegasque SCI), provided that the SCI does not fall within the corporation tax regime (e.g. it habitually carries out furnished lettings or it is owned by a company subject to corporation tax). If the French or foreign company selling the property does fall within the French corporation tax regime, the gains would be taxed in accordance with the corporation tax rules and not as mentioned above.

Sometimes, the purchaser might have the option to buy the shares of an existing company owning the residential property rather than the property directly. In addition to some potential stamp duty savings, acquiring the shares of an existing company might also bring some interesting CGT savings possibilities (on the future sale of the property by the company).

Indeed, a sale of shares would not change the ownership of the property by the company itself and the relief already available to it. However, by acquiring the shares, the potential purchaser must be aware that he will also acquire the history of the company (in particular its tax history). Undertaking an audit of the company might then become necessary.

CORPORATION TAX

A consequence that non-French tax residents are often unaware of is that the use of a foreign company to own French residential property can trigger unpleasant French corporation tax issues.

It is not usually advisable for corporation tax to apply to residential property for two main reasons. Firstly, corporation tax is due on the deemed profits derived from the free use of the property. Secondly, and more importantly, capital gains realised by the company on the sale of the property would be computed and taxed under the French corporation tax regime which would be less favourable than the private CGT regime described above.

In addition to the fact that no taper relief would apply, depreciation of the property will need to be taken into account. Given the effects of the depreciation rules, the longer the company owns the property the higher the corporation tax liability, at a current rate of 33.33%, on any future sale would be. For long term ownership, the application of corporation tax might not be favourable (but it might be for short term ownership given the current high CGT rates as explained above).

Finally, the application of corporation tax triggers the need to comply with more formalities and tax filing requirements (e.g. additional running costs).

Before using a foreign company (or other entity) to purchase a French residential property, the tax treatment of that company in France must always be checked. Furthermore, it should also be noted here that if the foreign company (or entity) is situated in a state which has not signed an appropriate Tax Treaty with France, it might be liable to an annual tax of 3% on the market value of the French property.

3% TAX

Under French tax law, French or foreign companies and entities (such as trusts and private foundations) which own French real estate, directly or indirectly, are subject to an annual 3% tax applied on the market value of the real estate.

However, a number of exemptions apply, particularly for EU companies/entities and foreign companies/entities located in a country which has signed a treaty with France which either provides an appropriate administrative assistance provision to prevent fraud and tax avoidance between both countries, or contains a non-discrimination clause. This concerns more than 100 countries around the world.

Companies/entities located in one of these countries are not subject to taxation provided that they comply with certain filing requirements. Indeed the exemption is not available as an outright right. Broadly speaking, the company/entity must either provide, or undertake to provide at the request of the French tax authorities, certain information regarding the real estate, the name and address of all shareholders, partners or other members of the company/entity. The information can be provided either by submitting a 3% tax return each year or by giving the undertaking to provide this information at the request of the French tax authorities. These formalities must be taken seriously as the consequences for not complying with the 3% tax legislation can be extremely unpleasant and costly.

The main traps to avoid are as follows:

- When the company/entity which has not complied with the formalities receives a formal request/notice from the French tax authorities to regularise its situation within 30 days, it is crucial not to ignore this request and provide the returns within the deadline. If the company/entity fails to respond to the letter then the 3% tax charge become due, plus a penalty of 40%;
- When filing the 3% tax returns it is important to provide the right information at the right place. Failure to provide the right information and errors in the return might give rise to the payment of the 3% tax charge;
- The information provided in the 3% tax returns must be genuine and accurate. A false declaration might give rise to the payment of the 3% tax charge plus penalties;
- In respect of entities which do not have owners as such (e.g. trusts, foundation etc), the concept of a beneficial owner becomes relevant when making the declaration. Failure to disclose the beneficial owner might give rise to the payment of the 3% tax charge;
- When details of the beneficial owner do not appear anywhere, steps must be taken in advance to ensure that it would be possible to provide to the French tax authorities, at their request, good evidence that a certain individual can truly be regarded as the beneficial owner of the entity (this might occur in respect

of trusts and foundations when the person seen as the settlor is not the beneficial owner). Failure to comply with these principles might give rise to the payment of the 3% tax charge;

- In respect of bearer shares companies, it might be difficult to prove that someone is the owner/shareholder of the company. Internal processes must be in place to ensure that it would be possible to provide good evidence to the French tax authorities that the individual in question is truly the bearer of the shares. Failure to put in place and keep these records in advance might give rise to the payment of the 3% tax charge;
- When the property is owned through a chain of shareholding ownership, all entities within the chain are potentially liable to the 3% tax (the number of entities within the chain is irrelevant). Each entity within the chain must therefore strictly comply with its own filing requirements. Failure to comply with these principles might give rise to the payment of the 3% tax charge.

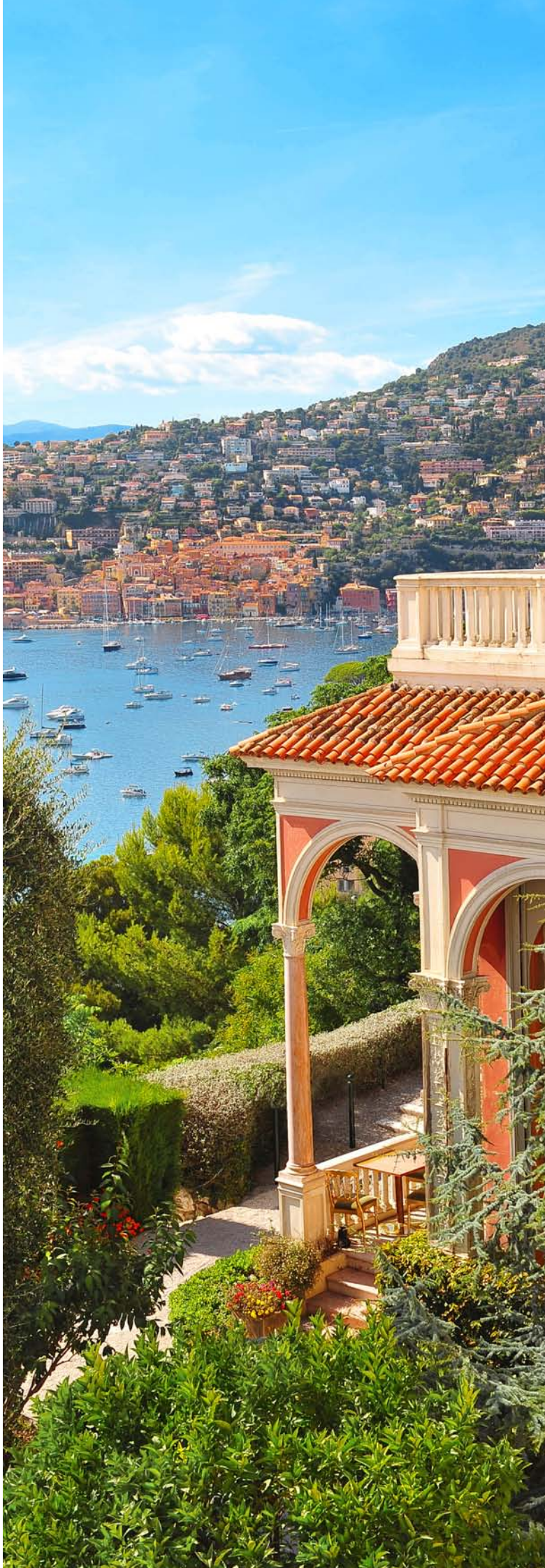
Having said this, it should be noted here that when no 3% tax return has been filed or no undertaking has been given, leniency may be shown to companies/entities eligible for exemption but who have not complied with the formalities. A spontaneously late declaration would not raise the payment of the 3% tax charge.

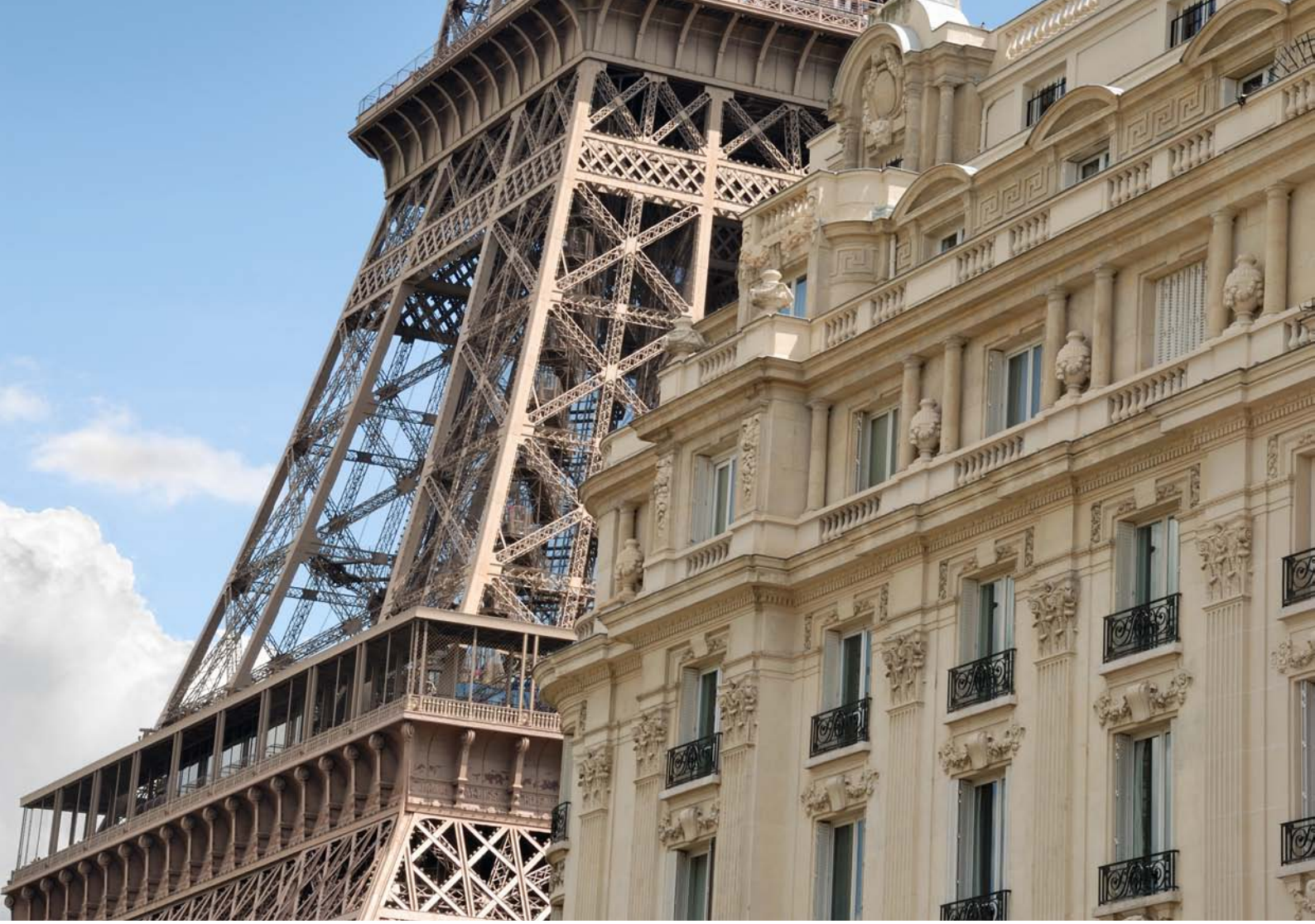
NON-FRENCH REAL ESTATE COMPANIES

Generally speaking, non-French tax residents fall within the ambit of the French tax legislation when they own French sited assets (or when they earn French source income).

The shares of a foreign company are not regarded as French sited assets. However, as it would be easier for non-French tax residents to avoid French taxation by interposing a foreign company to own a French property, French tax anti-avoidance legislation provides that shares of foreign companies whose assets consist mainly of French real estate are treated as French sited assets for French tax purposes, particularly in respect of French IHT, wealth tax, CGT and stamp duty.

These rules only concern so-called French real estate companies. Therefore, subject to certain conditions (in particular, the tax residence of the ultimate owner of the shares of the foreign company and the provisions of the relevant Double Tax Treaty) and other French tax provisions, the shares of a foreign company which does not meet the definition of a French real estate company are not treated as French sited assets. When feasible, this can permit some interesting tax planning opportunities.





FRENCH PROPERTY HELD IN TRUST.

French tax legislation does not prohibit the ownership of French properties through a trust. Legally speaking it is possible to have a French asset owned by a trustee. In broad terms the ownership of a French property (directly or indirectly) might have the following principal consequences:

- The settlor would still be regarded as the owner of the property held in trust, as if the trust did not exist, for French wealth tax and French IHT purposes. On the death of the settlor, the beneficiaries of the trust will be deemed to be the new settlors of the trust if the assets remain in trust;
- For other tax purposes, in particular French corporation tax, the trust arrangement would be disregarded. The corporate trustee (if any) would be regarded as the true owner of property (or the shares of the company owning the property). The situation and the French tax consequences of a French property being owned directly or indirectly by a corporate company (instead of individuals) have to be considered, in particular in respect of the French corporation tax issues;
- The trustees of the trust owning French sited assets will have to comply with specific filing requirements by disclosing the trust to the French tax authorities. Failure to comply with this will give rise to a high penalty of 12.5% of the total assets held in trust;
- The ownership of French real estate through an offshore company or a trustee also triggers 3% tax issues.

These tax issues aside, trusts might remain good vehicles to own French residential property when considering estate planning and family assets protection and ownership.

POTENTIAL RISKS TO FRENCH RESIDENCE STATUS.

The mere ownership of a French residential property by a non-French tax resident is not enough for this individual to be regarded as a French tax resident. However, it is how the residential property is used by the individual and his family that might trigger French tax residence issues.

Broadly speaking, the French tests of residence can be easily met. Among the various tests (which include carrying out a professional activity in France or having the centre of economic interests in France), the French tax legislation provides for a "Foyer" or "family home" test which should be considered carefully.

Under this test an individual could be regarded as a French tax resident merely because his close family (spouse/partner and/ or children) habitually live in France regardless of how many days he actually spends in France (even if it is only a few months per year). Under French tax law the mere presence of someone's family in France can often be enough to meet one of the French tests of tax residency.

Of course, the French tests of tax residency can be and often are overridden by the application of a Double Tax Treaty. However, such a Treaty might not grant protection in all circumstances and specific advice should always be taken to avoid unintended French tax consequences.

Furthermore, in respect of residents of countries which have not signed a Double Tax Treaty with France, the French domestic tests apply without restriction and it is sufficient for them to satisfy any one of the French domestic tests of residence to be regarded as and taxed as French tax residents (i.e. on worldwide income and assets).

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Frederic is a dual-qualified French and English private client lawyer. He is a member of the Paris Bar Association as well as the Law Society (England & Wales). He is also a member of the Society for Tax and Estate Practitioners (STEP) and the Paris Institut des Avocats Conseils fiscaux.

He advises international private clients and professionals in this field on French and international tax matters. Along with Frederic, the French tax team of Paris includes three partners with capabilities to cover all aspects of French tax, in particular, real estate tax, corporate tax, tax disputes, personal tax and wealth management.

Frederic has many years of experience advising private clients on personal tax and wealth management and other legal issues they might encounter. He started his career with Andersen Legal and Landwell & Partners in Paris. He then moved to London and worked at BDO Stoy Hayward LLP and Grant Thornton LLP.

Frederic studied Law at the University of Aix-en-Provence where he still lectures on French and international tax, estate and tax planning. He regularly writes articles and gives talks on these subjects.

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