

FRENCH TAX CHANGES 2011

On 6th July 2011, the French Senate adopted the draft bill concerning the review of the French taxation system (*Project de Loi de Finances Rectificative pour 2011*). Subsequently, the text has been referred to the Constitutional Council and the Council has a duty to rule within one month, as to whether or not the planned changes are acceptable, i.e. that they are in accordance with French constitutional law.

Providing that no changes are made (which can only be now on the grounds that the proposals are found to be unconstitutional), the next step would be that the text of the bill will be officially published. Only at that stage, will it become law.

Shown below is a summary of our understanding of the principle changes.

WEALTH TAX

- The entry level for wealth tax will be increased from €800,000 to €1.3 million, with effect from 2011.
- The deadline for wealth tax returns for 2011 will be postponed until 30th September 2011.
- Taxpayers with net taxable assets of at least €1.3 million will be taxed for 2011 on the existing *barème* scale.
- The *bouclier fiscal* and the *plafonnement* will be abolished in 2012. However, for those households of 'modest means', there will be a system of capping the *taxe foncière* for the principal residence only, where this exceeds 50% of the taxable income of the household.

Furthermore, in order to avoid the Treasury having to send out cheques in 2012 to those who benefit from the *bouclier fiscal* in 2011, it is our understanding that you will be able to estimate the amount of your *bouclier fiscal* rebate and deduct this from your wealth tax bill in 2012.

- From 2012, there will be two bands:
 - €1,300,000 to €2,999,999; and
 - €3,000,000 and above.
- From 2012, there will be two tax rates:
 - 0.25% for those with assets between €1,300,000 and €2,999,999; and
 - 0.50% for assets in excess of €3,000,000.

- The rates will not be progressive and the bands will only be used to determine the tax rate that will apply to all assets from the first euro. However, to smooth out the effects of the two separate thresholds, a discount method will be established for assets between €1.3 million and €1.4 million, as well as for assets between €3 million and €3.2 million.
- For those in the first bracket, it will not be necessary to complete a separate wealth tax return and you will only need to report the information on your income tax return.

INHERITANCE TAX & GIFT TAX

- The last two bands of the inheritance tax scale for successions and donations made in direct line, as well as for gifts between spouses and partners bound by a PACS, will be increased, as follows:
 - from 35% to 40%
 - from 40% to 45%
- The gift tax 'allowance period' - which was previously reduced to 6 years from 10 years in 2006 - is to be extended again to 10 years. It is expected that the new rules will apply with effect from the date of entry into force of the law.

Consequently, for donations already made between 6 and 10 years ago, the amounts will be reinstated in the calculation of inheritance tax, in the event of the death of a donor before the end of the ten year period from the date of the donation. For an initial period, however, donations already made will benefit from a form of 'taper relief' depending upon how long ago the donation was made, as follows:

- 10% if more than 6 years and less than 7 years
 - 20% if more than 7 years and less than 8 years
 - 30% if more than 8 years and less than 9 years
 - 40% if more than 9 years and less than 10 years
- The current general reduction in gift tax (50% for donors under age 70 and 30% for donors between 70 and 80) is to be abolished. However, some discount will be maintained in limited circumstances, for example, for the transmission of shares in a family business, although this will be reduced from 75% to 50%.

ASSURANCE VIE

- Currently, for amounts invested before age 70, on the death of the insured person each beneficiary is liable to a fixed rate of tax of 20% (plus 'social taxes') on amounts exceeding an abatement of €152,500. However, if the investment is made before becoming French resident, there is no liability for the 20% tax.

From the date of the law coming into effect:

- the tax rate will be increased from 20% to 25%, but only in respect of the part of the benefit which exceeds €902,838 (based on 2011 rate); and
 - the French tax authorities will consider the residence situation at the date of death (rather than at the date of investment) and arising out of this the beneficiary will be liable to the tax rates indicated above, in the following circumstances:
 - where the insured is resident in France at the date of death; or
 - where the beneficiary has been resident in France for six out of the last ten years, as at the date of the insured person's death.
- Currently, where the death benefits paid are divided, so that one person receives the 'life use' and other beneficiaries receive the 'bare ownership', it is the person receiving the 'life use' of the benefit that is liable for the 20% tax. Thus, if it is the spouse/PACS'd partner of the deceased who has the 'life use', then there is no withholding tax payable; this is due to the exemption arising under the TEPA law. Subsequently, when the benefit eventually passes to the other beneficiaries, there is no further liability for tax.

For the future, whilst the spouse/PACS'd partner will remain exempt from the 20% tax, the abatement of €152,500 will be shared proportionally and the beneficiaries receiving the 'bare ownership' will be liable to their share of the 20% tax, based on the value of the 'bare ownership' of the benefit that they are entitled to receive.

PENSION COMMENCEMENT LUMP SUM (PCLS)

Except for very limited circumstances, the UK PCLS has been taxable in France since the beginning of this year. Currently, in order to minimise the effect of the taxation of the PCLS on the overall taxable income of the taxpayer, a special calculation of the tax liability is applied to the PCLS.

The new rules propose to replace the existing calculation of the income tax with a fixed rate of withholding tax of 7.5% plus the *Contribution pour le Remboursement de la Dette Sociale* (CRDS) of 0.5%. In theory, if the person receiving the PCLS is the holder of a Certificate S1, they should be exempt from the CRDS.

TRUSTS

The new rules will concern trusts with **at least one of the following**:

- French resident settlor;
- French resident beneficiary (unless exempted by a Double Taxation Treaty (DTT), for example, the 1963 DTT on inheritance between the UK and France, due to the fact that this was in force before France changed its internal rules relating to French resident beneficiaries receiving inheritances); and
- French situated assets – even if the settlor/beneficiaries are not living in France.

A new definition of a trust has been included in the bill which, in effect, is based on a mixture of definitions from different sources. However, France does not have any real concept of trusts in the Anglo-Saxon sense of the word, whereby the principle of separation of property ownership between the settlor and the trustees is fundamental to the basis of trust law. Instead, it appears to have taken a view that the majority of trusts have been created for the sole purpose of evading taxes and so it is now seeking to impose taxes at the highest levels possible.

France signed the “Hague Convention of 1985 on the Recognition of Trusts”, but has never ratified this Convention. Had it done so, the text that has been included in the current bill would be ruled as unconstitutional.

However, there is one hopeful light and that is centred on another Hague Convention that France has ratified, which concerns the law applicable to agency. Under this Convention, a trustee of a trust is excluded from the definition of an “*administrateur*”. Interestingly, in the new bill, the same word has been used often in what appears to be a ‘generic’ term used for trustee or manager. Hence, in France’s attempt to set the net far and wide, it may actually be possible for the Anglo-Saxon style trust to escape the definition, as a matter of French constitutional law!

Notwithstanding the foregoing, our understanding of the planned changes is detailed below.

Income tax

Income received from a trust will be treated as investment income, in the hands of the taxpayer. Therefore:

- 100% of the income received will be added to other taxable income of the household;
- depending upon the overall income level of the household, this could have the effect of increasing the marginal rate of income tax of the household; and
- social taxes, currently at the rate of 12.3% will be payable, in respect of the income received from the trust.

Trusts continued

Gift & succession duty regimes

The text of the bill lays down provisions for the attribution of capital between the settlor and the beneficiaries and also for transfers for gift and succession duties. Of fundamental importance is the concept of when the taxable event will be deemed as a gift or an inheritance; overall, the emphasis is on the date of the transmission.

- The following will be subject to French gift and inheritance taxes:
 - lifetime gifts and inheritance transfers to beneficiaries who have been resident in France for at least six out of the last ten years;
 - the transfer of assets to a trust; and
 - the transfer of French assets owned by a trust.

The market value of the relevant trust assets, as at the date of transmission, will be used for the basis of calculating the tax liability.

- For new trusts that are set up after 11th May 2011, or where the trust is set up in a jurisdiction that has not concluded a Tax Information Exchange Agreement with France (referred to as a “non-cooperative territory”), the tax rate is 60% in all cases.
- For existing trusts, which are set up in a “cooperative territory”, the rate of tax will be determined, as follows:
 - if the relationship between the settlor and the beneficiary can be identified, the tax rate and allowance will be according to the standard IHT *barème* scale.
 - if the beneficiaries are, globally, the descendants of the settlor, the tax rate will be the top rate for descendants in direct line, i.e. 45% (after the enactment of the bill).
 - anything else will be subject to a tax rate of 60%, unless covered by specific exemptions in the French tax code, for example, charities and other limited cases.
- The *administrateur* will be responsible for paying the tax, however, if the trust is set up in a “non-cooperative” state, then the beneficiaries of the trust will be jointly and severally liable.
- In any event, when making a declaration for the purpose of calculating inheritance tax liability, beneficiaries will have a duty to declare assets received from the trust - both those received at the time of death of the settlor and in respect of any gifts received from the trust during the previous 10 years

Trusts continued

Wealth tax (ISF)

Generally, the proposed changes aim to ensure that assets placed in trust will anyway be considered as being owned by the settlor. Furthermore, in the case where the settlor is deceased and the beneficiary is French resident, the beneficiary will be deemed to be the settlor.

- With effect from 1st January 2012, there will be an annual levy of 0.5% of the underlying value of the trust's assets, even if these are less than €3 million.
- The *administrateur* will be liable for the payment of the levy, however, the settlor and/or beneficiaries will be severally liable.
- The *administrateur* will have an obligation to declare the trust assets by 15 June each year and failure to do so will result in a penalty of the greater of €10,000 or 5% of the underlying value of the trust assets. The *administrateur*, settlor and beneficiaries will be jointly liable for this penalty.
- However, the levy will not be payable where the relevant assets have been declared for ISF, even if the total net taxable assets of the taxpayer are less than the ISF threshold of €1.3 million.
- Where the trust is set up in a "cooperative territory", the levy will not apply to a discretionary trust that has been set up for charitable purposes and other limited exceptions, or one which has been set up to manage the pension rights acquired by beneficiaries, as a result of their professional activities, under a pension plan established by a company or a group of companies.

Clearly, the above brings all relevant assets into the ISF net for French residents or for French property held within a trust. Even where a trust is set up in a jurisdiction whereby, in accordance with the internal rules of that jurisdiction, it would be a breach of trust for the trustees to report the details of the settlor/beneficiaries, the obligation to report the value of the trust assets is also imposed on the settlor/beneficiaries concerned and so cannot escape the net.

Application of the rules relating to trusts

Once the bill becomes law, the application of the rules will come via implementing decrees. Hence, we will have to wait to see what transpires before we can be certain about how the above will actually work, in practice.

OTHER PREVIOUSLY MENTIONED PROPOSALS RELATED TO SECOND PROPERTIES

As has been widely reported, the planned tax on the *résidence secondaire* for non-residents was quickly scrapped, almost before it got off the starting block. Sadly, it would appear that this was not because of the deluge of protests made by expatriates who have invested in property in France, but more because the government realised that a large number of French nationals living outside of France would have been affected by this tax. In view of the fact that it is an election year in 2012, the government realised that there was a risk that this could be a vote loser.

There was also much written about the abolition of the taper relief in respect of capital gains on second properties, at least as concerned social taxes. However, this also disappeared from the agenda as the bill made its passage through parliament. Since this was not the first time that this proposal had been raised, however, one cannot help thinking that it may be raised again after next year's election.

27 July 2011

This outline is provided for information purposes only. It does not constitute advice or a recommendation from The Spectrum IFA Group to take any particular action to mitigate the effects of any potential changes in French tax legislation.

If you would like to discuss how these changes may affect you, please do not hesitate to contact your local Spectrum IFA Group adviser.