

# Owning French real estate in trust

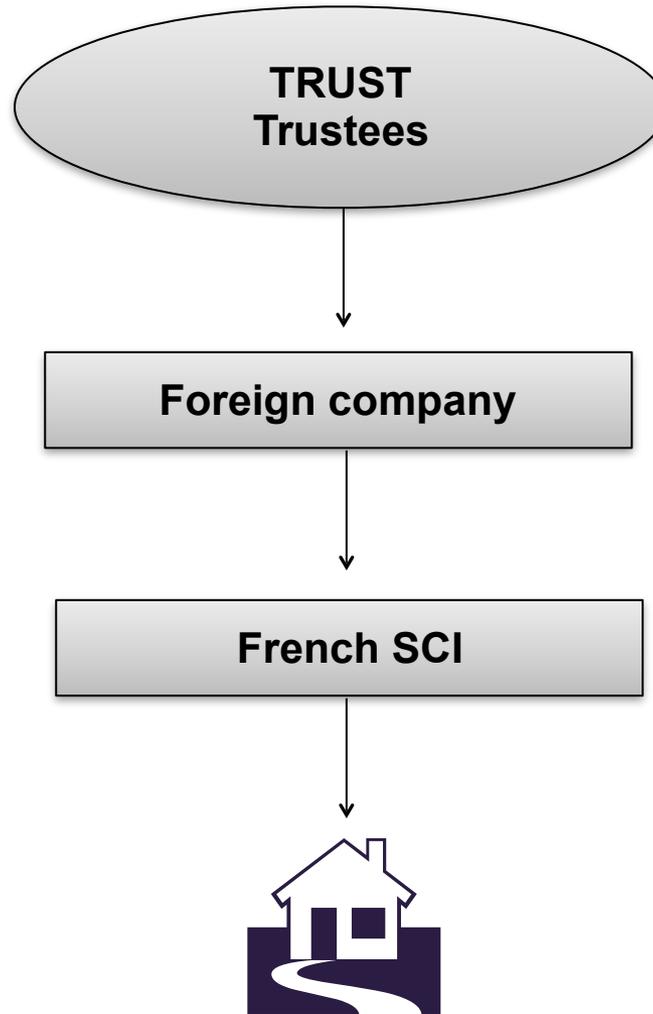
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# INTRODUCTION

- French civil code does not prohibit the ownership of French real estate by trustees (it is legally possible)
- Lack of tax provisions applicable to trusts in the past
- France enacted specific tax legislation applicable to trusts in 2011: although it did not make trusts attractive tools for tax planning it does not necessarily penalise the use of trusts
- The new legislation is not perfect (still needs further clarifications) but we now have enough material to address the general position of the ownership of French real estate in trust (this was not possible and was quite risky before 2011)
- The new legislation definitely gives more certainty around the taxation of trusts in France

# TRUST STRUCTURE



# INTRODUCTION

- Let us address the French tax consequences of such structuring considering four main taxes that foreigners face when owning French real estate:
  1. Wealth tax
  2. Inheritance tax (IHT)
  3. Corporation tax
  4. 3% tax
  5. Trustees' disclosure obligations
- This presentation applies to both residential and commercial properties

# 1. WEALTH TAX

- The settlor is still regarded as the owner of the trust assets as if the trust did not exist
- The settlor would then be regarded as the owner of the shares in the foreign company
- For this reason the use of a trust would not dramatically change the situation in France
- Non French tax residents (settlers) are subject to wealth tax on their French-sited assets only
- Wealth tax applies on the net value of the shares: market value of the real estate less qualifying debts

# 1. WEALTH TAX

- Bank loans are deductible but not shareholders' loans
- Would a loan from the trust be deductible? Not clear as it could be regarded as an indirect shareholder's loan (as the settlor is deemed to be the owner of the trust assets including the loan)
- Similar principles apply in respect of French IHT

## 2. IHT

- The settlor is also regarded as the owner of the trust assets as if the trust did not exist
- French IHT liability might then arise on the death of the settlor
- French IHT can only apply to French-sited assets when neither the settlor nor one of the beneficiaries is a French tax resident (French-sited assets are defined as for wealth tax)
- Double tax treaties covering death transfers apply even if a trust is involved (particularly relevant if the settlor is resident in certain Gulf countries)
- As for wealth tax the use of a trust would not therefore dramatically change the situation in France

### 3. CORPORATION TAX

- The interposition of corporate entities (i.e. a foreign company) triggers French corporation tax issues (not by reason of the use of the trust itself)
- Under French tax legislation corporation tax normally applies when French real estate is owned directly or indirectly by foreign companies (unlike when the property is owned by individuals directly or indirectly through a French SCI)
- This mainly concerns residential properties as it might not be beneficial for corporation tax to apply to them for two main reasons:
  1. Taxation of the free use of the property
  2. Higher capital gains tax liability on the future sale of the property (due to the depreciation rules)

## 4. 3% TAX

- Under French tax legislation foreign companies and other entities (such as trusts) owning French real estate directly or indirectly are potentially subject to a 3% tax applied on the market value of the real estate, unless an exemption can apply
- Companies and other entities located in a country which has signed an appropriate tax treaty with France can be exempt providing that information regarding their shareholders and members is revealed to the French tax authorities
- In respect of trusts the benefit of this exemption might not be so straightforward as it might give rise to certain complications to be considered carefully (as the financial consequences of the application of this tax might be very prejudicial)

## 4. 3% TAX

- In order to benefit from the exemption, the tax treaty must benefit entities not endowed with legal personality (such as trusts)
- Indeed, not all treaties signed by France can benefit trusts
- The trust must therefore be “located” in a country which has signed with France a treaty which can benefit trusts
- In respect of the location of the trust, the French tax authorities have a singular approach. They appear to consider that trusts are established in the state whose law applied to them
- It is the law governing the trust which therefore indicates what treaty will apply and if the exemption can be granted (if the applicable treaty can benefit trusts)

## 5. TRUSTEES' DISCLOSURE OBLIGATIONS

- Trustees have to comply with disclosure obligations if, on 1 January in the relevant tax year, they administer a trust that has French connections, i.e.:
  1. the settlor and/or at least one of the beneficiaries of the trust is a French tax resident; and
  2. an asset held in the trust is a French-sited asset within the meaning of article 750 ter FTC
- In our case, the shares of the foreign company could be regarded as French-sited assets (only French domestic provisions apply)
- The trustees have to comply with two different and separate filing obligations: a general declaration of existence and modifications of a trust, and an annual declaration of assets held in the trust

## 5. THE GENERAL DECLARATION

- The purpose of this declaration is to make the French tax authorities aware of the existence of the trust and any modifications made to it
- Once this declaration has been made, there is no need to make another declaration for the following years unless a modification is made to the disclosed trust
- In such a case, the declaration must be made within 30 days following the modification
- The term ‘modifications of the trust’ is drafted widely enough to include any changes affecting the trust

## 5. THE DECLARATION OF ASSETS

- The trustees must lodge a declaration of assets held in trust on 1 January of the relevant tax year
- The annual declaration must be filed regardless of the value of the trust assets or whether wealth tax is due on them
- Only French-sited assets of a trust have to be disclosed if none of the settlors, deemed settlors or beneficiaries are French tax resident

## 5. PENALTIES FOR FAILURE TO DISCLOSE

- Following the Constitutional Court's decision of 22 July 2016, the penalty regime has been significantly amended
- As of 1 January 2017, no flat rate penalty (5% or 12.5%) applies on the trust assets. A €20,000 fine might apply instead
- In addition, the settlor and/or the beneficiaries face a penalty of 80% of the unpaid wealth tax or income tax due to their failure to disclose their assets or income from the trust
- In a decision on 16th March 2017 the Constitutional Court ruled that the flat rate penalties applicable in the past were unconstitutional

# FREDERIC MEGE

- Frederic is a tax partner at Gowling WLG
- He is a dual-qualified French and English private client lawyer (Avocat/Solicitor)
- He is a member of the Paris Bar Association, the Law Society (England & Wales), the Society for Tax and Estate Practitioners (STEP) and the Paris Institute of French Tax Lawyers
- Frederic has many years of experience advising private clients on personal tax and wealth management and other legal issues they might encounter
- He worked at Andersen Legal and Landwell & Partners in Paris and BDO Stoy Hayward and Grant Thornton in London
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