

FRENCH INHERITANCE AND TAX PLANNING

The following is the text of a lecture given by Martin Scannall, partner and Avocat a la Cour to the members of STEP Ireland and FILA in Dublin on 15th April 2003 and reflects our thinking on French Inheritance planning for non residents of France as at that date.

INTRODUCTION

Anybody buying property in France is going to have to deal with French Law, and especially French inheritance Law. What I would like to try to do this evening is to take you through some of the considerations, which face a purchaser of French property and look at some inheritance and tax planning techniques, which can be used.

France is a Civil Law country which means there is no concept of Trusts, no concept of Executors and Trustees, no concept of equitable and legal interests in Land, and no concept of grants of probate, or anything like that. For those reasons and others, Wills play a very small part in French inheritance planning, which instead is dealt with in other ways, as we shall see.

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The foreign investor in French property will find that that property is subject to French Law, and that includes French inheritance Law. Both French Inheritance Law and French tax law are designed to ensure that property passes down the bloodline. In terms of law, the legal reserve rules see to that, instituting descendants or failing them, ascendants the legally reserved heirs. In terms of tax law, the lowest rates are those applicable to ascendants and descendants, and the surviving spouse, and the most punitive, to more distant relatives or non-relatives.

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THE LEGAL RESERVE RULES

Looking at the legal reserve rules contained in the French Civil Code there are two classes of reserved heir and only two. These are, in the alternative, descendants, meaning children or the issue of predeceased children, or ascendants, meaning parents. One child is entitled to one half of the parent's estate; two children are entitled to two thirds between them and three or more to three-quarters. If there are no children, the ascendants, meaning parents, have an entitlement that is one quarter for one and one half for both. You will note that the surviving spouse is not a reserved heir. What is left over is called the disposable portion and may be dealt with by Will. So, the principle is that the estate splits and goes down the bloodline.

These rules are what is called "*d'ordre public*", meaning public policy. That in turn means that there is a distinction to be drawn between legitimate estate planning and schemes the sole purpose of which is to deprive reserved heirs of their lawful rights. Generally speaking arrangements which are intended to benefit the surviving spouse and then the children fall into the category of legitimate estate planning. Arrangements intended to disinherit children outright do not and can be struck down by the Courts.

INHERITANCE TAX RULES

Just as the legal reserve rules operate to pass property down the blood-line so the inheritance tax rates are the most beneficial in direct line, and the more the heirs the less the overall liability for a given asset. In France each heir is taxed individually on the value received at rates which depend on the relationship between the heir and the deceased. I have illustrated two tables here, the direct line table and the between spouses table, but in simplified form. Taking descendants, meaning children first you will see that they each individually get 46,000 tax free, and then after a few small intermediate rates will pay 20% on any value received between 15,000 and 520,000. The surviving spouse gets 76,000 tax free, and then after a few small intermediate rates will pay 20% on any value received between 30,000 and 520,000. Higher rates apply for higher values, the top rate in this category being 40%. Large families are therefore good news in tax terms. Non relatives, by contrast are severely punished, 60% flat rate, and that, I am sorry to say that includes partners who are not married and step children.

UNDIVIDED OWNERSHIP RULES (*Indivision*)

The next factor in this equation is the French concept of *Indivision*. This word describes what in England would be called tenancy in common, where parties own property together with no right of survivorship. Most married couples, it is fair to

say, would not intentionally buy property in this way, but as joint tenants, with a right of survivorship, and more often than not, would also have mutual Wills. Ask such a couple how they would like to hold their foreign property, and the answer would probably be in the same way, surviving spouse first and children later. But nine times out of ten that is exactly what does NOT happen.

The reason it does not happen is that, as always, things are different in France. In France, the way matrimonial property is held is governed by the parties matrimonial regime, either the regime laid down by law, which is community of acquisitions, or that chosen by the parties, generally either complete separation of property or complete community, of which more in a moment. Because of that, it is the custom of the Notary, when starting a transaction, to send the buyers a questionnaire, asking for their details, including their matrimonial regime. It is in this innocent question that the trap lies, for in England, and to the best of my knowledge, in Ireland, the concept of marriage contracts is unknown. So the answer given, or at least the assumption made, is that there is no marriage contract and therefore the parties are as the expression goes “separate as to property”, the upshot being, purchase is made as to one undivided half each.

The trouble with indivision is that if any one undivided owner fails to agree with the others, the deadlock can only be resolved by Court Order. No sale is possible without mutual consent, but

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equally no party can be forced to remain in undivided ownership with the others. These rules help to explain why one is so often faced with a large number of sellers for any one property. The problems created by splitting title in this way are not insoluble, but to put it no higher, they complicate matters more than somewhat

COMBINED EFFECT OF *INDIVISION* AND LEGAL RESERVE - DEVOLUTION

To take the commonest case where parties simply buy property and take no advice at all, they will end up as “undivided owners as to one half each”. A typical example might be a married couple with three children. They have mutual Wills. One dies. The three children, whether of full age or not automatically inherit their three-quarters of the half share. The other quarter goes under the Will of the deceased. If the property is then to be sold, the consent of all parties is required. If a child is a minor the question of who can sign is referred to the child’s personal law. In the case of a British Citizen, this reference is probably to English Law. If it is, in English Law minors cannot hold an interest in land. The parent does not have the authority to sell, and the resultant impasse can be broken only by a discretionary High Court Order, involving the use of Counsel, an expensive business.

COMBINED EFFECT OF *INDIVISION* AND LEGAL RESERVE – INHERITANCE TAX

The inheritance tax implications are as follows. Assume the property to be worth 800,000. Half of that is 400,000. Split that half four ways and each heir, the three children and the surviving spouse take 100,000 each. Each child has 46,000 tax-free and the surviving spouse has 76,000 tax-free. Thus each child will pay inheritance tax on 54,000 and the surviving spouse inheritance tax on 24,000, in the case of the children at a marginal rate of 20% and in the case of the surviving spouse, at a marginal rate of 15%. The total liability will be in the order of 30,000, which is pretty modest, on an asset of a reasonable value. However, the surviving spouse is NOT free to deal with the property as he or she wishes, and that, generally speaking is, or perhaps should be the prime objective.

INHERITANCE PLANNING – SOME GENERAL POINTS

When dealing with inheritance planning, one needs to bear in mind that most properties are kept for ten to fifteen years and then sold, either because someone dies, or the children grow up, or people move on to something bigger and better. In the majority of cases therefore inheritance planning is aimed at protecting the surviving spouse, and in my opinion, for what it is worth, that should always be the priority. Leave the

surviving spouse in control, and he or she can sell, decide not to sell, gift the property to the children, or whatever and not end up ensnared in the murky waters of French inheritance law, indivision and all the rest of it. There are three basic techniques for achieving this, the *tontine* clause, the *communauté universelle*, and the *Société civile immobilière*. I will also touch on the *Pacte Civil de Solidarité*, introduced with much fan-fair a few years back but no use to you unless you live in France, and not a great deal more use if you do,

LA CLAUSE TONTINE.

For relatively modestly valued properties a simple transfer of title to the surviving spouse, or indeed anybody else buying jointly, can be fairly simply achieved by adopting, at the time of purchase, the *tontine* clause. This clause which must be inserted in the deed of purchase by the *notaire* records that the purchase of the property is made for the benefit of the surviving party who is deemed retrospectively to have owned the whole from the outset. The predeceased party is, by contrast deemed never to have had any interest in the property. Thus this clause circumvents the legal reserve rules on the first death and rather crudely reproduces joint tenancy with the right of survivorship, the property passing, on the second death, to the children.

However for inheritance tax purposes there is a deemed transfer of half. If, again we take the 800,000 property, one half is 400,000. This time there is only one tax-free allowance the surviving spouse at 76,000 leaving 324,000 at a marginal rate of 20%, and a liability of some 62,000.

The Tontine can be used by married couples or by others buying property together wanting the property to the survivor, such as “partners” but the tax consequences then become severe, if the individuals are not related, the rate of IHT as between non-relatives being 60%.

This problem becomes particularly acute in the not uncommon case of second marriages where there are children from a first marriage and the desire is to benefit the surviving spouse and then the children or stepchildren. The first transfer as between spouses may not be particularly heavily taxed, but the second, if from surviving spouse to stepchildren will be especially heavily taxed at the 60% rate so that cumulatively most of the value of the property will be lost in tax. This is one reason why most French notaires are not very receptive to the suggestion of the tontine clause and why, if it is to be used at all, thought needs giving to the potential long-term consequences.

There is however one small concession which occasionally will be relevant, and that is that where the property is worth less than 76,000 and is the main residence of the parties there is no deemed transfer of half the value for inheritance tax

purposes. Instead the transfer attracts stamp duty, as for a sale at 4.89%. This concession is contained in Article 754A of the French General tax Code, which will be referred to later in the context of the *Société civile immobilière*.

LA COMMUNAUTÉ UNIVERSELLE (MARRIAGE CONTRACT)

This approach involves the adoption a French matrimonial regime and by contrast with the *tontine* therefore requires to parties to be married. This technique, devised with the assistance of Counsel in London and CRIDON (*Centre de Recherches, d'Information et de Documentation Notariales*) in Lyon takes advantage of the Hague Convention on the Law Applicable to Matrimonial Regimes of 14th March 1978 which came into force in France on 1st September 1992. Article 6 of the Convention permits the spouses, after marriage to designate, in respect of their immovable property, the Law governing that immovable property. Thus it is possible for the spouses to choose a French matrimonial regime, adopting the French system of “universal Community with attribution to the survivor”.

This requires two things. Firstly the Deed of partial Change of Matrimonial regime to be executed before a notary, preferably before purchase. Although, unlike the *tontine* this is not

essential, and second an opinion, from a lawyer in the country where the spouses have their matrimonial domicile that that Law will permit them to adopt a French regime for French property. That is certainly the case in England, and unless something has changed also the case in Ireland, as I have seen opinions from Counsel here to that effect.

Once again the Deed of purchase will recite the fact that the parties have adopted the universal community of assets with attribution to the survivor, limited to their French immoveable property, and once again, the property will automatically pass to the surviving spouse. On the second death the legal reserve rules will operate and the children inherit. In other words it achieves the same thing as the *tontine* but the attraction of this approach is that there is NO inheritance tax in France on the first death. The reason for that is that the contract adopting the Universal Community is not a Will or other testamentary disposition. It will also apply to any property bought in France, so where, as happens, people buy more than one property, or, for example add to an existing property, the new purchase will automatically become a community asset.

This is all good news, but once again the position where there is a second marriage and children from the first marriage has to be considered. By contrast with the *tontine* which potentially rides roughshod over the rights of stepchildren, the marriage contract is vulnerable to attack by those very same stepchildren if the effect of the contract were to be to disinherit them. This

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right is called the *action en retranchement*. It is a right, and as such need not be exercised. That is to say that on the death of the parent the property will automatically accrue to the surviving spouse, unless the children choose to put in a claim.

PACTE CIVIL DE SOLIDARITE

If you do not fit the legislator's ideal, married couple with children, but instead have had more than one marriage, with children from the previous marriages, or have stepchildren with whom relations are bad, or a partner to whom you are not married, then ingenuity is needed to overcome the obstacles placed in your way by the French Civil Code. One small concession is the *Pacte Civil de Solidarité*.

The *Pacte Civil de Solidarité* is a legal arrangement which gives a degree of recognition to parties, who although not married, are in a stable relationship whether same sex or not. The recognition extends to some slight tax advantages, particularly in terms of inheritance tax.

One of the problems the *PACS* seeks to address is the draconian taxation of gifts between people unrelated (including by marriage) which is 60%. It is this rate of tax that is faced by unmarried couples who are joint purchasers of property in France and wish to leave their share to the other party.

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Regrettably the *PACS* is useless to you unless you live in France, but if you do, having entered into a *PACS* agreement registered at the Court of your residence, you will after two years qualify for a tax free portion of 57,000 (instead of 15,000) and reduced rate of duty of 40% (instead of 60%) on the next 15,000 and 50% on the remainder. For smaller value properties where people are moving to France this arrangement could be quite appealing.

SOME OTHER TAXES

I mentioned at the beginning that the third technique involved the use of the *Société Civile Immobilière*. Since the use of this entity offers tax-planning opportunities not otherwise available it is worth looking at some other French taxes, and incidentally the tax treatment in France of foreign companies. This constitutes a bit of a diversion from inheritance planning per se but will give some background. I will look at capital gains tax, wealth tax, and the taxes applicable to foreign companies owning property in France.

CAPITAL GAINS TAX.

A non-resident individual will pay a one third *prelevement* or withholding tax at the point of sale. The gain is computed by taking the purchase price, adding 10% for the purchase costs,

adding structural works for which French VAT invoices can be produced, applying a coefficient of monetary erosion for the year of purchase or improvement, and subtracting the revised figure from the sale price less agent's commission. Then you subtract 5% for every year the property has been held after the second, so that after 22 years the sale will be capital gains tax free in France, and what is left after all of this is the net gain, chargeable at 33.33%.

WEALTH TAX

Wealth Tax. Wealth tax is payable once the individual's net French assets exceed 720,000. Husband and wife are not separately taxed in France, thus in the case of a married couple this is by *foyer* or household. The rate is initially 0.55% PER ANNUM on the value between 720,000 and 1,160,000, then 0.75% for the value between 1,160,000 and 2,300,000, and so on up to a top rate of 1.80%. In most cases this tax is an irritant, no more

TAXES ON FOREIGN LEGAL ENTITIES.

From time to time it is suggested that Irish, Isle of Man or companies from other jurisdictions should be used to hold French immovable property. Generally speaking this is not a good idea. Foreign Companies fall into two categories, those

incorporated in a country which has a double tax treaty with France and those that do not, and there are three taxes to consider, the 3% annual tax, corporation tax whilst the property is held and taxation on the gain.

3% ANNUAL TAX

The 3% annual tax, (Art 990D) is, as it's name implies, is an annual tax payable by 15th May of each year on the open market value at 1st January of the property owned by the Company in France. If the Company has it's registered Office in a country that has an appropriate double tax treaty with France, as is the case with England and Ireland, this tax can be avoided by claiming an exemption annually. If not, no such exemption is available. In the exemption claim one has to disclose the shareholders and their addresses. If the shareholder is in turn an entity in a non-double tax treaty country, the tax will apply, so fancy structures with an Irish Company, in turn owned by a Bermuda Company etc...will not work.

CORPORATION TAX

Corporation tax. Professional opinion is divided on whether or not a foreign company holding French property is automatically liable to corporation tax. The safer view is that it probably is, and even though the Company may not have an income, nil

returns must still be filed, and in particular the depreciation rules applied. This brings us to the third factor.

244BisA. WRITE DOWN PROVISION

Art 244bisA of the CGI deals specifically with disposals of French immovable property by non-French legal entities. As you have seen the private individual is very generously treated for French CGT purposes. Not so the foreign company. A Company must write down the book value of the property every year by 2% and the difference between the written down book value and the price for which the property is sold is the gain, again chargeable at one-third.

What all this means is that there are only two sensible ways of holding property in France and these are in personal names, with or without one or other of the arrangements outlined above or through a special purpose vehicle called the *Societe Civile Immobiliere*.

SOCIETE CIVILE IMMOBILIERE

The French divide legal entities into *commercial* meaning trading and *civil*, meaning non-trading. The *Societe Civile Immobiliere* is an unlimited liability non-trading tax transparent entity. The word *Immobiliere* identifies this entity

as being specifically designed to hold property, and nothing else.

Such an entity is registered at the *Registre du Commerce et des Societes*, has a memorandum of association called *Statuts*, has an objects clause, a capital, a registered office, procedures for the transfer and transmission of shares, called *parts d'interet*, has a manager called a *gerant*, and procedures for annual general meetings, the keeping of accounts and so on.

The *Societe Civile Immobiliere*. is widely used in France to hold properties of all kinds, including residential property, the attractions, in French eyes being twofold. Firstly, since it is the legal entity, the SCI, which holds the land, not the individuals direct; the problems of undivided ownership are overcome. Secondly, It is possible to make gifts of shares to children at reduced lifetime rates, as an inheritance and inheritance tax planning exercise, without losing control of the asset.

Where non-residents of France form a *Societe Civile Immobiliere*, which then purchases the property, they no longer own land, subject to the undivided ownership and entrenched heir-ship rules, but instead own shares in the SCI. The devolution of those shares being governed by the Law of the individual shareholder's domicile, not French Law, they escape the French legal reserve rules altogether, assuming the individual is domiciled outside France. By contrast with the *tontine* and the *Communauté Universelle*, therefore the *Societe*

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Civile Immobiliere. gives complete testamentary freedom and may seem at first sight the obvious choice. Not so, I would suggest.

The SCI does have its' uses which will be explored in a moment, but it also has its' drawbacks. In the first place it is a legal entity and as such must be administered. At the very least there must be an annual general meeting, statutory books must be kept at the Registered office, accounts must be prepared, and all this involves fees and costs, both in terms of initial incorporation costs and annual costs. In the second place an SCI must not let furnished as furnished letting is treated as a trade, and thus is *ultra vires*. The consequence of breaking this rule is that the SCI becomes liable to corporation tax. In the third place the UK revenue consider the SCI to be "opaque", by which they mean not a partnership, but a Company, with the result that shareholders using the property owned by the SCI receive a taxable benefit from such use as "shadow Directors". This may or may not be relevant to Irish residents but it is certainly causing a good deal of head scratching in the United Kingdom. Lastly, despite, or perhaps because of being tax transparent in French Law the taxation of gains on a disposal by an SCI with non-resident members is not the same as the tax treatment of gains on a disposal by non-resident individuals. The initial computations are identical, add 10% purchase cost, add structural improvements, apply the coefficient of monetary erosion, etc, but the net gain, divided pro-rata between the members of the SCI, is treated as income

received by the members and taxed accordingly. The top rate is currently 49.50%.

Although the *Societe Civile Immobiliere* is tax transparent, it is not quite as simple as that. As a legal entity it is prima facie liable to the 3% annual tax, like any other legal entity, although that tax is easily avoidable by filing an undertaking, at the time of purchase, to disclose information, on demand to the French Revenue.

Where the *Societe Civile Immobiliere* comes into its' own is in relation to high value and complicated transactions. Examples might be a number of unrelated individuals investing in a French property. Estate agency and architectural practices whose partners fancy a place in the sun spring to mind. Here the corporate style structure and relative ease of share assignments are the determining factors. Trust investments would be another example. Reconciling a Trust Investment with French Law which has no such thing, is quite hard work, but the SCI, with the shares being moveables can provide a key. Equally there are cases where a family is so complicated, children from previous marriages on both sides or estranged children for example, that the *Societe Civile Immobiliere* is the only sensible answer.

For the more adventurous, the SCI also offers tax planning opportunities, which I will mention, for what they are worth.

The first derives from the different treatment for tax purposes, of the shares (*parts d'intéret*) representing the capital of the SCI and the shareholders loans to the SCI, called *comptes courants d'associés*. The former are assets for French wealth tax purposes. The latter, under current French revenue practice, are not. The reason for this is their assimilation with other kinds of financial investment in France that if made by foreigners would not be liable for wealth tax. Thus a very valuable property, purchased by an SCI with a capital under the wealth tax threshold and large non resident shareholders loans theoretically escapes French Wealth Tax, or so the story goes. In fact this strange concession, for that is what it must be, is not only illogical for why should a foreigner escape a wealth tax liability in a given set of circumstances when a French resident would not, but hangs on the thinnest of threads, as I have it on good authority to know.

The second, even more exotic, involves inserting in the *Statuts* a *tontine* clause in relation to the shares. You will have seen how the *tontine* operates as a deemed transfer for half the value of a property held using such a clause. The argument runs that by putting the *tontine* in the *Statuts*, you put it at one remove from the property, and thus no IHT, but only share transfer duty at 4.80% applies. Consider now that the rate of IHT in those circumstances between non-relatives would be 60% and one can see how tempting such a scheme might be, however risky.

The SCI is not for the faint hearted. It is there to be used when all else fails, and even then with caution.

WILLS -FORMAL VALIDITY

So far we have looked at inheritance planning by tweaking the rules in one way or another to achieve the desired result. Wills are for the reasons you have seen less significant in French Law, but not to be ignored.

France has ratified and passed into law (19th November 1967) the Hague Convention on the formal validity of Wills (5th October 1961) which provides five tests. These are 1) Law of place of execution, 2) Law of Testators Domicile, 3) Law of Testator's habitual residence, 4) Law of Testator's nationality and 5) Law of place of location of immoveables. Thus a Will made in Ireland in the correct Irish form will be accepted as formally valid in France.

WILLS- ESSENTIAL VALIDITY

Essential validity is another matter. Assuming the Will does not exclude French property it will by definition include French property.

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IMMOVEABLES.

So far as immoveable property is concerned the provisions of the Will are overridden by the Legal Reserve rules, but only insofar as necessary to satisfy those rules. Thus a typical mutual Will appointing the surviving spouse sole beneficiary with a gift over to the children will be defeated to some extent, but the widow or widower will still take the disposable portion. And may also have the options given under the Civil Code, which are to elect for the disposable portion, or to take one quarter and a life interest in the balance or to take a life interest only.

This choice is largely academic, although for tax purposes the life interest has a value and thus affects the overall tax calculations, because, unfortunately the granting of a life interest does not in fact mean the widow or widower may remain in the property against the wishes of the heirs. It used not to be so, but with effect from 1st July 2002, the heirs were given an inalienable option to convert the life interest into a “*rente viagere*” or annuity. This only serves to emphasise the vulnerability of the surviving spouse if steps are not taken at the outset to protect the position.

MOVEABLES

So far as moveables are concerned, these follow the Law of Domicile, and the executors appointed under the Will have power to administer. This is proved by affidavit of Law.

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FRENCH WILLS.

The accepted view is that the French property owner should have a French Will. I personally would be quite reticent about advising a client to have a French Will. The problem is one of faulty execution or conflict between the different Wills in different jurisdictions. And practical experience suggests this is no academic point. Probably 50% of the French Wills crossing my desk for French Affidavit of Law purposes in UK probate matters have a problem of one kind or another. That said, a French Will will almost certainly be holograph, prepared by the *notaire*, so that it can be copied out in full in the hand of the testator and dated and signed by the Testator, but without witness, and then handed back to the notaire for safe custody. But do not write out your holograph Will in your home country because in that case it is, surprisingly; most likely void, as it satisfies none of the tests above. The notaire in turn will register the fact of custody with the Central Wills Registry.

INTESTACY

I do not propose to say much on this subject, as it is to be hoped that most people will, as a result of their investment in foreign property, give consideration as to what happens to that property on their death. However there is one point that cannot be stressed too much. The surviving spouse has virtually no rights worth speaking of on an intestacy. Even following the

recent reform of French Inheritance Law which allegedly improved the position of the surviving spouse, he or she takes one quarter absolutely. The reason for this rather niggardly treatment may be explained partly by the obsession of the legislator for keeping property in the bloodline and for the fact that whilst some assets will fall into the estate of the deceased, and thus be subject to the intestacy rules, other will not, but instead be governed by the parties' marriage contract, which as we have seen earlier can be one of complete community of assets, in which case, on the first death, there will be no estate.

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