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Parliament Passes Modified Finance Bill

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COUNTRY DIGEST

Parliament Passes Modified Finance Bill

The French Parliament on July 6 passed a modified 2011 finance bill, but it has not yet been published because some Socialist members of Parliament referred the bill to the Constitutional Council on July 13, citing concerns about wealth tax and exit tax provisions. (For prior coverage of the finance bill, see *Tax Notes Int'l*, May 23, 2011, p. 623, *Doc 2011-10604*, or *2011 WTD 97-2*.)

Following is a summary of the bill's most notable tax aspects.

Wealth Tax

As of 2011 the tax threshold has been increased from €800,000 to €1.3 million and the current tax brackets will change in 2012. Thus, for estates valued at €1.3 million to €3 million, the tax rate will be 0.25 percent, and for estates valued above €3 million, the tax rate will be 0.50 percent. To reduce the threshold effect, tax relief is available for estates valued at €1.3 million to €1.4 million and for estates worth €3 million to €3.2 million. For example, the tax will be reduced by €1,500 for net assets valued at €1.3 million, and by €7,500 for net assets valued at €3 million.

The elimination of the wealth tax for estates worth less than €1.3 million will apply this year and the deadline for filing returns and making payments has been moved back to September 30 (instead of June 15). Starting in 2012, for estates worth €1.3 million to €3 million, the tax reporting will be made directly on the income tax return, and a detailed statement will be required only for estates worth at least €3 million.

The wealth tax ceiling (which covers as much as 85 percent of the income received during the previous year) will be eliminated in 2012.

The wealth tax exemption for professional assets has been relaxed. Previously, the taxpayer was required to have a 25 percent stake in the company; now, a 25 percent holding of the voting rights, but not the financial rights, is required. For a capital increase, if the manager still holds at least 12.5 percent of the voting rights of the company, has entered into a shareholder agreement that represents 25 percent of the voting rights, and owned a 25 percent stake in the company during the five years preceding the capital increase, the wealth tax exemption will continue to apply.

In addition, the definition of professional assets has been broadened. In particular, if an individual holds shares in several companies that are subject to corporate income tax, it is no longer required that the activity of the companies be similar or ''related and complementary'' in order for the shares to be classified as a single professional asset. However, if the activities of the companies are neither similar nor related and complementary, each company must provide normal remuneration. If the activities of the companies are either similar or related and complementary, the determination of the remuneration conditions is made at a global level.

The modified bill also revises the valuation of shares in a real estate company with French real estate assets held by a nonresident. Beginning in 2012, the valuation for purposes of the wealth tax will be made without regard to the debts held by the nonresident — directly or indirectly, by one or several intermediary companies — against the real estate company.

Donations and Inheritances

The tax rates for the last two income bands applicable to estates and gifts in direct kinship and to gifts between spouses have been increased by 5 percentage points. Specifically, the 35 percent rate applicable to amounts between €902,838 and €1,805,677 has been increased to 40 percent, and the 40 percent rate applicable to amounts above €1,805,677 has been increased to 45 percent.

Gift tax reductions based on the donor's age have been eliminated, except in the case of gifts of some companies' shares. Also, the tax-free gifts allowances will now apply every 10 years instead of every six years.

The new finance bill relaxes the condition for the exemption of family gifts made in cash to a child by increasing the age limit for the donor from 65 years old to 80 years old.

The new bill also increases from 20 percent to 25 percent the gift tax on the net portion of a cash gift that is in excess of €902,838, as well as to amounts in excess of €152,500 paid by a life insurance company to a beneficiary at the time of the insured's death. Further, the gift tax will apply to payments made to a beneficiary if the life insurance agreement was signed by a nonresident and if the insured (or under some conditions,[1] the beneficiary) is a French tax resident at the time of the death of the insured.

These measures will apply once the bill enters into force.

'Dutreil' Agreement

The modified finance bill has eased the rules governing the Dutreil agreement (*pacte Dutreil*), which provides for a partial exemption from the wealth tax and the gift and inheritance tax for company shares if a collective undertaking holds the shares for at least six years. New shareholders can maintain an existing agreement if the collective undertaking is extended by two years.

If one of the shareholders decides to sell his shares during the period of the collective undertaking, the partial exemption will not be jeopardized for the other shareholders taking part in the undertaking if:

- they keep their shares until the end of the undertaking period;
- the threshold of 20 percent for listed companies (34 percent for unlisted companies) is still reached;
- the purchaser (or another shareholder) maintains the existing collective undertaking in order to reach the threshold; and
- the undertaking is extended by two years.

This measure will apply as soon as the bill enters into force.

Tax Due on Division of Assets

The 1.1 percent tax due on divisions of assets has been increased to 2.5 percent with effect from 2012.

Elimination of the Tax Shield

The income-based ceiling on direct taxes (tax shield) will be eliminated as of January 1, 2013. Until 2012 the tax shield will continue to apply to income received in 2009 and 2010, to wealth tax paid in 2010 and 2011, and to local taxes related to the taxpayer's primary home in 2011.

Moreover, as of 2012, taxpayers subject to the wealth tax will no longer be able to claim wealth tax refunds, but they will be able to deduct the amount corresponding to the refund from the wealth tax due in 2012 and possibly in future years. Refunds will still be possible for taxpayers no longer subject to the wealth tax.

Trusts

The modified finance bill clarifies the tax regime for gifts or inheritances made through a trust and the taxation of assets included in a trust.

First, the bill defines the terms ''trust'' (the definition of which will apply to all provisions of the French Tax Code) and ''settlor'' (the definition of which will apply only to provisions relating to the wealth tax and registration duties).

A trust is defined as all the relationships created in a country other than France by a person (the settlor), by an *inter vivos* deed, or by a will at death in order to put goods or rights under the control of a trustee in the interest of one or several beneficiaries, or for the realization of a precise purpose.

A settlor is defined as the individual who set up the trust or, if the trust has been set up by an individual acting as a professional or by a company, the individual who has put goods or rights in the trust. There is also a tax settlor, which is defined as the beneficiary, in the event of the death of the initial settlor, who has received the goods remaining in the trust.

Under the new bill, all transfers made through a trust will be subject to inheritance tax and gift tax. If the transfer is in the form of a gift or inheritance, the tax rules on gifts and inheritances will apply.

For transfers that cannot be classified as a gift or inheritance, the goods, rights, or revenues put into the trust will be taxed under the rules applicable to inheritance at the time of death of the settlor, regardless of whether the goods are immediately transferred to the beneficiaries (even if they are not included in the taxable inheritance of the settlor) or remain in the trust. In such situations, the tax rate is determined by the beneficiaries' relationship to the settlor, with rates ranging from 5 to 60 percent. If the beneficiaries of the trust are not individually identified, they are taxed at the marginal rate of the scale (that is, 45 percent for a direct kinship or 60 percent for an indirect kinship).

A rate of 60 percent also will apply if the law applicable to the trustee is the law of an uncooperative state or if the trust was set up after May 11, 2011, by a settlor who is not a French tax resident.

The territoriality rules applicable to the taxation of gifts and inheritances have been revised to extend their scope to:

- rights and goods included in a trust and revenues that are capitalized in the trust, if the settlor is a

[1]Specifically, if the beneficiary was a French tax resident during at least six of the 10 years preceding the death of the insured person.

French tax resident or if the beneficiary (if the settlor is not a French resident) was a French tax resident at the time of the transfer and has been a French tax resident for at least six of the previous 10 years; or

- cases in which the assets in the trust are located in France, if the settlor is not a French tax resident and the beneficiary cannot be considered as a French tax resident under the aforementioned rules.

These rules will apply from the date of publication of the new law.

The new finance bill also subjects assets included in a trust to wealth tax. If the settlor or tax settlor is subject to the wealth tax, he must include in his estate all the goods or rights put in the trust and all the capitalized revenues included in the trust. These rules apply to all trusts (revocable, irrevocable, simple, and discretionary).

If the assets put into a trust have not been previously declared or subjected to wealth tax, a levy of 0.5 percent (the marginal rate of the wealth tax) will apply. This rule applies to all the assets if the parties are tax resident in France, but only to the French assets if the parties are not French tax residents. The wealth tax becomes payable either by the trustee, the settlor, or the beneficiaries as of January 1, 2012. It does not apply to charitable trusts.

The trustee must file a tax return if there is a liability to the wealth tax in France; otherwise, a penalty of €10,000 — or, if the taxable amount exceeds €10,000, an amount equal to 5 percent of the goods, rights, and capitalized revenues put into the trust — will apply. This requirement becomes mandatory on January 1, 2012.

The gift and inheritance tax will apply at the death of the settlor even if the management of the estate continues.

Revenue reinvested in the trust is exempted from income tax, meaning that only the revenue distributed by the trust (whatever the goods or rights put into the trust may be) is subject to income tax. This provision also applies from the date of publication of the bill.

Exit Tax on Unrealized Capital Gains

A new exit tax on unrealized capital gains will apply retroactively from March 3, 2011, to all French tax residents who move abroad. The tax will apply to:

- all underlying capital gains relating to shares that represent at least 1 percent of the capital of a company, or to a direct or indirect stake evaluated at more than €1.3 million, if the taxpayer was a French tax resident during at least six of the 10 years preceding the transfer of residence outside of France;
- all capital gain on shares for which taxation has been postponed; and
- all sums payable under an earn-out provision, if the taxpayer was a French tax resident during at least six of the 10 years preceding the transfer of residence outside France.

The rate of the exit tax will be the capital gains tax rate, plus social contributions, in force at the time of the transfer.

However, an automatic tax deferral is granted to French tax residents who transfer their tax residence to another EU member state or to a European Economic Area member state that has entered into an administrative assistance agreement with France to fight fraud and tax evasion, and a mutual assistance agreement for the collection of taxes. For other states, a tax deferral can be granted upon a specific request by the taxpayer.

There is also either tax relief or a tax refund if the transfer occurs more than eight years after the taxpayer moved abroad or if the taxpayer returns to France within eight years.

'Google' Tax

The 1 percent tax on purchases of online advertising services (known as the Google tax) that was supposed to apply from July 1 has been abolished. (For prior coverage, see *Tax Notes Int'l*, July 4, 2011, p. 26, *Doc 2011-13793*, or *2011 WTD 122-2*.) ◆

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