tax notes international
Volume 64, Number 12 ■ December 19, 2011

France

by Sophie Borenstein

Reprinted from *Tax Notes Int'l*, December 19, 2011, p. 889

2011: The Year in Review

2011: THE YEAR IN REVIEW

France

by Sophie Borenstein

French tax changes in 2011 affected a wide range of taxpayers.

Businesses

The taxation of dividends a parent company receives from a subsidiary is no longer capped at the amount of expenses the parent incurs. The thin capitalization rules now apply to the interest paid to unrelated companies when a company related to the borrowing company secures a loan, except when there is a mandatory change of control.

The deductible amount of tax losses that can be carried forward against financial year profits is now limited to €1 million plus 60 percent of taxable profits above €1 million. Tax losses can be carried back only to the previous financial year and only up to €1 million.

The long-term capital gains tax on participating interest has increased, because the corporate income tax now applies to 10 percent of the capital gain.

Individuals

The upper individual tax rate has risen to 41 percent, and the withholding tax rate on dividends and interest has been increased to 19 percent. The tax credit on income distributions equal to 50 percent of dividends and capped at €115 for a single person and €230 for couples has been eliminated.

The social security contributions rate rose to 13.5 percent, while the specific social contribution rate (*forfait social*) increased to 6 percent. Capital gains on securities are now taxed entirely, and the transfer threshold has been eliminated. The capital gains tax rate has increased to 19 percent.

The tax allowance based on the holding period for real estate capital gains has been modified, and properties are exempt from capital gains tax only after being held at least 30 years (as of February 1, 2012). The fixed allowance of €1,000 has been eliminated.

The tax shield, a ceiling on direct taxes based on income, will be eliminated as of January 1, 2013.

The Scellier tax reduction has been cut to 15 percent when buildings purchased or built in 2011 do not comply with environmental rules.

The wealth tax threshold increased to €1.3 million, and beginning in 2012, the rates will be 0.25 percent for estates worth between €1.3 million and €3 million, while a 0.50 percent rate will apply to income above €3 million. To calculate wealth tax, the valuation of shares of a real estate company with French real estate assets that a nonresident holds is now made without accounting for debts the nonresident holds, directly or indirectly by one or several intermediary companies, against the company.

The two top tax rates applicable to estates and gifts to direct kin and to gifts between spouses have increased to 40 percent between €902,838 and €1,805,677 and to 45 percent above €1,805,677.

Trusts

The tax regime for gifts and inheritances made through a trust and the taxation of assets included in a trust have been clarified, and new statutory definitions for trust and settlor have been provided. A tax settlor is the beneficiary upon the death of the initial settlor when assets remain in the trust.

Inheritance tax and gift tax now apply to all transfers made through a trust. For beneficiaries not individually identified, rates of 45 percent (direct kinship) and 60 percent (indirect kinship) apply. The 60 percent rate also applies to assets that remain in the trust, when the trustee is subject to the law of a noncooperative state, or when the trust was set up after May 11, 2011, by a non-French tax resident settlor.

The territoriality rules that apply to gift and inheritance tax have also been amended to cover assets, and revenue capitalized, in a trust when the settlor is a French tax resident or the beneficiary, when the settlor is not a French resident, has been a French tax resident at the time of the transfer and a French tax resident for at least six of the 10 previous years, or when the assets in the trust are located in France (when the settlor and the beneficiary are not French tax residents).

Assets included in a trust (except for charitable trusts) are now subject to wealth tax. If assets put into a trust were not previously declared or taxed under the wealth tax, a levy of 0.5 percent applies.

Trustees must file a tax return as of January 1, 2012, when the settlor, tax settlor, or one of the beneficiaries has a tax domicile in France during the year of the return or when one of the trust assets is located in France. A penalty equal to 5 percent of the goods, rights, and capitalized revenues put in the trust with a minimum of €10,000 may apply if a tax return isn't filed.

Income tax applies only to revenues that the trustee distributes.

Exit Tax on Unrealized Capital Gains

All underlying capital gains are now taxed regarding shares that represent at least 1 percent of the capital of a company or a direct or indirect stake with a value greater 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 France. Capital gains tax will also be paid on shares for which taxation has been postponed and on all sums payable under an earn-out provision for taxpayers who were French tax residents during at least six of the 10 years preceding the transfer of residence outside France. The applicable rate is the capital gains tax rate at the time of the transfer.

However, an automatic deferment of payment is granted to French tax residents who transfer their tax residence to an EU member state or to a state that is a member of the European Economic Area 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.

Stock Options and Free Shares

The tax rate on gains from exercising stock options has been increased to 41 percent. The employer contribution was increased to 14 percent and the employee contribution to 8 percent. Gains from the exercise of stock options or free shares made by nonresidents are now subject to a withholding tax (with rates of 0 percent, 12 percent, and 20 percent) upon the sale of relevant shares if the beneficiary was not a tax resident in France during the year of transfer.

Outlook

The corporate income tax for companies with turnover that exceeds €250 million for financial years 2011 and 2012 might be increased by 5 percent. Also possible is the creation of an offset, with no time limit, of previous tax losses when computing employee profit sharing.

The full general exemption of capital gains on securities after eight years could be ended and limited to taxpayers that hold a minimum 10 percent stake in the company and reinvest their gains in small and midsize companies.

The flat withholding tax rate on interest and dividends might be increased to 24 percent.

A further contribution for high-income taxpayers could be required at a 3 percent rate for taxpayers declaring more than €250,000 per person and at a 4 percent rate for taxpayers declaring more than €500,000 per person.

A 15 percent reduction of tax loopholes is being considered.

Social security contributions could begin being applied to real estate capital gains regardless of the property holding period. (This measure would not apply to primary homes.)

The capital gains tax exemption on secondary homes might be applied to taxpayers who have not owned their primary home during the four years preceding the sale and who reinvest the sale price, within 24 months, in acquiring or building housing that will be used exclusively as a primary home.

The 40 percent allowance on dividends paid from profits distributed by a real estate investment trust or a SPPICAV (non-listed real estate vehicle) could end, which would no longer allow beneficiaries to benefit from the flat withholding tax rate and from the fixed allowance.

A tax on rent for housing smaller than 13 square meters when the monthly rent exceeds an amount between €30 and €45 per square meter is possible.

The Scellier tax reduction could be further reduced to 13 percent and limited to new housing that meets environmental standards and falls within price limits. The regime might be eliminated in 2013. ◆

♦ *Sophie Borenstein is a partner at Reed Smith in Paris.*