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Article : The effect on trustees and corporate administrators of the replacement of the French *Impôt de solidarité sur la fortune* ("ISF") by *l'Impôt sur la fortune immobilière* ("IFI")

Date 6th October, 2017.

The French Government has put forward its proposal for the replacement of ISF by the new IFI in the *Projet de loi de finances pour 2018*, which has been presented to the *Conseil des ministres* and is shortly to be debated in Parliament.

The current text of the amendments can be found at this link, and the main body of the amending article 12 at page 64. That link will become obsolete when the Parliamentary database takes the *projet de loi* over from the executive

The proposed structure of the new taxation, and its ramifications throughout the current scheme of taxation of wealth and capital in France is therefore unlikely to suffer much modification given the current majority supporting the present government. The problem is that the current and singularly incorrect definition of the trust and the fiscal forced heirship rules in a grantopr or settlor interested monopoly have not been rectified as a part of the general platform for French taxation of property. The current *Question Prioritaire de Constitutionnalité* before the *Consel Constitutionnel* is unlikely to entirely eradicate that policy decision even if successul on the knife edge fo constitutional review. A response may be handed down by the end of his year. Too much time, intellectual effort and money have been expended on that set of Emperor's new clothes.

Please note that post-Brexit, many of the protections currently enjoyed by British citizens and residents will no longer apply, and only the capital movement protections available for third states will be applicable.

I do not propose to go into the text itself in any great detail, as it is undebated, saving to make the following points:

I. The provisions only modify certain aspects of the current trust régime concerning ISF and its corollary le prélivement or levy of 1.5% instituted by article 990J, which is amended. They do not affect the succession and gift duty provisions of article 792-0 bis I or II CGI.

II. The event declarations 2181 Trust1 and the penalty régime will therefore remain unaffected. Under the present drafting, each creation, change or termination of a trust will still require the full asset values of all movable or immovable assets to be declared

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by the trustee on a gross basis. Any netting off will still have to be declared and then negotiated at the level of the succession or gift declaration to be made by the individual settlor or beneficiary concerned in France.

III. The IFI is not based upon gross values, the immovable property is declared annually at its net value. There are however restrictions and caps on how much debt can be deducted to arrive at the net value. There will be a considerable amount of work involved in calculating the deductible amount of foreign mortgage and debt arrangements on leveraged property acquisitions.

The one point to bear in mind is that the well worn practice of financing high value French property acquisitions through 100% bullet repayment mortages will cease to be as attractive where the value of the overall immovable holding exceeds €5.000.000. That will certainly affect French residents owning property abroad. It will also affect those non-residents owning French properties and immovable rights worth a total of €5000.000. Whether the use of SCIs with debt on their balance sheets may work or not here needs review and advice. Where the total value of immovable property rights owned exceeds €5.000.000, such mortgages or *affectations hypothécaires* will no longer be deductible from IFI in their totality, but will only be deductible on a *pro rata temporis* basis by reference to the amount to capital remaining outstanding on a deemed amortisement basis, if the article is passed.

Also, where the value of immovable property as a whole exceeds €5 million, then, to the extent that the total debt exceeds 60% of the value of the total value of immovable property declared, there will be a cap applied as to 100% deduction. Only 50% of the balance of the debt over the 60% cap will be fully deductible. This will be of general application, not just to trustees, and is an attempt by the Government to recover tax where it would otherwise be eluded.

IV. The IFI itself is raised along entirely similar principles to the current ISF. It is treated as a succession duty and recovered in that manner. The liability arises where net, not gross,

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property holdings exceed €1.300.000. When that is the case, the tax is levied as from €800.000 at the present graduated rates.

V. The IFI will not apply to immovable property devoted to professional activities. However, that means that the current ISF issues as to whether rental property is considered to be treated as a professional activity or not will continue to arise under the new régime.

VI. The projet expressly excludes immovable property holding companies that manage their own properties from being considered as carrying on an industrial or commercial or any other form of exempted activity.

VII. The projet dispenses property used in "une activité industrielle, commerciale, artisanale, agricole ou libérale". Companies are one thins, trustees or individuals, on the other hand holding assets used in an artisanal, liberal profession, of agricultural activity for example will need to take advice on how to structure and declare or not declare under the new régime.

VIII. It is likely that the French administration will therefore attempt to define what is a professional activity abroad by reference to French domestic income tax principles, not by any reference to the foreign activity itself. Wrongly, in my view. The deployment of Tax Treaty classifications for income tax purposes may parry any attempt by the administration to attempt to requalify foreign activities by reference to domestic income tax principles so as to exclude their exemption. This is, like the 3% tax on immovable property holding entities, a stamp duty taxation governed by succession duty rules, not an income tax derivative

IX. There are exceptions and dispensations for certain other types of property user, for example, certain types of social work, charities etc. However post-Brexit certain of these régimes may no longer be applicable to British charities.

X. The provisions bring into the IFI charge foreign immovable property, foreign immovable property rights and certain types of property holding structures over foreign property into the charge for French residents.

XI. Non-residents will only be liable to taxation on their net immovable wealth situated in France, or considered to be so situate. The issues of foreign corporates and trusts falling

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into the general French concept of prépondérance immobilière will therefore need o be reviewed in the light of the changes. If in doubt take advice.

XII. Whilst the scope of the annual trustees declarations 2181 Trust2 under article 990J should now be limited to the net value of immovables, immovable rights and certain immovable property holding vehicles, the declaration may be changed if the French administration were not to content itself with the foreign definition or even assessment of net value declarable over French situs property.

The scope of the new legislation in principle is relatively clear, however adjusting current views and opinions to the new legislation, particularly as to what it does not change, is of crucial importance to offshore trustees, beneficiaries and settlors.

Whilst the effect of the 3% annual tax on immovable property holding entities has been curtailed by the CJEU in Luxemburg, this new tax and trust levy is based on information, and is therefore unlikely to be circumscribed to the same extent either by the EU Commission or by the CJEU.

This change is welcome, but is not fundamental, so for the moment trustees or beneficiaries of trusts with French connections should now review their position. What is clear is that there may now be openings for trustees with movable investments in French stock exchange portfolios or other financial asset. Should not Trustees now reassess to see what flexibility the changes will give them n the future from the taxation of wealth, and limiting any gift or succession duty exposures on such investments?

I will be happy to assist clients seeking advice in his area, particularly those seeking to move back to France post Brexit, with potential exposure either as settlors or beneficiaries.

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