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GES NewsFlash

France — Amended Finance Law 2011 notably affects trusts, wealth tax, and introduces exit tax

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The French Parliament passed the 2011 Amended Finance Law on 6 July 2011, and it has been confirmed as complying with the Constitution by the Constitutional Council. The amended law, which contains significant changes to the taxation of trusts and wealth tax and introduces an exit tax system, has entered into force on 31 July 2011.

Taxation of trusts

The amended Finance Law contains new provisions on the tax treatment of foreign trusts, clarifying the application of the wealth tax to trusts and specifically providing that transfers made through a trust will be subject to inheritance tax and gift tax if the settlor is a resident of France at the time of death or if the assets held via a trust are located in France (unless otherwise provided by an applicable tax treaty).

Currently, trusts are not recognized under France’s personal tax law; instead, general tax principles are used to tax income arising from a trust, assets held in a trust or a transfer of property via a trust. This treatment has sometimes resulted in the absence of any taxation in France. To address this issue and ensure the taxation of assets and income held in a trust, the French tax code will contain new defined terms (including “trust” and “settlor”) and will set out events that trigger taxation and identify who will be liable to tax. “Trust” is defined as any legal structure created under the law of another country by a person, known as the “settlor,” to place assets or rights under the control of an administrator (trustee), in the interest of one or more beneficiaries. “Settlor” is defined as the person who sets up a trust or, in cases in which the trust was set up by a person acting in a professional capacity, the person who has placed the assets or rights in the trust.

Having defined “trust,” French tax law also will be amended to determine the level of taxation in France. If the transfer of property via a trust is considered a gift or inheritance as defined by French law, the normal rules for gift tax or inheritance tax will apply. In all other cases, inheritance tax will apply at the time of the settlor’s death, even if assets are not actually transferred to the trust’s beneficiaries. If beneficiaries are the direct heirs of the settlor, inheritance tax will be due according to the brackets and rates applicable to direct heirs (i.e. at a marginal inheritance tax rate of 45%). In all other cases, inheritance or gift tax will be due at the highest inheritance tax rate (i.e. 60%). The highest rate also will apply if the trustee is resident in a country included on France’s black list of tax havens or, for trusts established since 11 May 2011, if the settlor is a French tax resident.

Moreover, as from 1 January 2012, assets held in a trust will be included in net assets subject to the French wealth tax. The settlor of the trust will be the taxpayer for these purposes.

Any trusts involving French residents (either as the settlor or as beneficiaries) should be reviewed to determine the tax obligations and financial consequences under the amended rules.

Wealth tax

The tax threshold for the wealth tax will be increased from EUR 800,000 to EUR 1.3 million for 2011, so that taxpayers whose net worth is less than EUR 1.3 million will not pay any wealth tax in 2011. Those whose net worth exceeds that amount will have the tax assessed and settled according to the current rules and progressive scale (progressive rates from 0% to 1.8%)

As from 2012, wealth tax will be calculated on all net taxable value on a simplified scale. Taxpayers with assets of between EUR 1.3 million and EUR 3 million will be subject to a tax of 0.25% and those with assets over EUR 3 million will be subject to tax at a rate of 0.5%. This is not a two-bracket progressive scale, but rather a proportional scale for the entire assets of a taxpayer, with the rate depending on the amount of the taxpayer's net worth.

The mechanism setting the total of wealth tax and income tax at an upper limit of 85% of the previous year's income will no longer apply as from 2012, and the reduction per dependent will be increased to EUR 300 and extended to children who are claimed as dependents in the household.

In addition, changes will be made to the compliance obligations in respect of the wealth tax; the deadline for submitting the return and paying any tax due will be postponed to 30 September 2011 (from 15 June 2011).

As from 2012, taxpayers with net worth of less than EUR 3 million will no longer have to file a complete wealth tax return; instead, their worldwide net taxable assets will be reported on their individual income tax returns. When filing an income tax return, a taxpayer will have to be able to prove the amount of his/her net worth (this means assessing goods listed as assets and debts as liabilities). While claiming to have introduced a simplified tax return process for individuals with assets under EUR 3 million by reducing the wealth tax return filing obligations, the law has, in fact, considerably increased the complexity of filing income tax returns.

Although the French government has issued a number of communications on the simplification of the wealth tax return, taxpayers should be prepared for a potential future tax audit by retaining all supporting documents. This implies preparing a complete French wealth tax return to assess net worldwide taxable assets, even though supporting documents will no longer have to be submitted to the tax authorities.

Exit tax

Following a 2004 decision by the European Court of Justice (ECJ), France abolished its exit tax as incompatible with EU law. Based on recommendations provided in the ECJ's decision — and to discourage the transfer of domicile outside of France for fiscal reasons — the 2011 amended Finance Law introduces a new exit tax mechanism that applies retroactively for certain residents transferring their domicile 3 March 2011.

Upon departure from France, income tax and social taxes will be levied on the unrealized capital gains on certain securities/equivalents and payables, as calculated on the value on the day before the transfer outside France. To do this, the law introduces a new trigger event so that the transfer of tax residence is deemed to have taken place on the day prior to the actual departure, i.e. one day before the taxpayer ceases to be subject to a worldwide tax obligation in France.

Targeted are those taxpayers who were domiciled in France for at least six of the 10 years before the transfer and who hold directly or indirectly at least 1% of the capital of a company (or the holding is valued at more than EUR 1.3) at the time of the transfer. Unrealized capital gains on the securities and equivalents are taxable, as well as payables representing an additional price to be received in execution of an indexation clause (earn-out payments). In addition, regardless of the length of the taxpayer's tax residence in France or the size of the shareholding, all declared capital gains on a transaction carried out in France that benefited from a postponed date of taxation will be taxed at the time of the transfer.

While tax is immediately triggered, payment may be postponed under certain cases:

- A legal extension without the taxpayer having to provide financial guarantees is granted for transfers to an EU Member State or to a registered EEA country, provided the EEA country has signed both an administrative assistance treaty and a treaty that provides administrative assistance for recovery of tax;

- Taxpayers that transfer their domicile outside France and the EU/EEA can opt for an extension, but they will be asked to provide financial guarantees (e.g. bank guarantee) before departure and to designate a tax representative in France. However, when the transfer is made for professional reasons, adjustments are permitted to avoid having to provide guarantees.

The grace period ends, triggering payment of the tax due, when certain events take place, such as the sale, purchase, reimbursement, cancellation or donation of securities (under certain conditions) or the taxpayer's death. Additionally, provided the securities have been kept, the tax will be cancelled or refunded eight years after the transfer of domicile outside France or, in the event of a return to France, prior to the eight-year period. Finally, taxpayers who transfer their domicile outside France must comply with new tax reporting obligations.

While additional guidance is expected from the tax administration, taxpayers who left France since 3 March 2011 should determine whether they are liable to pay the exit tax once the law enters into force. Taxpayers planning a transfer of domicile, even for professional reasons, should prepare for the exit tax in advance of the transfer.

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