



BUYING A PIECE OF FRANCE

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A convergence of multiple factors make this the perfect time for US persons yearning to own a piece of France to take the plunge. The exodus of wealthy French families escaping record French tax rates causing a property glut, and the strong US dollar against the euro, make today's French real estate market an attractive opportunity for those who always dreamed of buying a *piéd à terre* in France.

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Although the US purchaser may have confidently lined up an English-speaking *notaire*, found a capable real estate agent and signed a *promesse de vente*, a US purchaser would be wise to seek tax, legal and accounting advice to fully understand the implications and requirements of their choices and avoid any nasty surprises.

TITLING OF THE PROPERTY

There are many titling options that depend on the US individual's personal situation: married, single, living in the United States or abroad, and so on. These options include individually titled, titled in a French entity (such as a *société civile immobilière* (SCI)), titled in a US entity (such as a limited liability company (LLC)) and titled in a trust. No one way is better than another, but it is important to address

the implications and pros and cons in both France and the United States for each option.

Individually titled

Taking title directly is simple. It causes minimal reporting burdens and generally provides favorable tax treatment. Before 17 August 2015, US citizens were exposed to the French civil law concept of forced

heirship, under which testators were not free to leave their interest in French real property to the person of their choice, but instead had to leave it to certain family members. For example, a male US citizen who was married in a non-community property jurisdiction with two children was required under French law to leave two-thirds of his villa in Provence to his two children, and only one-third to his wife; or the life interest known as the *usufruit* to his wife, and the remainder interest, or *nue-propiété*, to his children. French inheritance tax, with an exemption of €100,000 per child and graduated rates of up to 45 per cent, also exposed the French property owner to tax he or she would rather avoid.

After 17 August 2015, European Succession Regulation No. 650/2012

(the Regulation), sometimes referred to as "Brussels IV", came into effect. The Regulation provides that a testator can choose the law of his or her nationality to govern his or her worldwide succession, including that of assets located in an EU Member State. Where an individual has several nationalities, he or she may choose the law of any of the countries to which those nationalities relate. This means US citizens can choose US law (more specifically the state law to which they have the closest connection) to govern their worldwide succession, including their ownership of French real property. The choice of law must be made expressly in a declaration taking the form of a disposition of property upon death, such as a will.

Because nearly all US states enable testators to freely dispose of their property, US citizens should elect the law of their nationality in their will to avoid French forced heirship rules without having to use structures such as a company.

Titling in a French société civile immobilière

There may be several reasons for taking title in an SCI other than the avoidance of French forced heirship. Similar to the ownership by families of US property in a partnership, holding title through an SCI may be beneficial if there are multiple owners who want continuity of management and a degree of confidentiality.

An SCI does not, however, provide limited liability for its owners and for US tax purposes is treated as a foreign general partnership. This means US owners will typically have additional reporting requirements, including filing a Form 8865, Return of US Persons With Respect to Certain Foreign Partnerships, and reporting their shares on a Form 8983, Statement of Specified Foreign Financial Assets, if they meet certain

filing thresholds. Failure to file these informational forms can trigger substantial penalties.

Titling in a US limited liability company

In order to avoid the foreign reporting requirements associated with ownership

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of shares in an SCI, or because of prohibitions by their employers from owning foreign entities, some US citizens consider taking title to French real property in a US LLC. Some French tax inspectors recently took the view that US LLCs, which are treated as “transparent” entities for US tax purposes, should be treated as “opaque”, ie, taxable in their own right for French tax purposes, irrespective of their US treatment. The argument is that French limited liability companies, eg, SARLs, are always subject to corporation tax.

As long as the LLCs are also transparent for tax purposes, however, no French corporation tax is due, even if French real estate property is rented out. On the other hand, if LLCs are treated as opaque, they are then subject to French corporation tax. Even in the absence of rental income, when the French property is used free of charge, corporation tax is due on the notional income. The characterisation of an LLC as opaque is currently at issue as a result of a recent court case. Until the law becomes settled, it may not be advisable to hold French real estate in an LLC.

Titling in a trust

Although the use of a trust as a dispositive and testamentary substitute is commonplace in the United States, and its benefits are numerous (eg, continuity of asset management upon incapacity, avoidance of probate, confidentiality,

protections for minors or other beneficiaries, long term tax advantages, etc) US citizens should proceed cautiously before considering titling their French real property in their trust as there are extensive French reporting and tax implications.

As of 1 January 2012, assets or rights held in trusts having some connection with France are deemed to be part of the original settlor's estate and taxable in his or her hands. After the original settlor's death, French assets are taxable in the hands of the beneficiaries thereafter deemed to be settlors, irrespective of whether the trust is revocable or irrevocable. Trustees are also subject to extensive reporting requirements.

When the settlor of a trust, or one of its beneficiaries (existing or contingent), is resident in France, or if the trust fund contains French assets, the trustee must disclose to the French tax authorities the formation of the trust, any variations to its terms and its termination (event-based reporting), and the market value of the trust assets each year (annual reporting). Annual reporting may or may not include the payment of a specific tax at a rate

of 1.5 per cent of the trust assets. The penalty for failing to comply with the reporting requirements gives rise to a fine of €20,000, or 12.5 per cent of the value of the trust fund, whichever is the greater.

Even if the US person sets up a US trust with a US trustee, and the French real estate is only a minor portion of the trust assets, it will still be subject to French reporting rules. The trustees must identify all beneficiaries (existing or future) of the trust, and gather the somewhat burdensome information needed to comply with the extensive French reporting requirements.

Titling in an “offshore” entity

It is generally not advisable to use an offshore company because it entails both strict reporting requirements and punitive taxation.

TAX CONSIDERATIONS

In addition to choosing how to take title to the French property, a US purchaser should consider other tax issues, including coordinating French and US income tax on the rental income if it is rented, French and US capital gains tax (CGT) if it is sold, French wealth tax if certain thresholds are met, and French inheritance tax and US estate tax if the US citizen dies owning the property.

The French wealth tax

French law imposes the *impôt sur la fortune* (ISF) wealth tax on French residents on a worldwide basis (with some exceptions), and on non-residents owning French property. As such, individuals are required to declare the net value of their assets, and are subject to taxation on the value of these assets, if the net value of the assets equals or exceeds €1.3 million as of 1 January of that calendar year. The wealth tax rates currently range from 0.5 per cent to 1.5 per cent. French wealth tax is not deductible against US tax for US persons.

US persons not resident in France must pay the French ISF on the net value of their French property if it exceeds €1.3 million. Debts (eg, a mortgage) are taken into account for determining the net value.

Income tax

Under article 6 of the US–France Income Tax Treaty (the Treaty) and the Protocol amending the Treaty, rental income from French real property is sourced to France and taxed there first (at a top rate of 45 per cent). US persons are subject to worldwide income taxation so must also report it on their US Form 1040 Individual Income Tax Return, but may receive a foreign tax credit for the taxes paid to France, subject to some limitations.

French inheritance taxes are due for all transfers at the time of death, regardless of whether they result from a legal succession, a will or a gift owing to death

Capital gains tax

Under the Treaty, the sale of French real property at a gain will give rise to French CGT at a top rate of 19 per cent. This was previously 33.3 per cent for non EU residents, a rate that was struck down by an EU ruling in 2014. Investment property held for more than 22 years can be sold tax-free. US persons must also declare the sale of French real property on their US income tax return for the year of sale, and will be subject to US capital gains tax (both federal and state) and possibly the 3.8 per cent net investment income tax. As with income tax, US persons may be permitted a foreign tax credit for any French tax due. In the case of both income tax and CGT, US taxpayers will essentially pay the greater of the tax in France and the United States.

Inheritance or estate tax

French inheritance taxes are due for all transfers at the time of death, regardless of whether they result from a legal succession, a will or a gift owing to death. Subject to territoriality rules, tax must be paid in France if the deceased was a French resident, the heirs are French residents or the assets are located in France. The taxable estate is, in principle, determined in accordance with French civil law rules. The debts of the decedent, including any mortgage, are then

deducted from the estate assets.

Inheritance tax is calculated on the net portion passing to each heir or legatee. The net share received by each heir will be:

- less a tax allowance, the amount of which depends on the degree of kinship of the beneficiary to the deceased; and
- subject to a rate based on a scale depending on the degree of kinship of the beneficiary to the deceased.

As an example, the highest rate of tax for assets passing to a direct descendant is 45 per cent and, to an unrelated party, 60 per cent. The exemptions are €100,000 for each child; €31,865 for a grandchild; and €1,594 for an unrelated party. Of course,

the US person is also subject to US estate tax on a worldwide basis. The US person will be allowed a credit against US tax for any French inheritance tax paid on French real property. If the US person's worldwide estate is less than the US person's remaining applicable exclusion amount of US\$5.43 million, however the availability of the credit will be moot.

OTHER CONSIDERATIONS

Foreign Account Bank Reports: FinCEN Form 114

Invariably, a US person owning French property will need a bank account denominated in euros to pay expenses and receive rent, if applicable. The US person needs to be aware of the Foreign Account Bank Reports (FBAR) filing requirement. A US person must report his or her interest in a foreign financial account on both an FBAR and a Form 8938 if certain filing thresholds are met. An FBAR is required to be filed by every “US person ... which ... has a financial interest in, or signature authority over, any foreign financial accounts with an aggregate value exceeding US\$10,000 at any time during the calendar year.” The penalties for willful failure to file the FBAR can exceed 50 per cent of the account.

RECOMMENDATIONS

Given some of the recent changes, both tax-related and non-tax-related, this is an opportune moment to fulfil that dream of owning a property in France. US persons just need to remain cautious about their reporting and filing requirements in both France and the United States and not assume they are separate; they will need a coordinated plan to address how to title the property, how to dispose of it on their death, and how to satisfy their reporting obligations. Once this is all organised, they can fully enjoy their *piéd à terre*.