FRANCE

Trends and Developments

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Tirard Naudin is a boutique law firm based in Paris specialising in international tax and estate planning with a strong reputation for its expertise and creative approach. The firm acts for a broad range of corporate and wealthy private clients with cross-border needs. It handles complex tax litigations for corporate and private clients, in particular concerning European community freedoms and fundamental principles of law. The firm advises on all aspects of French taxation with a particular emphasis on international tax issues. It has extensive experience in advising and planning for foreign individuals moving to France. Work includes planning the most tax-efficient structure for the purchase of French commercial and residential property; achieving negotiated settlements with the French tax authorities; and, where necessary, dealing with tax investigations, appeals and litigation. Tirard Naudin advises clients in cases of conflict between common and civil law systems and it has a particular reputation for and expertise in advising in relation to trusts in a French context.

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France: A Paradise in Which to Live and a Tax Haven

Contrary to received ideas, France is in fact a very suitable place to for the wealthy to live. Not only for its gastronomy, landscapes and the French "*Art de Vivre*", but also especially for its advantageous tax system, particularly for individuals who contemplate settling down in France temporarily.

One point should immediately be nuanced: it is true that French gift and inheritance taxes are among the highest in the world. However, these can be reduced by anticipating the transmission of one's estate before becoming a French tax resident.

Before considering the tax consequences of becoming a French tax resident (as discussed below under Consequences of becoming a French tax resident), persons contemplating settling in France should be warned of the risk of modifications of their legal status, due to the change of their domicile.

Legal consequences entailed by settling down in France

Any transfer of a person's habitual residence from one country to another may entail modifications of the legal status of that person, which should be anticipated in order to avoid any unexpected annoyances.

Among other issues, settling in France may entail consequences for the matrimonial regime of a couple, and French restrictions on testamentary freedom should be taken into consideration when drafting or redrafting a will once a person has established their habitual residence in France.

Definition of the habitual residence

The European Court of Justice (ECJ) has stated that the concept of habitual residence is characterised, as a general rule, by two elements, namely, on the one hand, the desire to fix the habitual centre of one's interests in a particular place and, on the other, a presence with a sufficient degree of stability on the territory of the member state concerned, the environment of an adult being of a varied nature, made up of a vast spectrum of activities and interests, in particular professional, socio-cultural, patrimonial as well

as private and family (ECJ, 25 November 2021, No C-289/20).

Consequences of settling down in France on the matrimonial regime of the couple

Incidentally, a transfer of habitual residence (*résidence habituelle*) may modify the law applicable to the spouses' matrimonial regime and, by implication, the matrimonial regime itself – for example, a change from a foreign matrimonial regime similar to a separation of property to a French community regime.

Indeed, under the Hague Convention of 14 March 1978, in the absence of a designation of the applicable law by the spouses or of a prenuptial agreement, they risk being confronted with the automatic mutability of their matrimonial regime. This automatic change of law occurs in three cases:

- when the spouses take up residence in the state of their common nationality;
- if they reside more than ten years in a state after the marriage; and
- for spouses who did not have a common residence in the same state after the marriage, when they establish their residence in the same state after marriage.

However, this mutability of the applicable law only concerns spouses married between 1 September 1992 and 29 January 2019. For spouses married before 1992, the applicable law remains that of the country of first domicile. For spouses married since 29 January 2019, the EU Regulation of 24 June 2016 excludes automatic mutability.

French restrictions on testamentary freedom should be taken into consideration when drafting or redrafting a will

France applies rules restricting testamentary freedom. Under the "forced heirship" rules (*réserve héréditaire*), the children of a deceased person who was habitually resident in France at the time of death are entitled to a minimum proportion of the estate calculated according to the number of children. However, since 2015 with the EU Successions Regulation (EU Regulation No 650/2012, also known as Brussels IV), it is possible to choose the law of one's nationality as the law governing one's succession and therefore override these "forced heirship" rules, provided that the heirs are not minors or in financial difficulty.

To avoid the application of the "forced heirship" rules, it is therefore essential to plan one's succession by adapting one's will and/or creating a trust before becoming a French tax resident.

However, the implementation of such estate planning may be challenged by a law of 24 August 2021, applicable to international successions opened as from 1 November 2021. This law introduced a new right of compensatory levy on property located in France, for heirs who would be disinherited under the foreign law applicable to the succession, where the deceased or at least one of their children is at the time of death, a national of a member state of the EU or habitually resident there.

The conformity of the text with the EU Successions Regulation seems doubtful, to say the least, and exposes this new compensatory levy to censure by the European Court of Justice. This more than surprising rule will never apply in practice, in the authors' opinion, now that the European Court of Human Rights has, in a deci-

sion dated 15 February 2024, confirmed that forced heirship is not a human right guaranteed by the European Convention of Human Rights.

How this affects plans to settle in France?

- Every effect on the legal status of a person contemplating setting in France should be carefully studied before establishing their habitual residence in France.
- Among other precautions, in an international context, it is advisable for the spouses to proceed to the designation of the law applicable to their marriage.
- Estate planning should also be visited or revisited before moving to France: setting up trusts, drafting or redrafting of the will, etc.
- Assuming real estate is purchased in France to become the home of a family, it is absolutely essential to identify its appropriate ownership structure, taking into consideration, among other factual elements, the wishes of the purchaser and whether the home may be sold within a few years or owned to be transferred to the next generation.

Consequences of becoming a French tax resident

Before discussing the ordinary tax treatment applicable to French tax residents and the special tax regime applicable during the first five years of residence in France, it is important to recall the criteria to be met to qualify as a French tax resident.

How to become a tax resident in France?

The question is essential insofar as a tax domicile in France (*domicile fiscal*) entails an unlimited tax liability. It should also be noted that the definition of the tax domicile (*domicile fiscal*) is different from the definition of the habitual residence (*résidence habituelle*) discussed under *Definition of the habitual residence* above.

Whereas non-resident taxpayers are only liable for French taxes on their income from French sources and assets qualified as located in France, French resident persons are, as a general rule, subject to French taxes on their worldwide income and on their entire wealth, regardless of where their assets are located, except when tax treaties' provisions provide otherwise.

The same definition of tax residence applies for all French taxes which may be due by an individual – ie, income tax (*impôt sur le revenu*), wealth tax (*impôt sur la fortune*), and gift and inheritance tax (*droits de donation et de succession*).

Subject to double tax treaties, for a taxpayer to be domiciled in France, regardless of their nationality, it is sufficient that one of the following criteria be met (Article 4 B of the French Tax Code):

- Personal criterion – having one's home or main place of residence in France (*foyer*), or, under certain circumstances, spending more time in France than in another country (*lieu du séjour principal*).
- Professional criterion – having a professional activity in France (*activité professionnelle*), whether salaried or not, unless this activity is carried out on an accessory basis.
- Economic criterion – having the centre of one's economic interests in France (*centre des intérêts économiques*) (eg, principal investments, seat of his business, centre of professional activities, or the place from which a person derives most of their income).

There are very few obstacles to the extensive definition of the tax residence given by Article

4B of the French Tax Code. However, France has signed more than 130 tax treaties with respect to income tax, 35 treaties with respect to inheritance tax and eight treaties with respect to gift tax (these are the treaties signed with Germany, Austria, the United States, Guinea, Italy, New Caledonia, Saint-Pierre-et-Miquelon and Sweden).

These treaties provide tie-breaker rules to determine the place of residence of an individual for tax purposes.

Ordinary tax treatment applying to French tax residents

I) French income tax and social contributions

As a general rule, French income tax (*impôt sur le revenu*) and social contributions (*contributions sociales*) are assessed on the overall worldwide net income (regardless of whether it remains abroad or is transferred to France) received by a tax household in a given year. All profits and income earned by the two spouses and their minor children are, generally, thus subject to a single taxation.

In a nutshell, depending on the type of income, it may either be subject to the French income tax standard rates (ie, a progressive scale with a marginal rate of 45% over EUR160,336 (for 2023)), or to specific flat rates. For instance, financial income (eg, interest, dividends and capital gains on securities) are subject to a flat tax of 30% (12.8% income tax and 17.2% social contributions (for 2024)).

A supplementary contribution can also apply to a couple's high annual income, at a rate of 3% for the fraction of income between EUR500,001 and EUR1 million, and 4% for the fraction of income over EUR1 million (for 2024). This contribution is assessed on the household's reference tax income (*revenu fiscal de reference*), corresponding to the net annual amount of all income and capital gains, including capital gains on the sale of real estate.

II) French wealth tax (IFI)

Since 1 January 2018, the scope of French wealth tax (*Impôt sur la Fortune Immobilière*) has been limited to real property.

French residents are liable for IFI when the net market value of their worldwide real property, whether held directly or indirectly through French or foreign companies or trusts, exceeds EUR1.3 million on January 1st of a given year.

As an exception, new French tax residents are temporarily exempt from IFI on their non-French real estate for a period of five years, and are therefore only taxable on their real estate located in France during this five-year period. Beyond that period, these individuals are taxable under normal conditions on their worldwide real estate and rights (provided that their private real estate wealth exceeds EUR1.3 million after deduction of debts, subject to certain limitations).

When real estate wealth exceeds the tax threshold, it is taxed according to a scale ranging from 0.5% to 1.5% above EUR10 million.

III) French "exit tax"

In a nutshell, the French exit tax applies to individuals who transfer their tax residence abroad after six years of continuous residence in France and hold a participation of at least 50% in a company or securities (stocks, shares, bonds, funds units, etc) for a total market value exceeding EUR800,000 on the date of departure.

When these conditions are met, the transfer of residence triggers income tax and social contributions on any unrealised gains calculated at the date of the transfer, at the overall flat rate of 30% (12.8% income tax and 17.2% social contributions).

An automatic exit tax deferral applies when an individual transfers their tax residence to an EU member state (or a state which has concluded with France an agreement to prevent tax evasion/avoidance and a mutual assistance agreement for tax collection). For individuals leaving for a state other than those mentioned above, an exit tax deferral will only apply upon request, subject to providing financial guarantees in respect of the sole income tax (ie, amounting to 12.8% of the unrealised capital gains).

In both cases, the exit tax is cancelled at the end of a two-year period following the departure from France (when the total market value of the securities declared was under EUR2.57 million) or at the end of a five-year period when the EUR2.57m threshold is exceeded. However, if the stocks/shares/bonds are sold within these time periods, exit tax is due (pro rata the fraction sold).

Upon the transfer of tax residence and until this tax is cancelled, the individual is subject to an annual reporting requirement in France in this respect.

IV) Liability for French gift and inheritance taxes

In terms of gift and inheritance taxes, under French domestic law, the extent of France's taxing power depends on the tax domicile (as defined by article 4B of the FTC, as discussed under *How to become a tax resident in France?*) of the deceased (or donor), of the beneficiary, and of the location of the transferred assets, on the day of death or donation:

- if the deceased or donor is tax domiciled in France, all movable and immovable property is taxable in France, regardless of its nature or location (even foreign debts and securities or foreign assets or rights that make up a trust and the proceeds that are capitalised there);
- if the deceased or donor is tax domiciled outside France, but the beneficiary has been domiciled in France for at least six years during the last ten years, all movable or immovable property located wherever situated is taxable in France; and
- if both the deceased or donor and the beneficiary are domiciled outside of France, only the assets located in France are taxable in France (including French trust assets).

The marginal tax rate on inheritance in direct line – ie, between parents and children – is 45%, which is the highest rate in the European Union. The taxation is even more confiscatory for the other heirs since they can be taxed up to 55% if they are part of the family and even up to 60%, without deduction, if not.

In contrast, the tax system is favourable to spouses: a surviving spouse or a partner bound to the deceased by a civil solidarity pact (*Pacte de solidarité civil*, of Pacs) is totally exempt from inheritance tax (the exemption does not extend to gift taxes: for donations between spouses or Pacs partners, only an allowance of EUR80,724 is applicable).

V) Reporting obligations due by trustees of trusts having at least one of the settlors or potential beneficiaries settling down in France

The transfer of tax residence in France of one of the settlors or of one of the potential beneficiaries of a foreign trust entails reporting obligations due by the trustee of such a trust. It also entails tax consequences upon distributions from the trusts decided by the trustees and upon the settlor's death.

The trustees would have to file:

- an "event-based" return of which the main purpose is to report (within 30 days) the date of the transfer of tax residence in France of the settlors or beneficiaries and the market value of the trusts' assets on this day;
- annual returns to be filed by 15th June, of which the main purpose is to report the market value of the trusts' assets as of 1st January of each year; and
- "event-based" returns of which the purpose is to report (within 30 days) any "modification" of the trusts (eg, distributions, change of beneficiaries, change of the terms of the trust, or death of the settlors or beneficiaries).

Upon the settlor's death, the trustees of the trusts should appoint, for French inheritance tax purposes only, the beneficiaries becoming "beneficiaries deemed settlors" (*bénéficiaires réputés constituants*) and allocate to each of them a portion of the trusts' assets. Assuming the trustees of the trusts do not appoint beneficiaries and do not decide on such an allocation, French inheritance tax would be due on trusts' assets at the 60% flat rate.

Favourable tax regime applicable during the first five years of residence in France

New French resident taxpayers who have been non-French residents for at least five years during the ten preceding years, benefit from exemptions regardless of whether they decide either to stay in France or to leave elsewhere before the end of this period:

- No wealth tax – as discussed under II) French wealth tax (IFI) – is due on real estate properties located abroad (Article 964 of the FTC). During the first five years of residence in France, they are only subject to IFI on their French-located real estate properties and rights, regardless of their structure of ownership.
- No gift or inheritance tax on the transfer of assets located outside France which are gifted or inherited by the new French tax resident, provided the donor/deceased is not a tax resident of France.
- No exit tax is due on unrealised capital gains, claims arising from an earn-out clause, and tax-deferred capital gains, for income tax and social security contributions, provided they leave France less than five years after they took tax residence in France.

How this affects plans to settle in France?

As a first comment, assuming the persons settling down in France wish to use the accumulated earnings they saved before becoming French tax residents, they should organise their financial assets to segregate what fraction of their accumulated earnings qualifies as income and what fraction qualifies as capital/principal. This can be achieved by using holding companies or trusts, depending on the objectives of the settlor and family members.

Persons settling in France should be conscious of the high French inheritance tax rates which cannot be avoided when a taxpayer dies while being a French tax resident, with the extended right of France to levy gift and inheritance taxes.

It is absolutely essential to have a well-organised and flexible estate before arriving in France. As always, the keyword is anticipation. You will find below several examples of what may be achieved to reduce the French tax burden.

I) "Non-domiciled" UK residents who wish to settle down in France

They may take advantage of their specific status, by making lifetime gifts to their children that would have been subject to inheritance tax upon their death in France.

II) American citizens may enjoy living in France without a French tax burden

American citizens may benefit from more favourable tax provisions and plan to settle in France for more than five years. Under the tax treaties signed between France and the United States:

- French income tax only applies to non-US source income (ie, that derived from France or other countries);
- IFI only applies to assets located in France during the first five years of residence, as explained before; and
- certain assets located in the United States are fully exempt from gift and inheritance taxes.

III) Other taxpayers (excluding US persons) may also enjoy living in France if their assets are properly structured:

- several organisations of the estate may be used, regardless of the citizenship of the persons, in order to allow the new French tax residents to cover their financial needs during their stay in France;
- organising the ownership structure of their assets depending on their nature and location;
- setting up trusts before becoming a French tax resident; and
- gifting before settling in France.

Conclusion

In a nutshell, while living in France can be highly enjoyable, it may not be the most advantageous place to pass away. Due to the extensive scope of inheritance taxes and high inheritance tax rates, France is not a favoured destination for end-of-life planning. Nonetheless, the pleasures of residing in France can be fully appreciated until the last breath, provided that one's estate has been properly organised in advance.