# TAX NEWS

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## LEADER

January's edition of Tax News set out the principal reforms in France's gift and inheritance laws as contained in the law of 23rd June 2006 which came into effect at the beginning of this year. The Amended Finance Bill for 2006 sets out what the reforms change from a tax point of view, how they should be implemented and introduces the new provisions necessary into the tax code to allow the reforms to have the desired effect. The beginning of this year also saw the introduction of the Fiducie to French law. A brief analysis of this institution is to be found on page 2.

## TAX CONSEQUENCES OF RENOUNCING THE FORCED HEIRSHIP RESERVE

**Renouncement of the reserve does not constitute a gift**

It is now possible for a reserved heir to relinquish his right in all or part to his reserved portion in favour of another person. The beneficiary does not have to be a member of the family.

*Tax treatment*:

- *Between the relinquishing heir and the beneficiary of the gift:* If, in advance of the opening of a succession, an expectant heir renounces his right to take any action in the future to reduce gifts made to a particular beneficiary which infringe his reserve, such a renunciation does not constitute a gift from the renouncing party to the beneficiary and therefore does not entail a liability for gift or inheritance tax.
- *Between the deceased and the beneficiary of the gift:* The person benefiting from the renunciation is held to have received the gift directly from the deceased and is liable for inheritance tax on the portion he receives depending on his relationship with the deceased.

**Renouncement in favour of one's children does not incur double taxation**

It is now possible to relinquish one's share in favour of one's children. The succession is administered as though the intermediate generation had never existed. It is not permissible to favour a particular child.

*Tax treatment:*

The Amended Finance Bill for 2006 provides that the taxes payable by the children who inherit in the place of a renouncing heir are calculated as though they were the direct beneficiaries of the succession. For the calculation of their tax liability they benefit collectively from the same abatement as would have been applied to the heir who has renounced – i.e. 50,000 euros – divided between them under the usual legal conditions.

On the other hand, should the heir renounce the inheritance in favour of a specific person who accepts it, the transaction should be analysed as a double transfer giving rise firstly to inheritance tax in the hands of the renouncing heir and secondly to gift tax in the hands of the beneficiary of the renunciation.

**The surviving spouse or the legatee may choose to limit their inheritance**

Unless the testator has specifically expressed opposition to such an action, the surviving spouse (on the condition that that the deceased has provided in his favour) or one of the legatees (on the condition that the succession has been accepted by at least one of the legal heirs) now have the possibility to limit their inheritance by accepting only part of the assets which have been left to them.

*Tax treatment:*

Such an act is never considered to be a gift from the surviving spouse or the legatee to the other heirs. The beneficiaries of such an action are in fact considered to have received their share directly from the deceased.

The surviving spouse or legatee is taxed only on the assets which they accept depending on their relationship with the deceased.

The assets which the surviving spouse or legatee chooses not to accept are taxed in the hands of the beneficiaries to whom they are transferred depending on their relationship with the deceased.

## DISTRIBUTION AND PARTITION (« donation-partage »)

**Specific measures applying to the distribution and partition (« donation-partage »)**

*Distribution and partition within the reconstructed family:* A distribution and partition made by a husband or wife, with the agreement of their spouse, to a non-common child is subject to gift tax at the rate applicable between parents and children on the full value of the gift including the part which would in the past have been construed to have been granted by the step-parent and therefore taxed at the rate between non-family members.

*Distribution and partition across generations:* A distribution and partition benefiting heirs from different generations is a direct transfer from the ascendant to the descendant whatever the generation of the latter. The taxes payable by each beneficiary on such transfers are thus calculated according to the rates applicable in direct line and depending on the relationship between the relevant beneficiary and the donor. The abatement applied to each beneficiary's share is that normally applicable, that is 50,000 euros for a child or 30,000 euros for a grandchild. If one of the donor's children does not benefit from the distribution and partition, his own children cannot apply his unused abatement to their share for the calculation of the taxes due.

In the event that a member of an intermediate generation dies, his children are not obliged to reintegrate donations received directly from their grandparents in the context of a cross-generational distribution and partition into his estate for tax purposes.

*Inclusion of past gifts into a distribution and partition:* The share allotted to certain beneficiaries in the context of a distribution and partition can be totally or partially made up of gifts made in the past. Such an arrangement is analysed from a civil law point of view as a partition made by the donor and not as a gift and as such is not subject to transfer taxes but only to a partition levy at the rate of 1.1%.

## ALSO ...

**Gifts recovered by ascendants**

Ascendants have the right to recover gifts made to children without issue who predecease them.

*Tax treatment*: The restitution to a parent of assets given to a child who predeceases him does not entail a liability for gift or inheritance tax on the assets recovered.

## SAME TAX TREATMENT FOR GIFTS WITH AN OBLIGATION OF RESTITUTION AND STEPPED GIFTS

A gift or bequest with an obligation of restitution (libéralité résiduelle) allows an individual to give or leave an asset to a beneficiary with the obligation that upon the death of this beneficiary what remains of this asset must be transmitted to a second designated person.
A stepped gift or bequest (libéralité graduelle) allows an individual to leave an asset to a beneficiary with the obligation that the substance of the asset be conserved in order that upon the death of the beneficiary the asset to be transmitted to a second designated person.
*Tax treatment:* The tax treatment of stepped gifts or bequests and gifts or bequests with an obligation of restitution provided in the Amended Finance Bill for 2006 is the same. The taxation of these two kinds of gift takes place in two stages:

*The first transfer takes place when the donor dies or makes the gift:* At the time of the first transfer of assets, the first legatee or donee pays gift or inheritance tax on the value of the assets received under the usual legal conditions. All abatements and reductions to which the donee is entitled by right of his relation with the donor or deceased are taken into account. The second beneficiary is not liable for any tax at the time of this transfer.

*The second transfer takes place upon the death of the first beneficiary:* When the assets are transferred from the first to the second beneficiary, they are subject to gift or inheritance tax depending on the relationship between the original donor and the second beneficiary. Tax is calculated on the value of the assets on the day of death of the first beneficiary.
Tax paid by the first beneficiary is deductible from the tax due from the second, in its entirety for a stepped gift or bequest or pro rata in proportion to the assets effectively transferred in the case of a gift or bequest with an obligation of restitution. If the tax due from the second beneficiary is lower that that paid by the first the difference is not refundable.

### Impact on the principle of presumption of ownership

*The presumption set out in Article 751 of the tax code :* Article 751 provides that the value of the full ownership of a divided moveable or immoveable asset can be reintegrated into the usufructary's estate when the bare owner is one of his heirs. The Amended Finance Bill for 2006 revises this principle of presumption of ownership to take into account the introduction of stepped gifts and bequests, gifts and bequests with an obligation of restitution and also cross-generational distribution and partitions.
From now on divisions of property made without valuable consideration more than three months before the death of the usufructary which are registered by a deed executed by a notary are excluded from this presumption of ownership as long as the value of the bare ownership has been determined in accordance with the scale set out in the tax code.

*The presumption set out in Article 752 of the tax code :* The presumption that financial assets and debts owned by the deceased, from which he received income or in connection with which he undertook any kind of transaction within the year preceding his death, form part of his estate no longer applies to assets which are part of a stepped gift or bequest or a gift or bequest with an obligation of restitution. This is to take into account the specificities of such gifts in as far as the estate of the first beneficiary may contain financial assets and debts which should not be included in his succession but deducted to be attributed to the second beneficiary.

## ALSO ...

**Right to accommodation for surviving PACS partner bolstered by tax exemption**

The surviving partner now benefits from the right to use and occupy a shared home for a year following the death of the other partner. If the surviving partner's home was rented or belonged to the deceased, the rent or other indemnity paid by the surviving partner will be reimbursed by the deceased partner's estate for a year.

*Tax Treatment*: The value of the temporary right to accommodation is not subject to transfer duties. Furthermore the sums paid in rent or other indemnity reimbursed to the surviving partner by the deceased's estate is now deductible from the global estate for inheritance tax purposes.

## THE FRENCH *FIDUCIE*

The French *fiducie* which was adopted on 7th February 2007 is a very different institution from the common law trust both in substance and in form.
The first major difference between trusts and the French *fiducie* is that the latter is a contract. Such a contract must be registered at the *fiduciaire's* local tax office. In addition the law provides that a national register of *fiducies* will be kept. Therefore, unlike the trust, *fiducie* contracts will be public in the same way as certain information about companies. Another essential contrast with the trust is that the *"constituant"* of a *fiducie* can only be a corporate entity which is subject to corporation tax. In other words an individual, cannot set up a *fiducie*. Although the usage of the trust has traditionally been in connection with estate planning for the individual or the family, it will not be possible to use the *fiducie* in this way. Furthermore, as opposed to the trust, the *fiducie* cannot have a charitable purpose either. The *fiducie* can in fact only be used as a mechanism for managing assets or as a security device.
In any case the creation of a *fiducie* by a *constituant* who intends to make a gift to a beneficiary would be void. Furthermore, should anyone (notwithstanding the risk of invalidity) be foolhardy enough to constitute a *fiducie* with the intention of making a gift anyway, the tax consequences of such an act would be extremely severe.
Only banks and insurance companies may hold the office of *fiduciaire*. Finally, both the *constituant* and the *fiduciaire* must be resident in the European Community or in a State which has signed a tax treaty with France containing an administrative assistance clause.
Under the pretext of tax neutrality, the tax treatment of the fiducie leaves no place for tax planning. The assets and rights transferred into the *fiducie* are considered for tax purposes to remain the property of the *constituant*. Consequently, income generated by the assets and rights transferred into a *fiducie* will be subject to corporation tax in the hands of the *constituant*.
Since a *fiducie* contract cannot be made by individuals the law contains no measures regarding wealth tax.
Against this background, it is doubtful that the French *fiducie* will provide an effective replacement for the trust, particularly given that the trust is extremely favourably received by the French civil and tax courts.

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