

LEADER

The year 2007 has so far been a very important one in respect of tax and estate planning in France. After a significant relaxation in inheritance laws (see January Tax News) and the introduction of correspondingly favourable gift and inheritance tax treatment (see April Tax News), the law which will implement the first of the tax measures in the “tax package” advocated by the new President Nicholas Sarkozy during his presidential campaign, was adopted by the French National Assembly and Senate on 1st August. In addition to measures such as the introduction of an exemption from taxation of employees’ overtime and allowing the deduction of interest on loans for a primary residence, the text puts forward a certain number of reductions in inheritance tax, gift tax and wealth tax as well as adjustments to the recently introduced tax shield mechanism. The new measures applying to gifts and to successions will come into effect as of the date of publication of the law and will therefore apply to gifts made and successions opened after that date.

ABOLITION OF INHERITANCE TAX FOR THE SURVIVING SPOUSE

Before: French law did not provide for a spouse exemption as in the UK or a marital deduction as in the USA. The surviving spouse was subject to inheritance tax on net assets received from the deceased’s estate. After the application of a personal allowance of 76,000 euros the assets were taxed at rates increasing

progressively from 5 % on taxable assets up to the value of 7,600 euros to 40% on assets in excess of 1,700,000 Euros. *After:* The tax code’s new Article 796-O bis provides a full exemption from inheritance tax for the surviving spouse. This exemption does not, however, benefit to lifetime transfers.

INHERITANCE AND GIFT TAX REDUCTIONS

For ascendants and children

Before: Inheritance and gift tax was calculated on the share of each heir or donee after application of a personal allowance of 50,000 euros. In addition, in the case of inheritance tax, a global allowance of 50,000 euros applied to the estate divided between the heirs proportionally depending on the amount of their inheritance.

After: The personal allowance of each heir or donee has been raised to 150,000 euros. The global allowance has been removed.

Between brothers and sisters

Before: Brothers and sisters were subject to inheritance or gift tax on the net assets received from their deceased sibling after application of a personal allowance of 5,000 euros.

After: The personal allowance of each brother or sister has been raised to 15,000 euros.

For nephews and nieces

Before: A personal allowance of 7,500

euros applied to donations made by an individual to his or her nephews or nieces. On the other hand no personal allowance applied to bequests made to nephews or nieces.

After: The draft law extends the personal allowance of 7,500 euros already applying to gifts to bequests.

Cash gifts to direct descendants, or nephews and nieces

Gifts of cash made by an individual to children, grand-children, great-grand-children or, if no direct descendants exist, to nephews and nieces, are exempt from gift tax to a limit of 30,000 euros. The donor must be under 65 years of age and the beneficiaries must be over 18 years old or have been granted emancipation at the time of the donation. This exemption is cumulative with personal allowances for the calculation of gift tax due from the donor’s direct descendants or nieces or nephews. The gift must be declared by the donor at his local tax office within the month following the gift.

EQUALITY OF TREATMENT BETWEEN MARRIED COUPLES AND CIVIL UNION PARTNERS

With regard to inheritance tax

Before: Partners in civil unions (PACS) were subject to inheritance tax on the net assets received from the deceased’s estate. After the application of a personal allowance of 57,000 euros the assets were taxed at the rates of 40 % on taxable assets up to the value of 15,000 euros and 50% on assets over 15,000 euros. Although opting for a universal community regime including a provision of attribution of the whole ownership of the common assets to the surviving spouse allowed the payment of French inheritance tax to be avoided upon the death of the first spouse, this was not an option available to civil partners.

After: The new tax code provides a full exemption from inheritance tax for the surviving partner of a civil union.

With regard to gift tax

Before: Gifts between partners in civil unions were subject to gift tax under the same conditions as those applying to inheritance tax (i.e. a personal allowance of 57,000 euros and rates of taxation of 40 % or 50%).

After: The tax treatment of gifts between partners in civil unions is now in line with that applying between spouses. A personal allowance of 76,000 euros applies and assets are now taxed at rates increasing progressively from 5% on taxable assets up to the value of 7,600 euros to 40% on assets in excess of 1,700,000 euros.

INHERITANCE TAX RATES

Transfers to :

• *Surviving spouse or PACS partner:*
All assets 0%

• <i>Parents and children in direct line</i>	
Up to 7,600 €	5%
7,600 € - 11,400 €	10%
11,400 € - 15,000 €	15%
15,000 € - 520,000 €	20%
520,000 € - 850,000 €	30%
850,000 € - 1,700,000 €	35%
Over 1,700,000 €	40%

• <i>Brothers and sisters</i>	
Up to 23,000 €	35%
Over 23,000 €	45%

• <i>Fourth degree</i>	
All taxable assets	55%

• <i>Greater than fourth degree and other beneficiaries</i>	
All taxable assets	60%

WEALTH TAX IS REDUCED IN FAVOUR OF FINANCING SMALL BUSINESS AND RESEARCH

In order to encourage investment in small and medium sized businesses (PME) and in research, a wealth tax deduction has been introduced to the level of 75% of the amount invested directly or indirectly in the share capital of PME's or paid to public interest organisations. The deduction is capped at 50,000 euros. The tax benefit is calculated on payments made between 1st January and 31st December of one year and is deductible from the wealth tax declared and paid in the following year. The measure applies to contributions made as of 20th June 2007 so that it will be possible to deduct payments made between 20th June 2007 and 31st December 2007 from wealth tax due in 2008.

The part of the contribution giving rise to the wealth tax reduction cannot also

benefit from tax advantages with regard to other taxes.

The reduction in wealth tax allowed in relation to a contribution to the share capital of a PME is conditional on the shares being conserved until 31 December of the fifth year following that of the contribution.

The only contributions to share capital which will give rise to the reduction in wealth tax are those made to companies which fulfil the EC definition for a Small Business and undertake an industrial, commercial, trade, farming or profession activity. The company must have its operational head office situated in a state which is a member of the European Community or which belongs to the

European Economic Area Agreement and has concluded a tax treaty with France containing an administrative assistance clause to combat tax fraud and evasion. Finally, its shares must not be quoted on a recognised stock exchange.

... AND IN RESPECT OF THE PRINCIPAL RESIDENCE

Before: The principal residence was subject to tax on 80% of its fair market value.

After: The principal residence is now only subject to tax on 70% of its fair market value. However, the abatement granted in respect of the principal residence of the deceased for calculating inheritance tax is still 20%.

... AND THE TAX SHIELD IS REINFORCED

The Finance Act for 2006 introduced a mechanism for capping the level of annual direct taxation for each taxpayer in relation to his income (referred to as the "tax shield"). Taxpayers can now claim repayment of direct taxes paid during a particular year on income received the previous year if such taxes exceed a given level.

Before: Taxpayers could claim reimbursement of that part of their direct taxes paid to the state exceeding 60% of their income. The taxes taken into account for the calculation of the amount to be reimbursed were income tax, wealth tax (capped if applicable) and also property and residential taxes for a primary residence but not the "social contribution charges" which are due at the effective flat rate of up to 11% on passive income (dividends, interest, capital gains). This meant in practice that a taxpayer could suffer a global rate of taxation reaching as much as 71%.

After: The reinforcement of the tax shield is twofold. Firstly the level above which a reimbursement of direct taxes

paid to the state can be claimed has been lowered to 50% of a taxpayer's income. Secondly, the taxes taken into account for the calculation of the amount to be reimbursed are now income tax, wealth tax (capped if applicable), property and residential taxes for a primary residence

but also social contribution charges (i.e. CSG at the rate of 8.2%, CRDS at the rate of 0.5% and the social levy at the rate of 2.3%).

The combined application of the tax shield and the capping mechanism has been retained.

REMINDER : The mechanism for capping wealth tax was designed to avoid a taxpayer paying more than 85% of his previous year's income in wealth tax, income tax and social charges combined. The amount of tax exceeding 85% of an individual's income can be deducted from the wealth tax due. However, the cap may itself be capped for taxpayers with net taxable assets in excess of 2,420,000 euros. The reduction in wealth tax cannot exceed 50% of the amount of wealth tax due before application of the ceiling, or the amount of tax payable on taxable assets to the upper limit of the third band on the tax scale (i.e. 11,530 euros for 2007) if this amount is higher.

Although the Senate passed an amendment allowing payers of wealth tax to limit their wealth tax bill by applying the rules of the tax shield when they file their return, the text which has been ultimately retained the combined application of the tax shield mechanism and the capping mechanism applied at the moment of filing. The consequence of this in practise is that some taxpayers will still, at first, be required to pay their wealth tax calculated using the capping mechanism which might be limited before afterwards being able to request reimbursement of the overpayment calculated according to the rules of the tax shield mechanism. When a request for reimbursement is filed, a taxpayer should expect his tax returns to undergo careful scrutiny.

WEALTH TAX RATES FOR 2007

<i>Fraction of the taxable value of the estate</i>		
Up to 760,000 €		0%
760,000 € - 1,220,000 €		0.55%
1,220,000 € - 2,420,000 €		0.75%
2,420,000 € - 3,800,000 €		1%
3,800,000 € - 7,270,000 €		1.3%
7,270,000 € - 15,810,000 €		1.65%
Over 15,810,000 €		1.80%

THE FRENCH TAX TREATMENT OF TRUSTS

The French Supreme Court (Cour de Cassation) confirmed on 15th May 2007 that the creation of a trust cannot be analysed as a gift (donation) for French tax purposes. In the case (Tardieu de Maleyssie) the Court ruled that the constitution by a French resident of an irrevocable trust was to be considered as

an indirect donation which is only completed upon distribution of the trust fund to the beneficiaries. Together with the favourable case law relating to wealth tax (Evelyne Poillot case) the decision confirms that the trust is very favourably received by the French civil and tax courts.