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LEADER

The annual “3% tax” was originally created to discourage the acquisition of immovable properties in France through the use of “offshore” companies. However, it has a broader utility for the French Tax Authorities (FTA), since even when the entities involved in a structure of ownership benefit from an exemption from the 3% tax, the regime allows the FTA to be aware of the identity of the structure’s ultimate owners and of any changes in the ownership of the structure so that they can collect transfer duties, capital gains tax, wealth tax and gift and inheritance tax. The regime subjects French and foreign entities, which hold one or more real properties in France, to an annual tax equal to 3% of the market value of the property. It should be noted that not only real property situated in France is treated as French real estate but also rights on such property and shares in French or foreign entities of which more than 50% of French assets are made up of real property situated in France. The rules applying to this tax were the object of reforms passed on 25th December 2007 and article 990 D and following of the French Tax Code (FTC) have been rewritten. The more significant effect of the law is to extend the scope of the tax to entities which are not legal entities. In this respect, trusts might now be covered by the new scope of the tax. The reform also modifies the range of exemptions. Hopefully future instructions and commentaries given by the FTA will cast light on the way the new text is to be applied. The new rules have been applicable since the 1st January 2008.

SCOPE OF THE 3% TAX

Before – Article 990 D of the FTC used the legal term “corporate and legal entities” of whatever form. This meant that any corporate or legal entity endowed with a legal personality that held one or more real properties situated in France, directly or through any number of other corporate and legal entities, fell within the scope of an annual tax equal to 3% of the market value of the property.

After – The entities which now fall into the scope of the tax are detailed in a list and are no longer limited to ‘corporate and legal entities’. The list covers, legal entities, organisations, *fiducie*, and comparable institutions to the *fiducie* (“entities”) whether or not they are endowed with a legal personality. It is uncertain how the FTA will interpret this list but in its broadest interpretation, it could mean that all entities owning directly or indirectly French real property which are not individuals fall within the scope of the tax.

REVIEW OF EXEMPTIONS

Before: Article 990 E of the FTC provided a list of seven possible exemptions.

After: The law distinguishes three categories of taxpayer. Within each category, different possible exemptions are defined. This new classification is a direct consequence of a European Court of Justice decision (ECJ 11th October 2007 AFF, c451/05 Elisa) which ruled that the former provisions were in breach of the principle of free movement of capital between Member States in the European Union.

For the annual 3% tax to be avoided each entity involved in a French real estate ownership structure must benefit from one of the exemptions listed in article 990E of the FTC

FIRST CATEGORY:

INTERNATIONAL ORGANISATIONS AND SOVEREIGN STATES

Before: International organisations, sovereign states and public institutions owning directly or indirectly French real estate were tax exempt.

After: International organisations, sovereign states, and their territorial and political subdivisions are exempt from the tax. Entities held by them are now also tax exempt (article 990 E 1°).

SECOND CATEGORY:

ENTITIES IRRESPECTIVE OF WHERE THEY ARE INCORPORATED

Article 990 E 2° defines two exempted categories applying to entities regardless of where they are incorporated. There is no obligation of revelation in regard to these exemptions.

•Entities which are not property investment entities

For the application of the 3% tax, entities whose total French assets are made up for less than 50% of French real property are considered not to be property investment companies and are exempt from the tax (article 990 E 2° a). There are no filing obligations to be fulfilled to benefit from this exemption.

The law confirms that assets held directly or indirectly are included in the calculation. Buildings occupied by such entities in the exercise of their own professional activity remain excluded from the calculation. Attention should be drawn to the fact that the market value of the French movable assets must always be greater than the value of the real property on 1st January of each year. As far as the burden of proof lies with the entity requesting to benefit from this exemption it should keep accounting records of the market value of movable and immovable assets in order to be able to demonstrate that the entity is not a property investment entity.

•Quoted entities

Before: Companies whose shares are quoted on a stock exchange were exempt.

After: The scope of the exemption is extended to entities whose shares are quoted on a stock exchange (article 990 E 2° b). However, the law also provides additional conditions. A quoted entity can only be exempt if its shares are subject to significant and regular negotiations. As a consequence, the FTA is now entitled to challenge tax exemption for entities which have been quoted on a minor stock exchange with the exclusive aim of avoiding the tax. The law also exempts companies for whom 100% of their shares are held directly by any number of entities through an entity quoted on a stock exchange. This rule has to be considered with the greatest caution since any entity seeking to benefit from this exemption must be able to prove that all of its shares are held by a company registered on a stock exchange. The FTA could estimate that the burden of proof lies on the entity and ask for in-depth information on its ownership structure.

ARE TRUSTS INCLUDED WITHIN THE SCOPE OF THE 3% TAX?

The expression used in the wording of the new article 990 D of the FTC which is susceptible to implicate trusts, is "comparable institutions to the *fiducie*". This expression already appears in article 123 bis of the FTC, and in its remarks relating to this provision the FTA has considered that trusts are indeed included within its scope. On the other hand however, the word "Trust" is not unknown in French domestic tax law as the word is specifically used in article 120 9e of the FTC. Even though it could therefore be argued that the French legislator explicitly chose not to mention trusts in the scope of the new law, in our opinion, the FTA will nevertheless consider that trusts are covered by the provision. In any event a corporate trustee who is treated as the apparent owner of a real property structure for French tax purposes remains within the scope of the 3% tax.

**THIRD CATEGORY:
ENTITIES WHICH ARE INCORPORATED IN
A STATE WHICH FULFILS CERTAIN CRITERIA**

The third type of exemption which appears in article 990 E 3° of the FTC deals with the same entities as those described above but only if they are incorporated in France, in the European Union or in a state which has entered into a tax treaty with France containing an administrative assistance provision, or a non discrimination clause. Within this category, four tax exemptions apply.

•Property holdings of low value

Article 990 E 3° introduces a new exemption applying to entities which hold directly, or indirectly, a share of real property in France which does not exceed 100 000 € or 5% of the market value of such a property.

• Pension funds etc

Before: Pension funds and other organisations exercising a non-profit making activity were tax exempt if they could establish that this activity justified the ownership of property in France.

CAVEAT

Attention must be drawn to the fact that all existing French real estate property ownership structures should be revisited before 15th May 2008. Because the scope of the 3% tax has been extended some entities involved in ownership structures may have to choose between filing an annual tax return or making a commitment to communicate the information set out above in order to benefit from an exemption.

However, as the new regime applies from 1st January 2008 those entities which are incorporated in a tax haven country and which are qualified as property investment entities already have no choice but to pay the 3% tax.

After: This exemption only applies to these entities if they are incorporated in France, in the European Union, in a state which has entered into a tax treaty with France which contains an administrative assistance provision or in a State which has entered into a treaty with France which contains a non discrimination clause.

•Property investment companies with variable capital

Before: These companies, ruled by specific French legal provisions ("SPPICAV" and "FPP") were tax exempt.

After: The exemption is extended to foreign structures which are ruled in the same manner as these French entities. (Article 990 E 3° c)

•Entities which file an annual 3% tax return or make the commitment to communicate information to the FTA

Before: Corporate and legal entities which were incorporated in France or in another State which had entered into a treaty benefiting from a non discrimination clause with France could be tax exempt if they filed an annual return or made a commitment to communicate to the FTA within two months of the purchase date of the properties, specific information concerning the location, nature, and value of the buildings owned as at 1st January of that year, the names and the addresses of their shareholders and the number of shares held by each of them. The FTA also asked for proof of the fiscal residence of the shareholders which often proved quite difficult to provide.

Corporate and legal entities which were incorporated in a State which had entered into a tax treaty with France containing an administrative assistance provision could be tax exempt only if they filed a specific return (n°2746) with the FTA before the 15th May each year. To be included on this return were the location, nature, and value of the buildings owned as of 1st January of that year, the names and the addresses of their shareholders at that date and the

number of shares held by each of them.

After: Entities which are incorporated in the European Union or in a State which has entered into a tax treaty with France containing either an administrative assistance provision or a non discrimination clause can now choose between filing an annual return and committing themselves to the communication of certain information in order to benefit from the 3% tax exemption. The entities which make the commitment to communicate information must communicate to the FTA, at its request and for each year which is not statute barred, the location, nature, and value of the buildings owned as of 1st January of these years. In addition the names and addresses of their shareholders at that date and the number of shares held by each of them must be provided. Proof of fiscal residence of the shareholders no longer appears to be a requirement. As before, the commitment to communicate has to be made within two months from the purchase date of the building. If the commitment has not been made during this period, the FTA will send a request called a "Mise en demeure" directly to the taxpayer who will have to complete the 3% tax return (n°2746) within 30 days. The law introduces a temporary measure which allows entities to make a commitment to communicate for the property they held before the 1st January 2008. The deadline to make such a commitment is 15th May 2008.

Entities can also be tax exempt if they submit the above declaration to the FTA before the 15th May (article 990 E 3° e) every year. Information requested in this annual return is the location, nature, and value of the buildings owned as at 1st January of that year, the names and the addresses of shareholders who hold more than 1% of the shares at this date, known to the entity at this date. The number of shares held by the shareholders whose the names and the addresses have been submitted in the form is also required.