TAX NEWS

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TIRARD, NAUDIN

International Tax Newsletter

LEADER

In the past years, trusts with a French connection have been particularly targeted by the French legislator and French tax authorities (FTA), presuming that trusts are almost systematically fictitious and used for tax evasion purposes.

A recent trend shows however that several provisions of the French tax code applying to foreign trusts, as well as their (too) extensive application by the FTA, have been increasingly challenged by the taxpayers and eventually censored by the French Constitutional Court, ruling that privacy prevails on transparency. Similarly, in a recent major decision, the French Criminal Court ruled that taxpayers (beneficiaries of foreign trusts) could not be prosecuted on the ground of tax fraud by simply alleging the fictitious nature of a trust, when such allegations were not supported by further evidence, regardless of the jurisdiction used.

This recent trend confirms that multiple grounds exist for challenging the systematic application of the French legislation's (anti-abuse) provisions aiming at foreign trusts, based on fundamental law principles. This is even more important in the current context where FTA have only started very recently to process the considerable amount of data collected from the trustees' returns and are now increasingly initiating tax assessments in this respect.

This does not prevent however trustees of French connected trusts to keep complying with all the French specific reporting requirements applicable since 2012 (see below).

TRUSTEES' OBLIGATIONS IN RELATION TO FRENCH CONNECTED TRUSTS IN 2017

What should be done by the trustees for 2017:

Trustees in charge of trusts having a French connection are required to fulfill various practical obligations in accordance with French legislation which are summarized below:

- **Before 15th June 2017**
  - The trustees should receive evidence from each settlor (or beneficiary deemed settlor) that the said value attributed to them has been properly reported for French wealth tax purposes.
  - The trust annual report is due on **15th June 2017**. Trustees should provide the identity of each French resident settlor (or beneficiary deemed settlor) as well as the market value of the trust's assets (in €) attributed to each settlor / beneficiary deemed settlor) as of 1st January 2017.
  - Assuming they do not receive the evidence that the settlors (or beneficiaries deemed settlors) have duly complied with their wealth tax reporting obligations, the trustees should pay the *sui generis* tax (amounting, for 2017, to 1,5% of the market value of the trust's assets as of 1st January 2017) to the French tax authorities by **15th June 2017**.
- **An event-based report** is due **within 30 days** of any creation, modification or termination of a French-connected trust. Modifications may include (among others) distributions, transfers of assets into trusts, changes in beneficiaries or the allocation of the trust's assets to certain beneficiaries.

Assuming the trustees have failed to report trusts which have maintained a French connection since 2012, we recommend filing the missing returns as soon as possible and most importantly before the FTA request it.

How to report:

Since 1st January 2014, trust reports must be completed on mandatory declaration forms that have been issued by the French tax authorities. The law also requires that the declarations be completed in French only.

WARNING

As from 31st December 2016, failing to comply with the above reporting requirements triggers the application of a fixed penalty amounting to € 20,000 per missing return.

In addition, failing to report may also give rise to an additional 80% surcharge (with a minimum of € 20,000) applying to all French tax consequences bearing on the trustee(s), the settlor(s) or the beneficiarie(s) – income tax, wealth tax, inheritance/gift tax, trustees' specific 1.5% levy – which may be due in respect of the trust assets and distributions or reportable modifications which may have occurred.

In view of the approaching **15h June deadline** for the 2017 annual reports, please do not hesitate to contact us if you need any further information or assistance in completing the declarations.

RECENT CASE LAW IN MATTERS OF FRENCH CONNECTED TRUSTS

CRIMINAL LAW: THE WILDENSTEIN CASE

A famous art dealer (Daniel Wildenstein), his family, their trustees and advisors were prosecuted on charges of tax fraud for the use of offshore trusts supposedly to avoid taxes due upon the estate inherited following his death in 2001. According to the prosecutor, all the hidden assets placed in trusts should have been subject to inheritance tax in the hand of his sons.

Among others, one argument of the prosecutor was that the trusts in question were "fictitious" and consequently that any assets held in trust should have been treated in any event as part of Daniel Wildenstein's estate, even before the French law of 29 July 2011 (creating a specific wealth tax, inheritance tax and gift tax regime applicable to trusts) came into effect. The Criminal Court ruled, however, that neither the tax authorities nor the instructing judges were able to prove that their allegations were correct. As a consequence, Daniel Wildenstein's sons and the other parties were acquitted.

This decision is of major importance since the FTA are increasingly trying to apply retroactively the provisions of the Law of 2011 and, as already mentioned, are accusing all trusts of being fictitious structures. It must be noted however that the FTA have appealed the decision of the Criminal Court.

TAX LAW: CONSTITUTIONAL DECISIONS

Taxation of income capitalized in trusts: CFC rules of Article 123 *bis* of the FTC partly held unconstitutional

Article 123 *bis* of the French tax code (FTC) provides in substance for the taxation, under specific conditions, of all undistributed income capitalized within "entities" established in low tax jurisdictions, in the hands of their beneficial owners who are French resident individuals. The FTA consider that such provisions notably apply to trusts having French tax resident settlors and/or beneficiaries.

Under said Article also, the entity's income deemed distributed could not be inferior to a theoretical amount, determined on a flat-rate basis, when the entity was established in a non-cooperative State or in a State having no exchange of information agreement with France.

In addition, these CFC rules did not apply to "entities" established in the European Union (EU), provided that taxpayers were able to demonstrate that the use of such entities was not artificial.

The Constitutional Court ruled, in a decision of 1st March, 2017, that these two differences in treatment depending on the jurisdiction where the "entity" is established were contrary to the principle of citizens' equality before taxation.

As a result, French tax resident settlors and/or beneficiaries of non-EU trusts are now allowed to bring the proof that the trust was not created for artificial purposes in order to avoid application of the CFC rules.

Similarly, assuming Article 123 *bis* should apply, French tax resident settlors and/ or beneficiaries of trusts established in jurisdictions having no exchange of information agreement with France can now bring the proof that the trust's effective income is inferior to that determined of a flat rate basis.

Penalties applicable to trusts: A beacon of hope?

Failing for a trustee to comply with its French reporting obligations (see page 1) triggers specific penalties. Up until 31 December 2016, these penalties amounted to 12.5% with a minimum of €20,000 (and 5% with a minimum of €10,000 before 8 December 2013).

The French Constitutional Court, in a decision dated 16 March 2017, held the proportional penalties of 12.5% and 5% unconstitutional, as disproportionate in regards to the infringement they sought to sanction.

The fixed penalties of either €10,000 or €20,000 can however still apply in respect of reporting obligations due before 31 December 2016.

The French legislator anticipated this decision in the Amending Finance Law for 2016, dated 29 December 2016. Since 1st January 2017, failing to comply with French reporting obligations in relation to foreign trusts still triggers a fixed penalty of €20,000, but may also give rise to an additional 80% surcharge applying to all French tax consequences which may be due by the trustees, settlors or beneficiaries in respect of the trust assets, distributions or reportable modifications which may have occurred (see page 1).

THE FRENCH REGISTRY OF TRUSTS: PRIVACY *VS.* TRANSPARENCY

A law of December 2013 relating to fight against tax fraud provided for the creation of a French registry of trusts, aimed at gathering essential information in respect of French connected trusts (e.g. identity of the trustees/settlors/beneficiaries, characteristics of the trusts, etc). A decree provided for the public access to the information contained in this registry.

Such public accessibility was held unconstitutional by the French Constitutional Court in a decision of 21 October 2016, on the ground that it would allow anyone, in violation to the fundamental right to privacy, to collect information in relation to the settlors and beneficiaries of French connected trusts, as well as in relation to the trust itself. The registry is now only accessible to certain authorities such as the FTA, the judicial authorities or the customs.

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