

Buying a Pied à Terre in France

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BUYING real estate in France might sound enticing, but buyers should be aware of the tax and legal consequences. The situation is even more complex for Americans because the French and U.S. tax and legal systems (and cultures) are quite different. The new tax reforms, promised by newly elected President Nicolas Sarkozy during his campaign and published on Aug. 22, 2007,¹ should make investment in French real estate more attractive to foreign individuals.

This article will follow the journey of an American buyer toward proud ownership of a piece of French real estate as a second home (“pied à terre”), and will detail some of the estate planning tools available for non-French residents.

Purchasing Property

Locating the perfect pied à terre may require the use of a real estate agent (“agent immobilier”). If American buyers can “parler français” and navigate the French language, they may also venture by themselves and buy directly from an owner.

In any case, once the purchaser selects the ideal property and the parties agree on the purchase price, the buyer and the seller generally sign a preliminary contract called a “promesse de vente” or a “compromis de vente.” At that time, the buyer customarily makes a deposit of 5 percent to 10 percent of the purchase price. The buyer should carefully read and understand the preliminary contract. Fortunately, the prospective buyer has a seven-day “cooling-off” period during which he or she can unilaterally void the preliminary contract.

The legal professional who handles real property matters in France is called a “notaire,” not to be confused with our notary public.

In France, the notaire is a near equivalent to an attorney. The notaire prepares all necessary legal documents related to the conveyancing of real properties and conducts the land registry search. The preliminary contract generally contains special conditions (“conditions suspensives”) which, if not satisfied, render the preliminary contract void and entitle the buyer to withdraw and recover any deposit paid. Upon completion of this process, which may take several months (things can move slowly in France), the parties sign the final sales agreement or the “acte de vente” and then the buyer will become the proud owner of a piece of French real property (“bien immobilier”).

In addition to paying the purchase price, the buyer is generally responsible for legal costs and expenses incurred in the transfer of the French property, which will be paid to the notaire before completion of the sale. Costs are generally about 6.5 percent of the purchase price, which includes transfer duty payable to the French government, stamp duty, land registry charges, notaire’s fee and TVA (Value Added Tax or VAT) on the notaire’s fee. Those figures are fixed by law (non-negotiable) and are broadly the same throughout France. In addition, real estate agents generally charge a fee ranging between 4 percent and 10 percent of the net purchase price. Who pays this fee is negotiable, but it is generally paid by the buyer.

Non-French Residents

Depending on each individual’s situation, the preferred form of ownership may vary.

Individual Ownership. U.S. citizens/residents may purchase French real property in their individual names.

Individual Ownership. U.S. citizens/residents may purchase French real property in their individual names. If they do so, the French real property, as immovable property and under international private law rules, will be governed by French inheritance and tax laws. This includes forced heirship rules (“réserve héréditaire”) which require a certain share of the property to pass to certain members of the family, including children. For instance, an individual who has one child, must leave at least one-half of his estate to this child, and an individual who has two children must leave at least two-thirds of his estate to his two children in equal shares. A will to the contrary has no effect.

Community Regime. Because of these forced heirship rules, some couples may want to protect the surviving spouse and ensure that at the death of one spouse, the surviving spouse will inherit the French property and not be ousted by the children because of the French forced heirship rights. In that case, and for U.S. citizens/residents without children from prior marriages, the preferable form of ownership for French real property is generally the community property regime (Communauté Universelle Avec Clause d’Attribution), which is a type of matrimonial regime in France where a decedent leaves all French assets to the surviving spouse.

When the first spouse dies, the surviving spouse inherits the entire property. Thus, there is no forced heirship shares passing to the children or parents. The downside of this form of ownership is that, at the first spouse’s death, the children of the couple will not be taking advantage of the tax exemptions for assets passing to the children. (The tax exemptions are discussed later in this article.)

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Therefore, in the long run, at the surviving spouse's death, and if the surviving spouse still owns the property, the overall tax liability will likely be higher with this form of ownership because of the loss of tax exemptions.

Buying Through an Entity.

Because the community property regime described above is not advisable for couples with children from a prior marriage (children could claim their forced heirship share), an alternative is to take title through a French entity called a Société Civile Immobilière or SCI. One advantage of taking title through an SCI is the possibility of avoiding forced heirship rules even if the shareholders of the SCI have children outside of their current marriage. Indeed, shares of an SCI are deemed intangible personal property and, under international private law rules, are governed by the law of the shareholders' place of residence. Therefore, U.S. residents can avoid forced heirship on their shares in an SCI that owns French real property. Furthermore, shares of an SCI can be held and administered in a U.S. trust. Note, however, that if the sole purpose of the SCI is to avoid the forced heirship rules, French courts may deem it a fraud and pierce the veil. One disadvantage of an SCI is if the property is rented furnished. In that case, it receives a less favorable tax treatment; the SCI is no longer considered a transparent entity for income tax purposes and will be taxed under the corporate tax regime during ownership of the property.

Another option is the *Entreprise Unipersonnelle à Responsabilité Limitée* or EURL, which is a one shareholder company. Since only one shareholder is required for the EURL, this is an advantage for owning real property in France in certain situations compared to an SCI, which requires at least two shareholders. Furthermore, the EURL may opt for the application of the individual tax regime if the sole shareholder is an individual, even if the EURL is renting the real property furnished. Therefore, this form of ownership is preferred to the SCI for an individual who is

renting French real property furnished. This form of ownership is also preferred for an individual non-resident of France who does not want the forced heirship rules to apply, since similarly to shares of an SCI, shares of an EURL are intangible personal property governed by the law of the decedent/ shareholder's residence.

Split Interest Purchase. If only one spouse has children from a prior marriage, the couple could avoid forced heirship by buying in the form of a split interest. This form divides the ownership between a life interest and a remainder interest. For instance, the spouse with children from a prior marriage could be the owner of the life interest and the other spouse could be the owner of the remainder interest. At the death of the spouse with children from a previous marriage, the life interest would be extinguished and the surviving spouse would become the sole owner of the real property as the holder of the remainder interest.

Tontine. The "tontine" clause is a provision inserted in the deed during the purchase of the property. It provides that the surviving spouse will be deemed retrospectively to have owned the entire property from the outset. The tontine clause reproduces the "joint tenancy with rights of survivorship" form of ownership and is also an effective tool, in certain circumstances, to circumvent the application of the forced heirship rules.

French Tax Ramifications

Contrary to the United States, which taxes based on citizenship, France taxes individuals based on residence. Non-French residents are subject to tax on their French-source income and on their French situated assets, such as real estate.

Income Tax. Even if the owner is not a French resident, rental income derived from the French real property will be taxed in France. Article 164 of the *Code Général des Impôts* provides that the definition of French-source income includes gains realized from the sale of real property in France. Furthermore, Article 6 of the U.S.-France Income Tax Treaty (Treaty) provides that

a resident of a contracting state (i.e., the U.S.) owning real property situated in the other contracting state (i.e., France) may be taxed in the state where the real property is located.

Taxpayers residing in North America must generally file before June 30 every year at the Centre des Impôts des Non-Résidents (tax center for non-residents). French income tax is generally calculated by applying the progressive income tax scale, and non-residents with French-source income must file an annual declaration in the same way as residents. However, the tax rate applicable for non-residents is a minimum tax rate of 20 percent unless the taxpayer can show that the rate would be lower if his or her total worldwide income were reported to and taxed by the French tax authorities. Late returns generally give rise to penalties.

Wealth Tax. The French wealth tax may apply to the *piéd à terre*. The wealth tax was first established in France in January 1989 under the title of *Impôt de Solidarité sur la Fortune* or ISF. It is an annual tax based on the net wealth of the household. Wealth tax is paid by French residents who have worldwide taxable wealth in excess of €760,000 (as of 2007). Individuals resident outside France are subject to wealth tax on their taxable assets situated in France whose value exceeds €760,000 per household or "foyer." Therefore, the *piéd à terre* owned by a U.S. resident is subject to the wealth tax in France if its net value exceeds €760,000.² The wealth tax is based on the net value of the French assets; therefore, any mortgage or debt secured by the French real estate will be deducted before calculating the wealth tax.

Ownership of Real Property in France

Capital Gains Tax. If owners wish to sell their *piéd à terre*, it will be exposed to French capital gains tax. Non-EU residents are generally taxed at a 33.33 percent rate (EU residents are taxed at a 16 percent rate) if they sell their French real property having owned it for fewer than 15 years. After 15 years, no capital gains tax is due, regardless of the residency of the seller.

Inheritance Tax. At death, the French *piéd à terre* will be subject to inheritance tax in France whether the owner is a resident of France or not. French inheritance tax is payable if there is a legacy of French real property to a beneficiary, including shares of an SCI or EURL. The rates of tax and abatements differ according to the relationship between the decedent and the beneficiary. French inheritance tax rates vary from 5 percent to 40 percent for related parties. For assets passing to an unrelated party, the tax rate is currently 60 percent on net taxable amounts over €1,500.

The new French government, led by Mssr. Sarkozy, the newly elected president, passed a law which significantly changes French inheritance tax rules. Surviving spouses used to have a €76,000 tax exemption and were then taxed on inherited assets from their deceased spouses at rates varying from 5 to 40 percent. The new law creates a marital deduction similar to that of the United States, except that lifetime gifts to a spouse are still subject to gift tax. The new law also increases the abatement for children, for inheritance and gift tax purposes, as described below.

Gift Tax. Lifetime gifts may be a tax-efficient alternative for disposing of the French property to limit inheritance tax at death. Under the new French law, each parent can now gift €150,000 tax-free, to each of his or her children every six years. This is an improvement in comparison to the old abatement which was only €50,000 per child every six years. Gifts to children can be of real property or shares of an

SCI, as well as cash or other assets. Such gifts are made by French notarial deed. They are also subject to U.S. gift tax. Gifts up to \$12,000 per year (2007, as indexed for inflation) and per child are taxfree for U.S. tax purposes.

The new French law also creates a €30,000 one-time abatement for gifts to a child, grandchild, great grandchild, or in the absence of such descendants, niece or nephew. **3** However, this abatement only applies to gifts of cash and not to gifts of real property.

U.S. Tax Ramifications

U.S. citizens are generally taxed on their worldwide income. Because French real estate assets could potentially be subject to double taxation by both the United States and France, the Treaty provides guidance as to which country has primary taxing authority.

U.S. citizens/residents may purchase French real property in their individual names. If they do so, the French real property, as immovable property and under international private law rules, will be governed by French inheritance and tax laws. This includes forced heirship rules.

Specifically, Article 6 of the Treaty (Income From Real Property) provides that the income of a resident of a contracting state (i.e., the U.S.) from real property situated in the other contracting state (i.e., France) may be taxed in the state where the property is situated (i.e., France). **4** Thus, the Treaty does not provide an exclusive taxing right to France as the situs state, but assigns it the primary right.

Similarly, Article 13 of the Treaty (Capital Gains) provides that gains from the alienation of real property

situated in a contracting state may be taxed in that state. Accordingly, the income (both rental and capital gains) arising from the French rental property is reportable for both U.S. and French income tax purposes; however, taxpayers would generally be entitled to a foreign tax credit on their U.S. federal income tax return for income taxes paid or accrued to France with regard to such income.

Other Tax Changes Affecting Foreign Investors. Among other changes under the new law, measures to limit the wealth tax have been passed increasing the abatement for a principal residence from 20 percent to 30 percent and creating a deduction up to €50,000 for investments in certain types of businesses and charitable entities. These measures apply to non-residents owning real estate in France.

Conclusion

In conclusion, the most appropriate form of ownership for acquiring real property in France depends on each particular set of circumstances. In all instances, a prospective buyer of French real property should seek competent legal advice. Further, one should consider the following: the impact of the French wealth tax, how to avoid being resident in France and subject to French income tax, whether a will is necessary to dispose of the property and what treaty benefits may apply.

With the new tax regime, U.S. residents can now pass their real property in France to their surviving spouse tax-free, keeping in mind that inheritance tax will still be owed on the share passing to their children or other beneficiaries. However, by gifting €150,000 to each of their children every six years, parents can significantly limit the tax liability to their children of owning a French residence. With proper tax planning and advice, an ounce of patience and a gram of tolerance, owning a piece of French real estate can almost be just pure “*plaisir*” (pleasure)....

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1. The new law, dated Aug. 21, 2007, was published in the French legal newspaper "Journal Officiel" on Aug. 22, 2007, when most of the measures went into effect. The new French law is called Loi n° 2007-1223 du 21 août 2007 en faveur du travail, de l'emploi et du pouvoir d'achat.

2. Note that the U.S.-France Income Tax Treaty (Treaty) contains provisions relating to the application of the wealth tax and changes the above-referenced rules for U.S. citizens relocating to France as follows: (i) U.S. citizens in France are normally liable for the wealth tax in the same way as any other resident taxpayer; (ii) when U.S. citizens first relocate to France, they incur no liability for the wealth tax on the value of their non-French assets until Jan. 1 of the fifth year following the year of relocation; and (iii) to benefit more than once from the five-year exemption for foreign assets, a U.S. citizen must have left France for a period of at least three years before returning to France.

3. This abatement only applies if (i) the donor is less than 65 years old AND (ii) the donee is more than 18 years old (or is emancipated). This abatement is cumulative with other abatements.

4. Article 6 of the Treaty further provides that a resident of a contracting state (i.e., the U.S.) who is liable to tax in the other contracting state (i.e., France) on income from real property situated in the other contracting state may elect to be taxed on a net basis, if such treatment is not provided under the domestic law of that other state