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The 2011 Supplementary French Budget: the creation of a new French tax regime for Trusts and Estates

The 2011 supplementary French budget has clarified the taxation of trusts and unadministered estates, making them clearly subject to gift and inheritance taxes as well as to wealth tax. Income, however, is generally not subject to tax until distributed.

The 2011 supplementary budget (LFR 2011)[1] passed by the French Parliament on July 6, 2011 which came into force from July 31, 2011, contains substantial changes to the taxation of *sociétés civile immobilière* (SCIs), life policies, wealth tax, gift and succession tax, the abolition of the fiscal shield and the reintroduction of an exit tax. This article deals with the parts of the LFR 2011 that now codify the taxation of trusts and unadministered estates in France and introduce for the first time, a definition of a "*trust*" into the *Code général des impôts* (CGI) [General Tax Code][2].

The introduction of a general definition of a "trust":

For the purposes of the CGI and therefore for both the capital taxation of assets held in *trusts* and the taxation of income arising and distributed from *trusts*, but not otherwise, a *trust* is defined as
"*l'ensemble des relations juridiques créées, dans le droit d'un Etat autre que la France, par une personne, qui a la qualité de constituant, par acte entre vifs ou à cause de mort, en vue d'y placer des biens ou droits, sous le contrôle d'un administrateur, dans l'intérêt d'un ou de plusieurs bénéficiaires ou pour la réalisation d'un objectif déterminé*"[3]
[the collection of legal relationships created under the law of a State other than France by a person, acting as *constituant* by inter vivos deed or taking effect on death, which places assets or legal rights under the control of an *administrateur* for the benefit of one or more *bénéficiaires* or for the purpose of a specific objective].

In other words, *trusts* even though created outside France, are recognised as valid by the French Tax Code; however, this definition is still very unclear. There are of course many forms of trusts - discretionary, fixed, express or implied. The wide new definition in the CGI does not take into account any of these differences.

Although the CGI now uses the term "*trust*", the French draftsman has not used the terms "trustee" or "settlor" but "*administrateur*" and "*constituant*" to name the roles of particular individuals involved in a trust. The term *administrateur* would seem to be wider

[1] Law n° 2011-900 of 29 July 2011 *de finances rectificative pour 2011* available at http://legifrance.gouv.fr/affichTexte.do;jsessionid=C93F4BB3DB04DDC2FC7A39B6103D0BCC.tpdjo14v_1?cidTexte=JORFTEXT000024413775&dateTexte=20110821.
[2] All references to Articles of the Code are to those of the CGI unless otherwise stated.
[3] Art 792-0 bis.-I.-1. inserted by Art 14 I. 4° of LFR 2011.

than trustee and should not be regarded as identical. It would seem to include not only trustees, but also executors and administrators of Wills and estates.

The term *constituant* is defined for the purposes of this part of the CGI as:
"on entend par constituant du trust soit la personne physique qui l'a constitué, soit, lorsqu'il a été constitué par une personne physique agissant à titre professionnel ou par une personne morale, la personne physique qui y a placé des biens et droits."[4]
[the term *constituant* of a trust is either the natural person who has constituted it or if the trust was constituted by a natural person acting as a professional or by a legal entity, then the natural person who has added the assets and legal rights.]

In addition: "*Le bénéficiaire est réputé être un constituant du trust pour l'application du présent II, à raison des biens, droits et produits capitalisés placés dans un trust dont le constituant est décédé à la date de l'entrée en vigueur de la loi n° 2011-900 du 29 juillet 2011 de finances rectificative pour 2011 et à raison de ceux qui sont imposés dans les conditions prévues aux 1 et 2 du même II et de leurs produits capitalisés."*[5]
[The *bénéficiaire* is deemed to be the *constituant* of the trust for the purposes of this clause II, of the assets, legal rights and capitalised income of a trust, the *constituant* of which had died before the date of entry into force of LFR 2011 or by reason of the liabilities under clauses II.1 and II.2 and that capitalised income.]

The term *constituant* is therefore broader than that of settlor and includes the testator and intestator whether with or without Will or intestacy trusts and also subsequent *beneficiaires* who after the death of the original *constituant* themselves die if the rights to trust assets pass on to further *bénéficiaires*. Thus, trust assets are cumulated with the free estate of a *bénéficiaire* of a discretionary, life interest or relevant property regime trust or an interest in an unadministered estate, by the mechanism of including the *bénéficiaire* in the definition of *constituant.*

As regards "*bénéficiaires*", there is no set definition and it is more likely that they will generally equate with beneficiaries.

The LFR 2011 has attempted to establish a body of rules with strict obligations but without necessarily clearly establishing the persons to whom the obligations apply. The consequences can be serious; as described later, an obligation is placed on the *administrateur* to declare the value of the assets held in the *trust*. If the *administrateur* of a *trust* does not comply, he may be liable to penalties.

French gift and succession taxes

Under the new Art 792-0 bis II.[6], when French territoriality rules are met, French gift and succession taxes do apply to the assets held in the *trust*.

These taxes will apply to *trust* assets, regardless of their situs if the *constituant* or the *bénéficiaires* are French residents (*bénéficiaires* of the trust are French residents if at the time of the transmission they have been living in France for at least 6 of the previous 10 years).

Equally, the taxes will also apply if the *constituant* and the *bénéficiaires* are resident abroad to assets located in France.

[4] Art 792-0 bis.-I.-2. inserted by Art 14 I. 4° of LFR 2011.
[5] Art 792-0 bis.-II.-3. inserted by Art 14 I. 4° of LFR 2011.
[6] inserted by Art 14 I. 4° of LFR 2011.

The first test governing the taxation of the *trust*, depends on whether the transmission can be classified as a gift or a succession.

If a transmission can be classified as a gift or a succession, French taxation rules will apply on the net value of assets according to the usual family relationship between the *constituant* and the *bénéficiaires*. This might relate to distributions of capital from a *trust* or appropriation of a *trust* asset to a *bénéficiaire* and also relate to estates subject to administration without ongoing Will or intestacy trusts.[7]

When no such classification can be established, specific taxation rules ("*sui generis rules*") will apply and the *constituant's* death will constitute the event triggering the application of the *sui generis* taxes:

- If at the date of the *constituant's* death "*la part des biens, droits ou produits capitalisés qui est due à un bénéficiaire est déterminée"*, [the share of the assets, legal rights and capitalised income that belongs to a *bénéficiaire* is determined], the taxation of that part will again be calculated on the usual basis depending on the family relationship between the *bénéficiaire* and the deceased *constituant*.[8] Quite, what constitutes determination is uncertain. Does, for example, the presence of a continuing overriding power of appointment mean that the share is not determined?

- If at the date of the *constituant's* death the share of the assets, legal rights and capitalised income that belongs to a *bénéficiaire* is not determined then:

    - If *une part déterminée des biens, droits ou produits capitalisés est due globalement à des descendants du constituant,* [9][if there is a global transmission of a determined share to *bénéficiaires* who are the descendants of the *constituant*] the inheritance tax rate applicable to that part will be 45 per cent.
    - Any balance of the *trust* assets will be subject to the tax rate of 60 per cent even for family members from a parallel line of the deceased's family, such as a brother, sister, uncle, aunt, niece, nephew, or cousin. [10]

Where no such classification as a gift or a succession can be established, the *administrateur* will be liable for the payment of the tax. If these taxes are not paid and the *administrateur* is located in a non cooperative jurisdiction or a jurisdiction that has not entered into a tax recovery agreement with France, then, the *bénéficiaires* of the *trust* will be jointly liable.

Finally, the tax rate will also be 60 per cent (regardless of family relationships) if the *administrateur* is located in a non-cooperative state or territory or, for *trusts* which have been created after May 11, 2011 by a *constituant* who has his tax residence in France.

Under Art 14-III. of the LFR 2011, all of these provisions will apply to gifts and successions taking place after July 31, 2011.

Estate Duty Double Tax Treaty between France and the United Kingdom

The 1963 Estate Duty Double Taxation Treaty (the Convention) applies between France and the United Kingdom[11] with respect to duties on the estate of deceased person

[7] Art 792-0 bis.-II.-1. inserted by Art 14 I. 4° of LFR 2011.
[8] Art 792-0 bis.-II.-2.a). inserted by Art 14 I. 4° of LFR 2011.
[9] Art 792-0 bis.-II.-2.b). inserted by Art 14 I. 4° of LFR 2011.
[10] Art 792-0 bis.-II.-2.c). inserted by Art 14 I. 4° of LFR 2011.

imposed in these countries. It does not apply to lifetime gift tax, but only to tax arising on death.

Under the Convention, it is the domicile of the deceased (that is to say the domicile of the *constituant)* that determines which state has taxing rights on his succession. The question whether a deceased person was domiciled at the time of his death in any part of the France or the United Kingdom is determined in accordance with the law in force in that territory.[12]

If a *constituant* has a domicile in the United Kingdom under a British law in addition to a *domicile* in France under French law, Art II (3) (b) of the Convention provides tie breaker provisions.

Art V (2) of the Convention specifies that where a person was at the time of his death domiciled in some part of Great Britain duty shall not be imposed in France on any property not situated in France; and in determining the amount or rate of duty payable on any property which is chargeable in France, any property not situated in France shall be disregarded.

Therefore, if the domicile of the *constituant* at the time of his death is in the United Kingdom according to the provisions of the Convention, then France may not impose duties on the succession even though a *bénéficiaire* has tax residence in France. Some settlors of excluded property trusts with *bénéficiaires* resident in France may be encouraged to consider whether they have now established a domicile of choice in the United Kingdom.

The application of French double tax treaties applicable to gift and succession taxes and wealth tax with other states, where relevant, should be considered in detail.[13]

The application of wealth tax

Article 14 of the LFR 2011 provides an irrefutable presumption concerning the *trust* assets and the patrimony or taxable estate of the *constituant*. The assets cannot be part of the *bénéficiaires'* patrimony or taxable estate (except after the *constituant's* death). Under the new Art 885 G ter[14], wealth tax applies on the net asset value of a *trust*.

Generally, wealth tax applies if the *constituant* is French resident for tax purposes, regardless of the location of assets and also if *trust* assets are located in France, regardless of the *constituant's* residence for tax purposes.

However, failure to declare, then imposes a special levy rate of 0.50 per cent (*sui generis* levy), which has to be paid by the natural person *constituant* or the *bénéficiaires* of the *trust*[15]. French resident *constituant* or *bénéficiaires*s must pay the special levy on worldwide *trust* assets, irrespective of their situs. However, non French resident *constituant* or the *bénéficiaires* will only be liable for the special levy on assets located in France.

In addition, the *administrateur* must each year declare the value of assets in the *trust*. These new provisions will apply from January 1, 2012.

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[11] Double Taxation Relief (Estate Duty) (France) Order 1963 [S.I. 1963 No.1319]. The complications as to Northern Ireland are outside the scope of this article.
[12] Art II (3) (a) Double Taxation Relief (Estate Duty) (France) Order 1963.
[13] A list of current treaties is available at http://www11.minefi.gouv.fr/boi/boi2011/14aipub/textes/14a411/14a411.pdf.
[14] Inserted by Art 14 I. 5° of LFR 2011.
[15] Art 990 J, III inserted by Art 14 I. 6° of LFR 2011

Wealth tax applies at 0.25 per cent for individuals with a net asset value between €1.3 million and €3 million or at 0.50 per cent for individuals with a net asset value of €3 million or more. However, the sanction for the failure to declare is penal, as the special levy rate is set at the highest wealth tax rate.

The *administrateur* is the person responsible for declaring the net value of assets every year and if the declaration is not made, the *constituant* and the *bénéficiaires* will have to pay the special levy as a sanction for the *administrateur's* failure. However, *bénéficiaires* are not necessarily specified or known by other *bénéficiaires*; if one *bénéficiaire* is a French resident, the amount of the special levy (which is payable by the *constituant* as well as the *bénéficiaires* of the trust) can be considerably more since it will then be calculated on all assets irrespective of their location rather than just the assets located in France. The *bénéficiaires* cannot be aware of the value of assets held in the *trust*. For such *bénéficiaires*, the regime is very uncertain since they may be subject to a levy on assets (in case of non declaration) that they may never benefit from or have any mechanism for ascertaining.

The obligation to declare trusts to the French revenue

The new Art 1649 AB[16] provides reporting and filing obligations for the *administrateur* to declare the value of *trust* assets. This obligation is subject to a territoriality test and is due if the *constituant* or one of the *bénéficiaires* has a tax residence in France in the year of declaration or if any of the assets in the *trust* is located in France.

The *administrateur* is obliged to declare the creation of the *trust*, its termination and any potential modification to the trust, as well as any change in its terms; he will also have to declare the extent and the value of the *trust* assets, rights and accumulations as recorded on 1 January in each year. This declaration must be made if the wealth tax special levy is to be avoided.

Under Art 1736, IV bis[17], if the declaration is not lodged, a penalty of €10,000 or 5 per cent of the trust assets is payable by the *administrateur*, who is jointly liable with the *constituant* and the *bénéficiaires* of the *trust*.

These provisions will apply from January 1, 2012 and detailed regulations will be set out by subsequent decree. The fact that the *administrateur,* under his local law, may be prohibited from divulging the extent of the *trust* assets to the French revenue or to *bénéficiaires* may present some *administrateurs* with unpleasant dilemmas.

The personal representatives of estates worldwide with a French resident *bénéficiaire* may also be surprised to learn of their obligations.

The exemption of income tax on accumulated income

Art 120, 9° has been amended[18]. From July 31, 2011, "*Les produits distribués par un trust défini à l'article 792-0 bis, quelle que soit la consistance des biens ou droits placés dans le trust*". Only distributed income will be subject to French income tax and to social contributions. Thus, accumulated income should not be subject to tax until distributed. There is however concern that the term *les produits distribués* might also include capital distributions and not only distributions of income or accumulated income.

[16] inserted by Art 14 I. 7° of LFR 2011
[17] inserted by Art 14 I. 8° of LFR 2011
[18] By Art 14 I. 1° of LFR 2011.

There is no amendment to Art 123 bis, the anti-abuse rule that subjects French resident individuals who hold rights in an entity located in a privileged tax regime to income tax on 125 per cent of the profits of the entity, whether or not distributed. However, in view of the amended Art 120, 9°, Art 123 bis should not apply to *trust* income.

Conclusion

The new tax treatment is onerous.

The *administrateur*, who from January 1, 2012, is now subject to several reporting and filing obligations and to the payment of the wealth tax special levy in case of failure to declare will have to take detailed advise as to the territoriality rules.

Trust assets including assets in estates during the course of administration may be seriously affected by the new regime with regard to gift and inheritance tax because of the application of the territoriality rules. Tax will due from the *administrateur*, who will be jointly liable with the *constituant* and the *bénéficiaires.* Tax on assets may also apply to *bénéficiaires* even if they may never own these assets and to the *constituants* even though they no longer own or control them and without necessarily being able to recoup tax due.

The lack of distinction between different trusts and estates will produce many complications and mismatches of tax as well as the difficulties in ascertaining the identities of a *constituant, administrateur* or *bénéficiaire*. Any link to France – the location of assets or residence of the *constituant* or the *bénéficiaires* – will affect the trust or estate and may well dissuade some individuals from moving to France or holding assets located in France.

There will, however, be plenty of work for professional advisers.

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