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by Kristen A. Parillo

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News Analysis: Does France's Plan to Impose Social Contribution on Nonresidents Violate EU Law?

by Kristen A. Parillo

A newly approved French plan to impose France's social contribution on nonresidents' property gains has raised questions over whether the measure is compatible with EU law and whether it is creditable under France's tax treaties.

The measure is included in the second Amended Finance Act for 2012, which was approved by the French Parliament July 31 and published in the official gazette on August 17. The act entered into force on August 18. (For prior coverage, see *Doc 2012-16417* or *2012 WTD 149-2*.)

Nonresidents who derive revenue from immovable property located in France traditionally have been subject to French income tax and capital gains tax on that revenue, but not to the French social contribution. The social contribution comprises five separate charges that total 15.5 percent: the *contribution sociale généralisée* (CSG), the *contribution pour le remboursement de la dette sociale* (CRDS), the *prélèvement social*, the *contribution additionnelle ''solidarité autonomie*,'' and the *contribution additionnelle ''revenu de solidarité active*'' (RSA).

The charges forming the social contribution were progressively introduced between 1990 and 2004 to help reduce the deficit of France's social security system, which was until then only funded by social security charges levied on wages and self-employed business profits. The social contribution is levied on all types of income, including earned income (such as remuneration and pensions) as well as passive income, such as interest, dividends, capital gains, and income from property. Payment of the social contribution does not generate an entitlement to social security benefits.

In the amended budget plan announced July 4, the new Socialist government proposed extending the application of the social contribution to nonresidents who derive rental income or capital gains from French property. The government contended that the measure was necessary to equalize the tax treatment of residents and nonresidents. The tax rate on rental income derived from French property is generally a minimum 20 percent, but the capital gains tax rate varies depending on where the property owner is a tax resident: 19 percent for residents of the EU, Liechtenstein, Iceland, and Norway; 33.33 percent for residents of other countries designated as ''cooperative'' with the French tax authorities (such as the United States, Canada, and Australia); and 50 percent for residents of ''noncooperative'' countries (since January 1, 2012: Botswana, Brunei, Guatemala, Marshall Islands, Montserrat, Nauru, Niue, and the Philippines).

With the addition of the 15.5 percent social contribution, the tax rate on nonresidents deriving rental income from French property will thus increase from a minimum 20 percent to 35.5 percent (the same rate that applies to French residents). The capital gains tax rate for EU residents and residents of Liechtenstein, Iceland, and Norway who dispose of French property will increase to 34.5 percent (the same rate that applies to French residents), but it will increase to 48.83 percent for non-EU residents of cooperative countries and to 65.5 percent for non-EU residents of noncooperative countries.

The government's announcement of the proposal provoked an outcry in the United Kingdom, where an estimated 500,000 residents own holiday homes in France. Some observers called the French proposal a ''tax grab'' on foreigners, while others questioned whether it would run afoul of EU rules.

Following the Parliament's July 31 approval of the amended budget, opposition lawmakers referred the budget to France's Constitutional Council (the body responsible for reviewing the constitutionality of French legislation) on the grounds that some of the measures are unconstitutional. Regarding the proposal to impose the social contribution on nonresidents, the lawmakers contended that the measure would violate France's international treaties and EU regulations. They further noted that those instruments have a higher authority than French law.

In Decision No. 2012-654 DC, released August 9, the Constitutional Council concluded that the amended budget provisions are compatible with the French Constitution. In paragraphs 55-59 of the decision, which address the opposition lawmakers' concerns over the social contribution measure, the council said it can only judge the compliance of the measure with the French Constitution and that a complaint that it violates France's international treaties or EU law would have to be examined by the French and EU justice systems.

In other words, ''the council is saying that it is for the taxpayers to take it to the courts if they are not happy,'' Patrick Delas of Russell-Cooke Solicitors in London told Tax Analysts. ''That's easier said than done in practice, since payment is not suspended by contentious procedures.''

Delas said the council's position is consistent with its Decision No. 1975-54 of January 1975, in which it said that a law contrary to a treaty is not as such contrary to the French Constitution. ''It is for the 'ordinary' jurisdictions — the Cour de Cassation and the Conseil d'Etat — to say if a law complies with an international treaty, which the Cour de Cassation judged for the first time in *Jacques Vabre* in May 1975 and the Conseil d'Etat did in *Nicolo* in October 1989,'' he said.

Tax Impact Overblown?

Some observers have questioned whether the new rules will in practice result in higher taxation of nonresidents who own property in France. Athena Advisors, the leading international sales network for French property developers and agents, released a statement shortly after the amended budget was announced that said there was much confusion over the social contribution proposal and that it would likely affect a small number of foreign homeowners of French property. They noted that France's taper relief for capital gains tax (under which the rate gradually decreases the longer the property is held and goes down to zero when the property has been held for more than 30 years) and other allowances can dramatically reduce a homeowner's French capital gains tax liability.

Delas also weighed in, saying many U.K. homeowners of French property don't see their second home as a quick-return investment but rather as part of their long-term estate planning. ''So would this really be an issue for the typical U.K. homeowner?'' he wondered.

Nevertheless, even if the new rules don't affect a large number of taxpayers, it would still be important to clarify whether they are compatible with EU law, he said. ''As a matter of principle, I think it is important because we are certainly changing what has been the understanding among law professionals and the members of the public since the CSG and CRDS were introduced in the 1990s that they should only apply to those who benefit from the French social security system,'' he said.

Compatibility With EU Law

Determining whether the imposition of the social contribution on nonresidents' French property gains violates EU law could be a difficult task because of the long-standing debate over the legal nature of the social contribution — that is, whether they are fiscal levies or social security charges.

EC Regulation 1408/71, which provides a framework for coordinating member states' social security regimes to facilitate the free movement of EU citizens, says an individual can be subject to only one member state's social security legislation at any given time. Thus, if France's social contribution were to be classified as a social security charge, imposing it on nonresidents who are already paying social security contributions in their state of residence could be considered a violation of EU rules because they would be paying contributions in more than one member state.

However, the French authorities have conflicting views on whether the social contribution is a tax or social security charge, according to Ann Atchadé, a director in the international executive services department at FIDAL Direction Internationale in Paris. She noted that the Conseil d'Etat has held the CSG and CRDS to be taxes, the French tax authorities generally treat them as being within the scope of tax treaties concluded by France (and they are included in newer French tax treaties), and the social security authorities consider them social security contributions (and, as such, they fall within the scope of France's bilateral and multilateral social security agreements).

The European Court of Justice's April 2008 judgment in *Derouin* (C-103/06) appears to have added to the confusion, according to Michaela Britton of the law firm Mishcon de Reya in London. That case centered on Phillipe Derouin, a French tax resident who was a partner in a U.K. law firm organized as a partnership. Derouin objected when the French social security authorities claimed the CSG and CRDS were applicable to his U.K.-source income. He argued that the CSG and CRDS are taxes rather than social security contributions, and that under the France-U.K. tax treaty, only income taxable in France can be subject to the CSG and CRDS. According to Derouin, because his U.K.-source partnership income was taxable only in the United Kingdom and was not taxable in France under the terms of the France-U.K. tax treaty, that income should not be subject in France to taxes such as the CSG and CRDS. (For the ECJ judgment in *Derouin*, see *Doc 2008-7753* or *2008 WTD 69-14*. For prior coverage, see *Doc 2008-8209* or *2008 WTD 73-2*.)

The ECJ sided with Derouin and held that his U.K.-source income was exempt from the CSG and CRDS.

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The Court confirmed that the CSG and CRDS fall within the scope of EC Regulation 1408/71, but, importantly, it did not settle the question whether they are taxes or social security contributions. The Court said that because EC Regulation 1408/71 provides for a means of coordination and not of harmonization, member states are free to determine the tax base for contributions such as CSG and CRDS. Therefore, the Court found, a member state is entitled to forgo, unilaterally or in the context of a tax treaty, the inclusion in the chargeable base for CSG and CRDS income earned in another member state by a resident self-employed person.

Britton said the French government seems to have relied on one of the points that came out of *Derouin* — namely, the ECJ's opinion that the CSG and CRDS fall within the criteria of tax for the purposes of the France-U.K. tax treaty and also within the criteria of social security for the purposes of the EU regulations on the application of social security contributions — so that it can argue that the new charges on nonresidents represent tax and not a social security charge. Extending a tax to nonresident individuals is not in itself unconstitutional.

Britton said that the CSG and CRDS are generally not viewed as being covered by tax treaties because there isn't a direct connection between the payment of CSG/CRDS and the benefits to which an individual would be entitled as a result of the contribution. It may be argued that imposing the French CSG and CRDS on nonresidents could violate the single state principle of EC Regulation 1408/71, she said. ''This principle ensures that the legislative authority to levy charges for social security belongs to one member state, to the exclusion of the other member states' legislation,'' she said.

Britton noted that a taxpayer must pay social security charges only in the member state whose legislation applies. ''That principle ensures that EU citizens are not penalized for exercising their right to free movement and thus won't have to pay double contribution,'' she said. ''So if, for instance, a U.K. resident who pays a social security charge in the U.K. were also liable to paying the CSG and CRDS in France, that person would be paying social security charges twice, contrary to EU provisions.''

''It seems unfair for someone to have to pay social security in a country where that person would extract very little benefit, which would most likely be the case for most U.K. residents with second homes in France,'' she added.

Britton said that in addition to the principle of free movement, one should also consider whether the new charges may be contrary to the principles of nondiscrimination and equal treatment.

Atchadé noted that former President Nicolas Sarkozy proposed in his government's 2011 supplementary budget to impose a new tax on French homes owned by nonresidents. Under the plan, nonresident homeowners deriving less than 75 percent of their income from French sources would have been subject to a new tax, calculated at 20 percent of the theoretical annual rent that could be derived from the property. While the proposal was approved by the Parliament, Sarkozy decided to kill the tax via an amendment because of concerns that it would constitute a selective tax (since it would affect just one group of homeowners) and thus be found to breach EU rules. (For prior coverage, see *Doc 2011-13444* or *2011 WTD 120-6*.)

''So this new measure could be seen as a general trend in trying to make nonresidents contribute more to the French Treasury,'' Atchadé said.

Treaty Implications

Another thorny issue is how payment of the social contribution will be treated under France's tax treaties — in particular, whether non-French residents will be able to claim a credit for it against the tax due in their country of residence.

The IRS has previously said that CSG and CRDS contributions are not creditable or deductible taxes under the Internal Revenue Code or the France-U.S. tax treaty. In a statement posted on the IRS section of the website of the U.S. Embassy in Paris, the IRS states that the CSG and CRDS ''are social security taxes that are covered by the U.S.-French totalization agreement.'' (The website can be found at http://france.usembassy.gov/irs.html.)

Article 2 of the 2008 France-United Kingdom tax treaty lists the CSG and CRDS as taxes covered by the treaty, but the article 24 provisions on eliminating double taxation exclude them from the scope of French taxes that may be credited against U.K. tax. HM Revenue & Customs' position is set out in its double taxation relief manual on the France-U.K. treaty (DT7252), in which it states that the CSG and CRDS are inadmissible for credit under the treaty. (The manual can be found at http://www.hmrc.gov.uk/manuals/dtmanual/dt7252.htm.)

When asked by Tax Analysts whether HMRC plans to rethink its position in light of the new French rules imposing the social contribution on nonresidents' property gains, an HMRC spokesperson reiterated that the CSG and CRDS are not considered to be French taxes for the purposes of eliminating double taxation.

''As they are inadmissible for credit, the only relief due will be to allow them as an expense against the amount of the income or gain,'' the spokesperson said. ''Given that we understand that they are to be charged under social security legislation, they will not be taxes on income and thus cannot be admitted for unilateral relief against U.K. tax.''

Britton said it's hard to anticipate whether the U.K. government would relax its position because allowing a

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U.K. taxpayer to offset the social contribution he would pay in France against his U.K. tax liability would mean that HMRC is giving up tax revenue it could otherwise collect. ◆

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