

2011 Supplementary French Budget: A new French worldwide tax regime for Trusts and Estates

The 2011 French supplementary budget, Law n° 2011-900 of 29 July 2011 *de finances rectificative pour 2011* (LFR 2011) was passed by the French Parliament on July 6, 2011 and came into force from July 31, 2011. It contains substantial changes to wealth tax, gift and succession tax, the abolition of the fiscal shield and to the taxation of sociétés civile immobilière and life policies and the reintroduction of an exit tax.

The LFR 2011 has set out new rules for 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 text of the LFR 2011 is available in French at:

http://legifrance.gouv.fr/affichTexte.do;jsessionid=C93F4BB3DB04DDC2FC7A39B6103D0BCC.tpdjo14v_1?cidTexte=JORFTEXT000024413775&dateTexte=20110821

Background

This article deals solely with the changes made by Article 14 of the LFR 2011, mostly to Art 792-0 of the French General Tax Code (*CGI*) [*Code général des impôts*]. These changes now codify the capital and income taxation of trusts in France and introduce a definition of a “Trust” into the *CGI*.

They are relevant to practitioners worldwide, since French tax liabilities and reporting obligations now affect settlors, trustees and personal representatives, wherever they are resident, in relation to French assets and also for worldwide assets if a beneficiary or a potential beneficiary is resident in France.

Trusts and Estates

For the purposes of the whole of the *CGI*, a Trust is now defined by Art 792-0 *bis*.-I.-1. as the collection of legal relationships created under the law of a State other than France by a person, acting as Constitutor by inter vivos deed or taking effect on death, which places assets or legal rights under the control of an Administrator for the benefit of one or more Beneficiaries or for the purpose of a specific objective.

The term “Administrator” is wider than trustee and it would seem to include not only trustees, but also executors and administrators of wills and estates whether or not there are ongoing will or intestacy trusts.

“Constitutor” is defined for the purposes of this part of the *CGI* by Art 792-0 *bis*.-I.-2. as either the natural person who has constituted the Trust or if the Trust was constituted by a natural person acting as a professional or by a legal entity, then the constitutor is the natural person who has added assets or legal rights.

The term “Constitutor” is much broader than that of a “settlor.” It includes not only a settlor but also a Beneficiary who dies after the death of the original Constitutor if the rights to Trust assets pass on to further Beneficiaries in relation to estates both with and without will or intestacy trusts.

France now cumulates Trust assets and unadministered estates with the free estate of a Beneficiary for succession tax purposes by including the Beneficiary in the definition of a Constitutor.

There is no codified definition of a “Beneficiary”.

French Gift Tax and Succession Tax

French gift and succession taxes do now apply to Trust assets, regardless of their location if either the Constitutor or the Beneficiaries are French resident. Beneficiaries will be French resident at the time of the transfer, if they have been resident in France for at least six out of the previous ten years.

French gift and succession taxes will also apply to assets located in France even if both the Constitutor and the Beneficiaries are resident abroad for tax purposes.

There are different treatments for taxation of a Trust, depending on whether the transfer can be classified for the purposes of the *CGI* as a gift or a succession or not. Whether the classification is different from French private international law or not will be a fruitful and interesting area for investigation.

Art 792-0 *bis*.-II.-1. sets out, that if a transfer can be classified as a gift or a succession, French tax rules will apply to the net value of assets depending on the usual family relationship between the Constitutor and the Beneficiaries. This could tax distributions of capital from a Trust or appropriation of a Trust asset to a Beneficiary and also tax any estate during the course of administration.

If the transfer cannot be classified as a gift or a succession, specific *sui generis* taxation rules will apply and the Constitutor’s death will be the event triggering the tax point.

By virtue of Art 792-0 *bis*.-II.-2.a)., if at the date of the Constitutor’s death the share of the Trust assets, rights and accumulated income that belongs to a Beneficiary is defined, the tax will again be calculated on the usual basis depending on the family relationship between the Beneficiary and the deceased Constitutor. Quite, what constitutes a defined share is uncertain. The existence of an overriding power of appointment may well enable the French revenue to argue that a share is not defined.

If at the date of the Constitutor’s death the share of the Trust assets, rights and accumulated income that belongs to a Beneficiary is not defined then:

By Art 792-0 *bis*.-II.-2.b)., if there is a transfer of a defined share to Beneficiaries who are the descendants of the Constitutor, the inheritance tax rate applicable to that share will be 45%. Again, what actually constitutes a defined share is uncertain.

Art 792-0 *bis*.-II.-2.c). of the FGTC specifies that any balance of the Trust assets will be subject to tax at 60% even if passing to the Constitutor's spouse for whom the usual tax rate would be zero or to family members such as brothers, sisters, uncles, aunts, and their children for whom the usual tax rate would be less than 60% .

If the transfer cannot be classified as a gift or a succession, the Administrator will be the person liable for the payment of the tax. If these taxes are not paid and the Administrator is resident in a non cooperative jurisdiction or a jurisdiction that has not entered into a tax treaty with France, then, the Beneficiaries of the Trust will be jointly liable with the Administrator.

The tax rate will also be a flat 60%:

- For Trusts which have been created after 11 May 2011 by a Constitutor resident in France at the date of constitution or
- If the Administrator is resident in a non-cooperative state.

All of these provisions apply to gifts made and deaths after 30 July 2011.

Wealth Tax

French wealth tax now applies at either:

- 0.25% for a household with assets with a net value between €1.3 million and €3 million or
- 0.50% for a household with assets with a net value of €3 million or more.

The LFR 2011 specifies that Trust assets are part of the taxable estate of the Constitutor for wealth tax purposes. Accordingly, the assets cannot be part of the Beneficiary's estate for wealth tax purposes, except after the Constitutor's death.

Wealth tax does now apply to the net asset value of a Trust.

Wealth tax will now apply:

- If a Constitutor is French resident for tax purposes, regardless of the location of assets or
- if there are French situated Trust assets, irrespective of the Constitutor's tax residence.

In addition, Art 990 J, III of the *CGI*, triggers a special wealth tax levy (SWTL) at 0.50% per annum if there is a failure to lodge a wealth tax declaration. The liability to pay the SWTL is jointly and severally on the Constitutor and the Beneficiaries.

A French resident Constitutor or Beneficiary is liable to the SWTL on the value of the worldwide Trust assets.

A non French resident Constitutor or Beneficiary is liable to the SWTL only on French situated Trust assets.

The Administrator is also required annually to declare the value of the Trust assets.

Although the tax threshold for ordinary wealth tax is now €1.3 million, there is no threshold or exempt amount for SWTL purposes.

The Administrator is obliged to lodge the declaration as to the net value of the Trust's assets each year. If the declaration is not lodged, the Constitutor and the Beneficiaries are then the persons jointly and severally liable to the French revenue to pay the SWTL.

Reporting Obligations

Art 1649 AB of the FGTC sets out the reporting and filing obligations of the Administrator.

Filing is required if either the Constitutor or a Beneficiary is French tax resident in the year of declaration or if there are any French situs trust assets.

The Administrator is required to file details of the creation of the Trust or its termination or any change to the trust or its terms. The wealth tax return must include details of and the value of the Trust assets, rights and accumulated income on 1 January in each year.

This return must be lodged if the 0.5% SWTL is to be avoided. In addition under Art 1736, IV *bis* of the *CGI*, if the return is not lodged, a penalty of €10,000 or 5% of the value of the Trust assets is payable by the Administrator. The Constitutor and the Beneficiaries are also jointly liable.

All of these provisions will apply from 1 January 2012 and at some point decrees will be made setting out the detailed regulations.

Settlers of trusts who move to France and the personal representatives of estates worldwide with French resident Beneficiaries, may be surprised to learn of their new obligations and liabilities.

Double Tax Treaties

The application of particular French double tax treaties on wealth, gift and succession taxes and the extent to which these treaties may override a charge to French tax in particular circumstances do need to be carefully considered if they might be relevant. Details of all French tax treaties are available at:

<http://www11.minefi.gouv.fr/boi/boi2011/14aipub/textes/14a411/14a411.pdf>

Conclusion

The new tax regimes will affect many trusts and estates.

French tax liabilities and reporting obligations now affect settlors, trustees and personal representatives, wherever they are resident, in relation to French assets and also for worldwide assets if a Settlor, Beneficiary or a potential Beneficiary is resident in France.

Administrators will from 1 January 2012 be subject to several reporting and filing obligations and to the payment of the Special Wealth Tax Levy if they fail to declare.

Trust and estates will be seriously affected by the new regime with regard to gift and inheritance tax depending on the type of transfer and whether it can be classified as a gift or a succession or as some other transfer, as well as the relationship between the Constitutor and the Beneficiaries.

Tax may be a liability of the Administrator but with a jointly liability the Constitutor and the Beneficiaries. Tax on assets may then apply to Beneficiaries even though they may never receive any distributions and to Constitutors even though they no longer own or control them and without necessarily any ability to reclaim.

When the detailed Wealth Tax decrees are issued, some of the detail may be clarified. There will, however, be significant uncertainty and a need for great care.

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