

Leaseback Property

The so called “leaseback scheme” consists of purchasing an off-plan property with a view to renting it back immediately to a company associated with the developer who will operate the property as a hotel-type estate. The advantages for you as the purchaser/landlord are the following:

- to receive a guaranteed rent, enabling the reimbursement of the loan (at least partially),
- to obtain reimbursement of VAT paid on the purchase (19.6%),
- to occupy the property for a period of time which can vary between a few days and several weeks per year.

Sales off plan (*vente en l'état futur d'achèvement*) are a well recognised and organised way of purchasing a property in France and purchasers benefit from a series of statutory regulations providing a certain level of protection (cooling off period, stage payments, various guarantees).

However, the legal and tax framework of the leaseback scheme is quite complex and does present a number of risks. Before taking any further steps, the purchaser of this type of “product” should take advice and ensure he has a good understanding of the proposal especially as regards the lease agreement and its legal and tax consequences.

Following the purchase off plan and when the property is structurally complete, you as the owner, will “lease back” the property to a company associated with the developer. This will be achieved through a commercial lease (*bail commercial*) within a strict set of statutory rules.

Commercial leases are governed by the provisions of the decree of 30 September 1953, originally designed to protect shopkeepers whose main asset is often the shop's location and provide them with a credit capacity and the possibility to mortgage or assign the lease. It was extended to any commercial activity operated in the tenanted premises i.e. operating a hotel or, as in your case, a *Résidence tourisme* (tourist residence). It can be summarised as follows:

1 – Duration. The commercial lease gives the tenant security of tenure for the period of the lease. This duration is at least of 9 years.

2 – Renewal. At the end of the initial period and at the end of any further renewed period, the tenant has the right to renew the lease for a further 9 years. Alternatively the tenant can claim compensation from the landlord for the loss of his business the so called *Fonds de commerce*. Compensation should correspond to the value of the *Fonds de commerce* itself and the removal costs. Again, this corresponds to the idea of a shop but also applies in your case even if it is difficult to appreciate what would be the compensation allowed for the loss of an isolated flat if the rest of the property remains tenanted. Please note that the only way

to avoid this is for the tenant to surrender his rights but this cannot legally be done in advance even if some developers offer this. This is because, technically speaking, the right to renew the lease only arises at the end of the period (9 years) and, under French law, you cannot surrender a right that you have not acquired yet. Any anticipated surrender would therefore be worthless. It would, in particular, not be binding on any person to whom the lease would be assigned.

3 – Rental increase. The rental increase must remain in proportion to the inflation rate of the building industry according to a national index provided by INSEE (a Government agency). By way of example, the INSEE national index for the 1st quarter has increased from 1,362 to 1,385 between 2006 and 2007, thus an increase of 1.68% which does not necessarily reflect the local property market.

On the tax front, VAT paid on the purchase can only be claimed back by the purchaser if his tenant complies with certain rules strictly under supervision of the tax authorities. The tenant must be registered as a “tourist residence” (*Résidence tourisme*), which requires notably that a minimum of 75% of the property must be actually tenanted. This means that if more than 25 % of the landlord decide to terminate the lease at the end of say the first period of 9 years, the whole *Résidence tourisme* scheme may be jeopardised and lead to a claim for compensation in due proportion by the tenant. Furthermore, to operate as a *Résidence tourisme* the tenant must provide additional hotel-type services: e.g. reception, cleaning, laundry, catering. You, as a landlord, are not in a position to enforce this in practice and the Tax Authorities may ask you to reimburse VAT originally claimed back if the tenant does not comply with the rules (e.g. becoming insolvent). This would of course be a case of termination of the lease, which would certainly be a case of court proceedings with substantial costs. In the meantime VAT would have to be paid back.

If the scheme is terminated or if the property is sold within 20 years, you will have to pay back part of the VAT originally refunded. This “VAT regularisation” would amount to the total VAT paid on purchase less 1/20 per year of ownership. This means that if you sell the property, say on the 15th year you will have to pay back 5/20^{ths} of VAT originally refunded. The only way to avoid this is to sell the property to a buyer continuing with the scheme to whom you will be allowed to bill VAT. The buyer in turn will be able to bill VAT to his tenant.

Any incoming purchaser will still be bound by the existing lease anyway, which means that the marketability of the property is limited. Many developers have arranged an internal market for resales but the fact remains that you will certainly not be in an open market sale.

These principles should be kept in mind and make the leaseback scheme a long term and often non-liquid investment which you will probably not be able to realise easily or quickly.

The leaseback scheme will give you a French taxable income by way of the rents receivable for the period. Please note that the position as regards social security contributions is not clear as it appears that certain lease back investors operating on a large scale were recently made liable for social security charges (payment of social security charges in France as they are considered to be running a small business there). These could be high. It is therefore essential that you instruct a French accountant to clarify the position and make the relevant returns on your behalf.

The accountant is usually provided by the developer and as you might expect triggers additional fees. In addition, you will need to make your usual income tax return in the country where you pay tax (UK or other) covering income tax on the income received from France. If the country has a Double Tax Treaty with France (like the UK does), a credit for the French tax should be available against your local tax.

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