Real Estate
Going Global
France

Tax and legal aspects of real estate investments around the globe

2013
**Real Estate Tax Summary – France**

**General**

A foreign corporate investor may invest in French property directly or through a local (e.g. a société à responsabilité limitée [SARL], a société anonyme [SA] or a société par actions simplifiée [SAS]) or non-resident company, or through a partnership such as a société civile immobilière (SCI).

Foreign investors frequently invest in French real estate assets through a two-tier structure in which a French company owns the real estate asset, with the shares of the French entity being held by a foreign holding company (Luxembourg or Belgian holding company). This type of structure is frequently used for the acquisition/holding of French property since the sale of the shares in such a foreign holding company (or even the shares in the French company) may fall outside the scope of French capital gains taxation.

**Rental income**

Net rental income is taxable in France at a rate of 33.33%.

The effective rate of corporate income tax is:

- 34.43% (surcharge of 3.3%) should taxable income exceed EUR 2,289,000;
- 35% (surcharge of 5%) should taxpayer’s turnover exceed EUR 250m;
- 36.10% if the two above mentioned criterion are fulfilled.

Local and non-resident companies and partnerships owning French property are allowed to deduct interest expenses (on loans borrowed from third parties and banks or sister companies) and property-related costs from their taxable income.

Local and non-resident companies are also allowed to deduct the majority of other types of business costs including acquisition costs. Certain expenses, such as architect’s fees and refurbishment costs incurred during construction, cannot be deducted when incurred and must be added back to the acquisition price of the property.

There is no withholding tax (WHT) on tax-deductible interest on loans in France when properly documented.

**Barrier on deductibility of financial expenses**

Article 23 of the Finance Act for 2013 introduced a new cap on interest expense deductions for companies subject to Corporate Income Tax in France. Companies with a net interest expense over EUR 3,000,000 are subject to a limitation on their full
interest expense, capping the deductibility at 85% of the interest for financial years closed as of 31 December 2012, and 75% of the interest for financial years opening as from 1 January 2014. The term ‘net finance expenses’ is defined as the total amount of finance expenses incurred as a consideration for financing granted to the company, reduced by the finance income received by the company in consideration for financing granted by the company.

Specific barrier rules apply to a tax consolidation.

**Thin capitalisation rules**

Related party loans fall within the scope of the French thin capitalisation rules. Since 1 January 2011, related party loans also include loans granted by a third party (e.g. a bank), whereby repayment is guaranteed by a related party.

First, the interest rate levied on a loan granted by a related party should not exceed the annual average effective rates used by financial institutions for variable-interest loans to enterprises for an initial term of more than two years (3.39% for FY 2012) except where the company is in a position to evidence that the interest rate retained is a market rate. Otherwise, the excess interest would not be tax-deductible and would be treated as a deemed dividend.

Secondly, the interest charge should only be tax-deductible if:

- the related party indebtedness of the company does not exceed 1.5 times the level of its net equity at closing or opening; or

- if the interest charge does not exceed 25% of the operating profit before tax, before depreciation charges, before interest paid to related parties, and before part of the financial leasing charges; or

- if the borrowing entity receives interest from related parties for an amount higher than those paid to related parties.

The portion of interest exceeding the highest of these three thresholds is not tax-deductible during the relevant fiscal year except when this portion is less than EUR 150,000.

It should be noted that there is a safe harbour provision whereby thin cap rules should not apply if a French borrowing entity demonstrates that the overall debt-to-equity ratio (D/E) of the group to which it belongs (including foreign parent and foreign subsidiaries) is higher or equal to its own overall D/E.

Specific thin capitalisation rules apply to a tax consolidation.

At last, according to the new rules set forth by article 12 of the Finance Bill for 2011, when interest is paid on a third party’s financing, and a guarantee for the repayment of that financing is provided either by a related party, or by a party whose commitment is itself secured by another company (which is also related to the borrowing entity), then the portion of interest that is payable on the secured part of the financing is treated as interest paid to a related party and, therefore, subject to the thin capitalisation limits of article 212 of the French Tax Code.
When repayment of the loan is secured by a personal guarantee, the portion of interest that would be reclassified as related-party interest would correspond to the amount of interest paid in relation to the secured portion of the third-party debt.

When repayment of the loan is secured by a guarantee *in rem*, the same principle would apply, except that the portion of the loan that is guaranteed would be determined according to the following ratio: value of the asset at the date on which the security has been constituted against the initial amount of the financing. Accordingly, the interest payable in relation to this secured portion of the third-party debt would be reclassified as related-party interest for thin cap purposes.

The term ‘guarantee’ is not defined. As a result, any kind of guarantee is covered, whether personal guarantees or guarantees *in rem* (for instance, mortgage on a property).

The new provisions do not apply in various situations (e.g. if the financing takes the form of a bond issued by way of a public offering or under equivalent foreign regulations; if the loan is guaranteed by a related party solely by way of a pledge of shares against the borrowing entity; the loan has been obtained in connection with the acquisition of shares or its refinancing; if the loan has been taken out by *Sociétés civiles de construction-vente* (SCCVs) with a guarantee given by their partners limited to the level of the partners’ equity in the capital of the SCCV, etc.).

### Depreciation

Each component of a property must be booked individually and depreciated accordingly, i.e. facade, heating system, structures, interiors, etc.

For properties held by a look-through entity (such as an SCI or a *société en nom collectif* [SNC]), the deductible depreciation charge can be limited by the amount of the net rental income generated by the property (difference between the rents and all the property-related costs, including interest), the excess being carried forward indefinitely.

It should also be noted that under certain circumstances, buildings are not treated as depreciable assets, but as inventory (e.g. when owned by brokers or developers).

### Capital gains on the sale of property

Subject to tax treaties, capital gains realised upon the sale of French properties and the sale of real estate shares by local and foreign companies are taxed at 33.33% (34.43%, 35% or 36.10% including surtaxes payable by French tax residents only), which is the standard corporate income tax rate.

However, capital gains realised upon the sale of listed real estate shares is taxed at a reduced corporate tax rate of 19% where the shares are held for at least two years.

In addition, foreign entities and bodies are subject to a 33.33% WHT on capital gains realised upon the sale of French properties, or shares in companies whose assets mainly consist of French properties. A 19% WHT can apply when listed shares are sold. The 33.33% 19% WHT can be offset against the corporate tax due on the capital gains. If the amount of the WHT exceeds the corporate income tax charge, the excess is then refundable.
Additional corporate income tax (CIT) on dividends

Section 6 of the Second Amendatory Finance Bill for 2012 introduced an additional CIT of 3% applicable to dividend payments, or to deemed distribution realized as from 17 August 2012, by French or foreign companies and organisms liable to CIT in France and especially to distributions made by SIIC to their shareholders and to distributions from SPPICAV subsidiaries to their parent entities.

Some distributions are specifically excluded from the scope of the 3% tax:

- Amounts distributed between companies which are members of the same tax consolidated group;
- Distributions of dividends paid in shares (under some conditions);
- Distributions of dividends from SIIC subsidiaries to SIIC parent company and distributions to be paid by SIIC in 2013 to meet the distribution requirements.

3% tax

French or non-French entities with or without legal personality, including trusts and similar vehicles, owning either directly or indirectly (and whatever the number of companies interposed between the building and the ultimate shareholders) real estate properties located in France, which do not perform a professional activity other than a rental one, fall within the scope of a 3% property tax. This tax is levied annually and is based on the fair market value of French real estate property owned as at 1 January.

Under certain conditions, automatic exemptions (e.g. sovereign states, entities where stocks are admitted to negotiation on a regulated market and are regularly and significantly traded, pension funds, non-listed open-ended real estate funds) and exemptions subject to filing requirements may apply.

Withholding tax/dividends

Subject to tax treaty provisions, a 30% WHT applies to branch profits that are deemed to be distributed to the shareholders of a foreign company having a French branch. However, this WHT is no longer applicable to companies located in EU countries and subject to corporate income tax.

Subject to tax treaty provisions, a 30% WHT is levied on dividends paid by a French company to its foreign shareholder. Pursuant to the EU Parent-Subsidiary Directive and under certain conditions, the WHT does not apply to dividends paid by a French entity to its foreign parent company residing in an EU country.
Real estate transfer tax/Value added tax (VAT)

The acquisition of the legal title to a property in France can be subject to real estate transfer tax at 5.09%, or to real estate VAT at a rate of 19.6% (20% as from 1 January 2014), depending upon the characteristics and use of the property.

The purchase of shares in French or foreign real estate companies, unless listed, is subject to a 5% transfer duty. The same rules apply to the disposal of shares in foreign companies whose assets predominantly comprise real estate assets and/or rights.

As of the 1 March 2010, VAT rules applicable to real estate transactions have been amended. In substance, the VAT regime applicable to real estate transactions is now driven by the seller, whereas the transfer duty regime is driven by the purchaser.

Surtax on real estate capital gains

As from 1 January 2013, a new tax applies to real estate capital gains (unless a sale agreement has been signed and has acquired a definite date before 7 December 2012) on sales of property, whether involving real estate assets or rights, when the taxable amount, determined after the application of the allowance for holding period, is greater than EUR 50,000.

Taxes paid on sales of taxable assets (excluding, in particular, sales of main residences) are increased by between 2% (if the amount of the capital gains exceeds EUR 50,000) to 6% (if the amount of the capital gains exceeds EUR 260,000). This surtax rate applies to the full amount of the taxable capital gains. Hence, the taxation rate, currently 19%, will be between 20% and 25%, depending on the amount of capital gains realized.

The surtax is due by individuals or tax transparent entities (companies or groups who are within the scope of articles 8 to 8 ter of the FTC), and by taxpayers who are not French tax resident, but who are subject to the individual income tax.

SIIC (F-REIT) and OPCI

Favorable tax regimes applicable to specific real estate investment vehicles are developed in the following sections.
Real Estate Investments – France

General

Introduction
This guide comprises an overview of the tax and legal aspects relating to the acquisition of commercial real estate in France. It is not intended to be comprehensive and consequently should only be relied on as an introduction to general matters relating to French property law and tax.

We have excluded from this guide the specific rules relating to operators who buy and hold property as inventory with the intention of resale. Suffice it to say that those players can benefit from a favourable rate of transfer duties when they acquire property as inventory, provided that certain conditions are satisfied.

The tax aspects are considered with respect to investments made by corporate investors under the ultimate control of non-resident corporate investors. We have also included some key information on non-trading investments realised by individuals.

Foreign investment control
The general rule is that there is no longer any restriction on the purchase and sale of real estate which constitutes a foreign direct investment in France. A declaration has to be filed with the French Treasury once the investment has been made (the investment is deemed made as soon as an agreement has been entered into). A statistical form (compte rendu) has to be filed with the French Treasury within a reasonably short period, following the purchase or sale of a direct investment.

A foreign direct investment can take either of the following forms:

- The purchase, creation or extension of a business or branch.

- Any other operation which constitutes the acquisition of, or the increase in, the control of a company carrying on an industrial, agricultural, commercial, financial or real estate activity, or which constitutes an extension of such a company’s activity already controlled by the non-resident company or person.

Non-residents may freely incorporate a company in France. If the investment is in excess of EUR 1.5m a statistical form must be filed with the French Treasury within a reasonably short period after the investment is made.

No formality is required to acquire a company that owns investment property or has a real estate activity. However, in the case of an investment in a company whose activity is to construct and sell on or rent out buildings, a declaration must be filed with the French Treasury. A statistical form must be filed on disposal of the investment.
Direct investments in French real estate

Legal aspects

Ownership
Ownership of a property is the right to enjoy and use of the property in the most absolute manner, provided the use is not prohibited by laws or regulations (freehold). Leasehold rights, which confer on the tenant a real estate interest, also exist but are quite rare. It is possible for the bare ownership (‘nue propriété’) to vest with one owner and the usufruct (‘usufruit’) that gives the right to possession or the income, to vest with a different owner. A ‘nue propriété’ or ‘usufruit’ right purchased by or granted to a corporate investor is limited in time, and cannot exceed 30 years.

Any real estate interest must be filed with the relevant Land Registry to be enforceable against third parties.

Freehold
A person owning the freehold of a property (‘pleine propriété’) is the owner in perpetuity. They may use as they please the property, as long as the law does not prohibit it. Subject to exceptions, they own the land and everything above and below it, including all buildings and vegetation.

Two forms of ownership exist. They are very similar to freehold ownership, in that ownership is in perpetuity. These are co-ownership units and volume units.

Co-ownership
A property may be divided into a number of co-ownership units, rather like a condominium. The co-ownership (‘copropriété’) system, originally set up to allow a building to be divided into apartments under different ownership, can be used for offices or any other type of building, which is to be divided up among two or more owners. A co-owner owns unit(s) in perpetuity. The co-owner has the exclusive use of the unit for the purpose for which it is intended and a share in the common parts of the property and in the land.

Units can be conveyed in the same way as freehold property.

The French Law dated 10 July 1965 sets up an obligation for each co-ownership to have its own regulations (‘règlement de copropriété’), to which the owners are deemed to adhere. The regulations relate to the use and enjoyment of the premises and management of the building.

The co-owners hold a general meeting, at least once a year, to decide on issues that concern the property. The day-to-day management is conferred on a manager (‘syndic’) appointed by the co-owners, who represents the co-owners in dealings with third parties. The co-owners approve the manager’s accounts, and make decisions relating to the maintenance and repairs that may be required, and other matters to be decided on. The co-owners are asked to vote on proposed resolutions. The number of votes they have will depend on their share in the common parts and the land. However, where a co-owner has more than 50% of the votes, the number of votes is scaled down to the total number of votes of all the co-owners put together, in order to avoid any co-owner from having a clear majority.
The majority required to pass a resolution will depend on the nature of the resolution to be voted on. The unanimous decision of the co-owners is required for some major issues such as the change of the general assignment of the property, of the enjoyment rules of the property, or of the split of the expenses among the co-owners.

Generally, the expenses of the co-ownership are met by the co-owners in proportion to their percentage share in the underlying land. Certain expenses, however, may be split differently if they are of greater benefit to some co-owners. (One would not normally expect the owner of ground-floor premises to be liable for expenses relating to the elevator for example.)

**Volumes**

The division of property into volume units was originally set up to enable the State to allow private ownership of buildings to be constructed over public roads and railways at Paris – La Défense, at Lyon – Part-Dieu and at Montparnasse station in Paris. It has since become fashionable to use volumes for mixed-use developments, so as to avoid creating a co-ownership, which is not particularly well adapted for such properties. This is particularly true of mixed-use complexes: a co-owner of retail premises in a shopping mall will not have the same interests as a co-owner of offices in the same complex, but may need to have a resolution passed by the co-owners to be able to do certain things.

Volume units are a kind of ‘flying’ freehold. The owner of a unit has the absolute ownership, in perpetuity, of the airspace and buildings within the volume as identified by reference inter alia to the height above sea level. The owner’s volume will have the benefit and the burden of all relevant easements.

There can be no common parts. However, as the provisions of the law dated 10 July 1965 relating to co-ownership are mandatory, some properties that have been divided into volumes run the risk of being requalified as a co-ownership.

**Leasehold**

There are two categories of leasehold: construction leases (‘bail à construction’) and other long leases (‘bail emphytéotique’). As they confer on a tenant a real estate interest, mortgages may be taken over the leasehold right.

Both leases are granted for a period of between 18 years and 99 years. As all leases granted for a term over 12 years, they have to be registered at the Land Registry, and ad valorem duty at the rate of 0.715% has to be paid on the rent with a cap of 20 years’ rent if the term of the lease is longer. The lease must be executed as a notarised deed, so it can be registered at the Land Registry.

Such leasehold rights are not to be confused with other leases, such as commercial leases, which do not create any real estate interest.

**Construction lease (‘bail à construction’)**

A construction lease requires the tenant to construct a building on the leased land, which may already be partially built. When the lease expires, the buildings erected by the tenant will revert to the owner of the land.

**Long lease (‘bail emphythéotique’)**

These are almost the same as construction leases. The main difference is that, although the tenant may be entitled under the contract to build on the land, there is no
obligation to build. The other difference is that if the premises are used for a commercial activity, the statutory rent review provisions of article L.145-1 and following of the French Commercial Code (governing commercial leases) may apply, but never in the case of a construction lease.

Real estate acquisition

Preliminary negotiations and due diligence

The notion of ‘subject to contract’ does not exist in France as it does, e.g. in the UK. In the case of a proposed sale, unless the parties intend otherwise, there is a binding contract once the parties have agreed on the price for the property. The price is usually agreed at the outset of any negotiations. It is, therefore, essential that each party should be properly advised at the very beginning of any discussions; even if correspondence is exchanged outside France (even then French law could apply insofar as the deal being negotiated relates to a property in France).

Furthermore, although negotiations can be conducted freely, there is an obligation for the parties to negotiate in good faith. This obligation becomes stronger as the parties progress towards an agreement. If a party does not conduct negotiations in good faith, that party runs the risk of the other party being entitled to claim damages in tort for the loss suffered.

A party may be liable if the party brings negotiations to an end abruptly or fails to reveal information that is likely to prevent the deal from taking place (for instance, giving misleading information on the availability of finance).

A letter of intent or heads of agreement may set out the basis on which the parties are entering into negotiations. The existence of such a letter or agreement will enforce the obligation to negotiate in good faith. Such a document may comprise a number of assumptions. It is important to inform the other party each time an assumption proves to be incorrect or can no longer be relied on.

Preliminary contracts

It is possible to proceed directly to completion, without any preliminary agreement. But almost invariably the parties will enter into a preliminary agreement before dealing with searches and other pre-completion formalities. Also, it may be necessary to obtain consents or building permits before the property can be occupied or developed by the buyer, which can take time.

A properly drafted preliminary contract will stipulate all the terms and conditions (T&C) of the sale. This implies that due diligence (root of title, easements, planning permission, building insurance, permitted use, the result of searches relating to asbestos, lead, termites, soil contamination, etc.) should be done at the outset and not, as still so often happens, after contracts have been exchanged.

In and around Paris, the preliminary agreement usually takes the form of an option granted by the owner to the buyer called ‘unilateral commitment of sale’ (promesse unilatérale de vente).

In the South of France, notably, an agreement of sale (promesse synallagmatique de vente/contrat de vente) is favoured.
The unilateral commitment of sale: Option (‘promesse unilatérale de vente’)
In the unilateral commitment of sale, the owner undertakes to sell their property to a specific person, the beneficiary.

Accordingly, the seller provides the beneficiary with a free option, either for a fixed or an indeterminate period.

As the commitment of sale becomes a sale as soon as this option is exercised, the commitment must stipulate very precisely at the outset all the T&C regulating the transaction.

In the vast majority of cases, the option is used as a step towards a sale that is expected to happen and the seller will expect a financial commitment from the beneficiary. This will typically take the form of a restraining compensation, which will be retained by the seller if the option is not exercised. Generally, the amount of the compensation is equivalent to 5% or 10% of the purchase price. This amount will usually be secured by a deposit paid to a stakeholder (which deposit is then applied towards the purchase price if the sale takes place), or by a bank guarantee.

The parties may also include a penalty clause in their commitment, which stipulates the amount that the party failing to honour its commitment must pay to the other party.

In rare cases, the seller may also charge a non-refundable price for the option as separate consideration from the price for the property itself.

If the seller withdraws the option before it has been exercised, the buyer will not be entitled to sue for specific performance of the sale. The buyer will only be entitled to claim damages. It is only if the seller withdraws after the option has been exercised that the buyer may be entitled to claim specific performance of the sale, depending on how the contract has been drafted.

However, there are adequate contractual means that can be provided for to discourage the seller from withdrawing their offer to sell.

It is usual to allow the buyer to assign the benefit of the option.

Unless it is notarised (i.e. signed before a notary), or reproduced in full in a notarised deed, an option relating to a property must be registered within ten days from the date on which the benefit of the option has been accepted by the buyer, failing which it automatically becomes void. The option must, therefore, be in writing. The rule also applies to the assignment of an option. Notice of an assignment must also be served on the seller by a bailiff (huissier).

The agreement of sale (‘promesse synallagmatique de vente/contrat de vente’)
In the agreement of sale, both parties are committed: one party is committed to sell and the other party is committed to purchase, as soon as the property is identified and its price agreed upon.

Such an agreement will entitle the parties to sue for specific performance if the other defaults.
There is no requirement to register an agreement of sale.

The agreement will usually contain conditions precedent. But once these conditions are satisfied, and unless the parties have agreed otherwise (i.e. in the case of *a promesse synallagmatique de vente* *ne valant pas vente*), the sale becomes binding and effective retroactively from the date on which the contract was entered into. It is, however, possible and usually desirable to contract out of the implied retroactive effect.

As in the case of options, it is generally possible for the buyer to assign the benefit of the contract, but this must be done before all the conditions precedent are satisfied, failing which there could be deemed to be two successive transfers for transfer tax purposes. As in the case of options, property dealers are not permitted to sell on the benefit of an agreement of sale.

**Formalities**

Once contracts have been executed, the following pre-completion searches and other formalities will be carried out:

- **Land registry searches**: to check that there are no mortgages or other charges registered against the property or, if there are, that the sale proceeds will be sufficient to discharge the mortgages.

- **The purge of pre-emptive rights**:
  - Urban pre-emptive right: the local municipality (or, in rural areas, the local agricultural authority known as the SAFER) could have a priority in purchasing specific property up for sale in areas that have been defined beforehand by the town council. In this case, the buyer has to enquire with the proper authority whether it intends to exercise its right, by sending to it a declaration of intent to dispose of the property (*Déclaration d'intention d'aliéner* ‘DIA’) stating the price and conditions of the sale. The municipality may not respond (waiver of its right), accept the proposed price, or make a counter-offer.
  - Tenant’s pre-emptive right: the French law grants to the tenant a priority in purchasing the leased accommodation that the owner wants to sell.

- **Other local planning search**: to check whether the property is located in a zoned area and, if so, the authorised plot density ratios, and whether the property is burdened by any public easements.

- **Obtaining certificates from the authorities confirming that the premises have the requisite use, is not in a termite zone, etc.**

- **A certificate from the managing agent (syndic) of premises, which are part of a co-ownership.** This certificate must state that the seller does not owe any money to the co-ownership.

The purchase will be conditional on satisfactory searches being obtained and the beneficiary of any pre-emptive right confirming that it will not be exercising such a right.
**Planning permission and other consents**

The purchase may also be conditioned by the delivery of permits, licences or consents, which the buyer may require. The following are frequently encountered:

- **A demolition permit**

- **A building permit** is required to erect a new building, or for works to an existing building if these are to change its existing use, change the exterior of the building or its volume, or create additional floors.

- **A licence**, commonly known as a CDEC licence, required to create new retail premises with a sales floor area that is over 300 square metres (or 1,000 square metres in certain cases), or to change one retail category into another if the sales floor exceeds 2,000 square metres as well as to create hotels with over 50 bedrooms (or 30 rooms, if outside the Paris region) or cinemas with seating for more than 1,500 people.

- **A licence** (known as an ‘agrément’), required to build, rebuild, extend or occupy offices, warehouses and industrial premises in the Paris region, which are over a certain size.

- **A consent**, required to convert residential premises to offices, or any other use (noting that the changing office premises into residential premises is not subject to this prior authorisation of the French Administration).

**Deed of sale**

The deed of sale must be executed before a notary. It is usually preferable for each party to appoint its own notary (in which case, the notaries’ fee is split between the two notaries). The deed of sale will identify the parties and the property and set out the T&C of the sale and a full root of title, which has to be established over at least a 30-year period.

As a general rule, a seller will seek to sell the property without giving any warranty with regard to apparent or hidden defects. However, if it can be established that the seller knew of a hidden defect but did not disclose its existence to the buyer, the buyer may be entitled to claim damages from the seller for any loss suffered.

In any event, a seller who is regarded as being a property ‘professional’ cannot contract out of the statutory warranties provided by the French Civil Code, except if she/he sells his/her property to another professional.

The seller of a building constructed in the past ten years is liable to all future owners during the ten-year period in respect of all structural defects.

**Post-completion formalities**

Once the deed has been executed, the notary will lodge a copy with the Land Registry for registration and arrange for any outstanding mortgages to be removed.

**Acquisition costs**

Unless otherwise agreed, the buyer bears all acquisitions costs, including the notaries’ fees and expenses, the Land Registrar’s fees and the registration duty.
Notary’s fees and expenses

Notary’s fees are calculated by reference to the purchase price. They are approximately 0.825% plus VAT, calculated on the purchase price. Where two notaries are involved, they will share the fees. If the purchase is being financed by means of a loan to be secured by a charge over the property, a fee will also be payable in that respect. The fee is approximately 0.55% plus VAT of the amount secured by the charge. Expenses relate essentially to pre- and post-completion searches. Notaries’ fees are negotiable above EUR 80,000.

Land registrar’s fee

A land registrar’s fee equal to 0.1% of the purchase price on the purchase and 0.05% of the amounts secured by the mortgage (or any other charge over the property) is payable.

It should be noted that a privilege less expensive than a mortgage can be granted, the so-called ‘privilège du vendeur’ or ‘privilège de prêteur de deniers’.

Tax aspects

Taxation of the acquisition of real estate

Either VAT or registration duty (or both) is/are payable on the purchase of real estate in France.

VAT

The VAT regime applicable to the purchase of real estate depends on the VAT status of the vendor. In substance, if the vendor performs a VAT-able activity on a regular basis (i.e. if the vendor is an ‘assujetti’, hereinafter a ‘VAT-able person’), VAT at the current standard rate of 19.6% (20% as from 1 January 2013) would be payable by the vendor. Conversely, except in limited cases, no VAT would be mandatorily due if the vendor is not a VAT-able person. In addition, VAT and registration duties are now totally disconnected as the registration duty liability depends solely on the intention expressed by the buyer (i.e. intention to resale/erect/rebuild the building). The following cases illustrate the principles herein above-mentioned:

• The disposal of building land (‘terrains à bâtir’) by a VAT-able company, the vendor will be subject to VAT. If the buyer intends to erect a building on the land, she/he would be subject to a Eur 125 registration duty, provided that the buyer undertakes to complete the building works within four years and complies with the undertaking. This deadline may be extended automatically for a year if the works have commenced by then. Further extensions not exceeding one year each time may be granted if this can be justified by force majeure or other very good reason.

• The purchase of a building to be demolished or to be entirely reconditioned would also be subject to VAT if the vendor is a VAT person. The EUR 125 registration duty would apply, provided that the purchaser undertakes to complete the construction within a four-year period.

• The vendor of a building in the course of construction would also be liable for the VAT. Registration duty at the rate of 0.715% would be payable by the buyer.

• The purchase of a new building within the first five years from the date on which it was built would also give rise to VAT for the VAT-able vendor. Registration duty at the rate of 0.715% would also be payable by the buyer.
VAT is calculated on the purchase price increased by any other consideration provided to the seller. Unless the parties agree otherwise, the VAT is due by the buyer. If the French tax authorities consider that the actual market value of the property is higher than the price or the market value declared, they could levy VAT on the actual market value.

According to the new rules and to administrative guidelines, the acquisition of a real estate property subject to VAT may benefit from a VAT exemption provided that:

- the property is not a building land; in that case, the vendor may elect for VAT
- the property is completed for more than five years; the vendor may also elect to submit the sale to VAT
- the vendor is not a VAT-able person.

**Registration duty**

The total effective rate of registration duty is, as a matter of principle, 5.09%.

Registration duty is calculated on the purchase price increased by any other consideration provided to the seller. Unless the parties agree otherwise, the cost of the registration duty is borne by the buyer.

If the French tax authorities consider that the actual market value of the property is higher than the price or the market value declared, they could levy registration duty on the actual market value.

In this case, the French tax authorities would charge interest for late payment at 0.40% per month (i.e. 4.8% per year). Furthermore, an additional charge of 40% will apply if bad faith is established, or 80% if a fraudulent intention can be demonstrated.

For companies or branch offices in France, registration duty is fully tax-deductible, either as expenses, or by way of depreciation allowances where transfer duties are capitalised.

**Taxation of income and capital gains**

Income from, and capital gains realised on the sale of, real estate in France are taxable in France, whether a French resident or a non-resident receives them. The same rule applies to the gain made on the sale of shares in a company whose assets consist mainly of French real estate, regardless of whether the company is French or not.

These principles are subject to those of any applicable tax treaty for the avoidance of double taxation, in the case of a non-resident of a State with which France has entered into such a treaty. France has entered into approximately 100 such treaties. According to article 6 of the OECD Model Convention, the form followed by France in the case of many treaties, provides that real estate income and capital gains are taxable in the State where the property is located. Obviously, only a case-by-case analysis will determine if France has the right to tax or not, and there are still few exceptions, especially in the case of old treaties.

Generally speaking, it can, as a result be said that the same rules will apply to rental income realised by a French or a non-French resident, while, as concerns capital gains,
there are specific rules for non-residents holding, directly or indirectly, French real estate assets.

Permanent establishment in France
In principle, the ownership of a French property by a non-French company does not in itself constitute a permanent establishment (PE) in France.

Nevertheless, the direct holding of French properties may constitute a PE either when the conditions provided by the PE article of the relevant tax treaty are met, or in the absence of a tax treaty, when one of the following criteria is met:

- The non-French company carries on part of its activities in France through a fixed place of business
- The activities of the non-French company in France cover a ‘complete commercial cycle’ (applies only in a non-treaty context)
- The non-French company carries on activities in France through a dependent agent acting on its behalf and which has an authority to conclude contracts in the name of the company (e.g. conclusion of lease agreements).

Should the French property constitute a PE, the net after-tax profit would be deemed to be distributed and subject to a branch tax at a rate ranging from 0% to 15% in the presence of a tax treaty, or a fixed rate of 30% otherwise. The branch tax could nevertheless be mitigated:

- if the net after-tax profit has been distributed to French shareholders, no branch tax is due; or
- if the head-office of the branch is located in one of the EU Member States and is liable to corporate income tax, no branch tax is due; or
- if the effective distribution is lower than the net after-tax profit, the branch tax would be levied only on the profits distributed.

Corporate tax
The taxable rental income corresponds to the gross rental income less deductible expenses both determined on an accrual basis, whether realised directly, or through a given French vehicle.

If the investment is realised through the most common corporate structures — French limited liability companies such as société anonyme (SA), société par actions simplifiée (SAS), or société à responsabilité limitée (SARL) — the income is subject to French corporate tax.

The standard rate of corporate tax is 33.33%.

The standard rate of 33.33% is increased by a 3.3% corporate tax surcharge that applies for companies with taxable income exceeding EUR 2,289,000. This surcharge results in an effective overall taxation rate of 34.43%.

The standard rate of 33.33% is increased by a 5% corporate tax surcharge that applies for companies with a turnover exceeding EUR 250m (excluding VAT). This surtax results in an effective overall taxation rate of 35%.
Real Estate Investments – France

For companies with taxable income exceeding EUR 2,289,000 and a turnover exceeding EUR 250m (excluding VAT), the effective overall taxation rate is 36.1%.

There is no specific rule governing the taxation of either real estate income, or capital gains when French companies make the investment.

When the investment is realised through a partnership type company, which has not elected to be liable to corporate tax, such as unlimited liability partnerships in the form of a société en nom collectif (SNC), or a société civile (SC), the taxable income is determined at the level of the company, but the burden of tax lies in the hands of the shareholders.

The tax regime applicable to non-resident shareholders is, therefore, rather complex, and it is necessary to examine the relevant tax treaty in order to determine if, in addition to French corporate tax, French tax at source will be levied, either on dividends, or on income of partnership type companies (the standard withholding tax (WHT) rate being 30% reduced to 21% for individuals located in the EU, Iceland and Norway).

**Personal income tax**

Where a taxpayer holds a property directly or through a tax transparent company, such as an SNC or SC, the taxable rental income corresponds to the cashed rental income less deductible expenses paid.

The net rental income received by a non-resident is subject to rates ranging from 0% to 45% (for income received in 2012). However, a minimum rate of 20% applies unless the taxpayer can demonstrate that had the taxpayer been resident in France, his/her effective rate of taxation would have been lower than 20%.

**Registration duty**

Regarding registration duty (droits d’enregistrement), French tax provisions will apply, in principle, on any transaction performed on a local asset.

**VAT**

If the rental activity is liable to VAT, the owner will be entitled to recover the input VAT paid on the acquisition of the real estate property, if any, and/or the VAT paid on all its further purchases of services or goods (VAT credits are either deductible or refundable). VAT refund claims can be filed on a monthly basis.

**Purchase of a real estate company**

**Legal aspects**

Unlisted real estate companies are limited liability companies, typically an SA, SAS or SARL, or unlimited liability companies, typically a société civile immobilière (SCI) or an SNC.

In addition to a full audit of the company itself and as in the case of a direct purchase of the real estate, a full audit of the underlying real property has to be conducted. The seller would be expected to provide, as in the case of an ordinary share deal, warranties and an indemnity in respect of any undisclosed liabilities and any undisclosed matters that adversely affect the company’s assets.
Unlike the case of a direct real estate purchase, the intervention of a notary is not mandatory. The seller and buyer typically instruct their usual lawyers and other advisers to advise them in connection with the deal.

For the purchase of all the shares of an SCI, the buyer may have to purge the urban pre-emptive right of the local municipality, but only in very specific cases:

- If the local municipality has set up a reinforced urban pre-emptive right (‘DPU renforcé’) for the area in which the company is located.

- If the only asset of the purchased company is a property which would have been subject itself to this urban pre-emptive right.

If those conditions are met, the buyer will have to follow the same procedure as described above under section ‘Formalities’ (DIA).

After the due diligence process, a share purchase agreement is drafted as well as a representations and warranties agreement.

**Tax aspects**

**Registration duty on the purchase of shares**

In principle, a transfer of shares is subject to a 0.1% transfer duty for the transfer of shares in listed or unlisted companies limited by shares. In practice, listed companies rarely are subject to the 0.1% transfer duty.

The rate applicable to the transfer of equity interests in companies whose capital is not divided into shares (e.g. partnerships as SNC or SCI) is 3%.

The rate applicable to the transfer of interests in real estate companies, regardless of the corporate form of the company sold is 5% with the exception of stock-listed companies.

A ‘real estate company’ is defined as being a company whose assets predominantly comprise (or have comprised at any time during the year preceding the time of the transfer) properties in France or shares in ‘real estate companies’. This definition is extremely wide. For example, a company that owns both an industrial business and the building in which the industrial business is operated would be regarded as a ‘property company’ if the value of the building exceeds the value of the business and other assets owned by the company. This 5% duty is also applicable to sales of non-French companies meeting the above assets test.

Since the rate of transfer duties levied on a sale of a real estate company’s shares is close to the one levied on a sale of property, buyers are now much more likely to prefer buying the real estate rather than the company which owns it. The advantages of a direct purchase are the following:

- It is more straightforward.

- It allows a charge to be taken over the real estate to secure the financing of the purchase.
• The building can be fully depreciated on the basis of the purchase price (and not its historical book value as it is the case with a share deal).

• There is no latent capital gain to monitor post-transaction.

But in certain cases it may still be more advantageous to acquire the company. Also, in the current market, a seller might prefer to sell the shares in the company for the following reasons:

• The gain resulting from the transfer of shares may be exempt in certain cases if the seller is a non-French seller.

• The 5% duty will only apply on the market value of all the assets (including the real estate properties) held by the company reduced by the debt used by the company to acquire the real estate property.

• The seller passes on any risks/liabilities that the latter does not specifically warranty.

The debate remains open, and sellers and buyers might, as a result, have contradictory/opposite goals.

**Direct tax liabilities**

As opposed to an asset deal scenario where the purchaser does not bear any previous tax liability in connection with the property itself (save for the royalty due on development of office premises), if the vendor is in default, in a share deal scenario, the purchaser will inherit all current or pending tax liabilities which may exist at the level of the target company, the worst of them being the 3% annual tax liability.

Consequently, as part of the due diligence exercise, the purchaser should carry out a tax review of the company before the purchase and negotiate a price discount and/or a tax warranty in order to protect its interests.

**Construction issues and new buildings**

**Legal aspects**

**Purchase of a new building under a ‘turnkey’ contract**

It is not unusual for a developer to sell a new building in the course of its construction on the basis of a ‘turnkey’ sale and purchase. The buyer will generally make an initial payment at the execution of the deed of conveyance commensurate with how far the works have progressed. Further stage payments will be made as and when the building works progress.

The trend is now for institutional buyers to pay an initial deposit at the outset and the entire balance of the price when the building is completed (the developer’s additional financing costs will be incorporated in the agreed price to reflect this). The final price may be adjustable depending on the level of the rental income achieved, i.e. the seller shares with the buyer the risks and benefits linked to the level of rents achieved for the property.

A seller will want insurances that the buyer will meet its obligation to pay the balance of the price. Usually this will take the form of a bank guarantee. The buyer will want to
ensure that the seller completes the building that complies with an agreed specification, which should be sufficiently detailed, within an agreed time frame.

The deed of conveyance will typically be divided into two sections, the first dealing with the general T&C of the purchase, and the second dealing with the related seller’s construction obligations.

The buyer will have the benefit of a guarantee from the seller, backed by an insurance policy, against all hidden defects of a structural nature, or which affect the installations that are incorporated into the structure and which appear during the ten years following the date on which the building is completed. This guarantee and insurance also benefits all subsequent owners during the same period. Hidden defects to other installations in the building benefit from a two-year guarantee.

Special public policy rules, outside the scope of this discussion, apply to residential property, even where an institutional investor acquires an entire apartment building.

**Regulatory issues**
Both the Planning Code and the Construction and Housing Code regulate building works.

**Development plan**
A development plan (‘schéma de cohérence territoriale’) is prepared by municipalities that have social or economic interests in common.

The development plan, which may be revised periodically, formulates policy and general proposals for development and use of land and the infrastructure in the area, so as to achieve a balance between urban development, farming and other economic activities and to preserve the quality of the air, of the countryside and of urban areas. Local authorities may be given the power to acquire land by compulsory purchase for planning and related purposes.

Other than in many rural communities, a local municipality (or several municipalities together) will usually prepare a local land use plan (‘plan local d'urbanisme’) for all or part of the land within its district. The land within the perimeter of the plan is zoned for different use and building density ratios are attributed to each zone. The land may be comprised in a development zone called a ‘zone d'aménagement concerté’ (ZAC), which may have its own rules.

**Building permit**
In general, any development of land in France requires a formal application for building permit to be made to the local planning authority and the development may not be carried out unless such permit is granted.

A building permit is also required in the following cases:

- Works to convert the use of an existing building,
- Any change to the exterior (shop front, addition of a balcony) or the volume of the building,
- The creation of additional floors.
Building permit must comply with the development plan, the local land use plan as well as specific legislation, which, for instance, restrict building in coastal or mountain areas.

Works to destroy a building require a demolition permit.

The building permit is not granted for a specific period. However, it will lapse if the building works are not commenced within two years (this deadline may be extended by one year) or if the works are interrupted for one year (or three years in the case of certain phased developments).

Once granted, the building permit is attached to the land and will pass to any subsequent owners, on condition that the planning authorities are informed of the transfer and the original owner of the land agrees to the transfer. The authorities then issue a modified building permit showing the identity of the new owner responsible for the works.

A transfer is not required in the case of a ‘turnkey’ sale, as the seller remains responsible for the works until the building is completed.

**Other consents**

Other consents may be required as a prerequisite to building permit or even where building permit is not required.

- A licence (commonly called a CDEC licence) is required to create new retail premises with a sales floor area of over 1,000 square metres or to change one retail category into another if the sales floor exceeds 2,000 square metres. A licence is also required to create hotels with over 50 bedrooms (or 30 bedrooms, if outside the Paris region) and cinemas with seating for more than 1,500 people.

- A licence, known as an ‘agrément’, is required to build, re-build, extend or to occupy offices, warehouses and industrial premises in the Paris region and which are over a certain size.

- A discretionary consent is required to convert residential premises to offices or any other use.

**Environment law**

This area used to be governed largely by private rights between individuals. Recently there has been a trend towards the creation of wider power and controls over the use of land and the environment that has increasingly taken the form of administrative powers exercisable by public authorities.

Specific rules under a law of 1976 govern ‘installations classées’ which are factories, workshops, warehouses, building sites, quarries, and generally any installation operated by or in the possession of any person which may be dangerous or be the cause of nuisance for the neighbourhood, for health and safety, for agriculture, for the environment or for sites and monuments of interest. A nomenclature identifies the different types of ‘installations classées’, and these are the subject of a prior authorisation or declaration depending on how serious a risk the installation may be.

Even if an installation is not an ‘installation classée’, it may be caught by other legislation relating to waste and noise pollution or the pollution of air and water.
depending on the type of the installation, the products produced and stored, and the substances discharged into the drainage system and into air.

In certain areas there is a prohibition on construction, e.g. in conservation areas of natural beauty, near airports and near certain 'installations classées'. Special rules restrict development in the mountains and along the coast.

The vendor will be required to produce a report from a licensed firm, showing whether or not there is asbestos in the false ceilings, lagging or flocking in the building, and what measures need to be taken, if appropriate.

**Historic buildings**

Any works of demolition, alteration or extension of buildings listed in whole or in part as being of historic or artistic importance ('monuments historiques') require a special authorisation from the Arts Minister and are overseen by the authority responsible for listed buildings ('Administration des Beaux-Arts').

In the case of works to other buildings of interest, listed as a subcategory of historic monuments on a supplemental inventory, prior notice must be given to the Arts Minister.

**Building works**

*Architect*

An architect must be employed for all building works for which a building permit is required, except when a building permit is applied for by an individual for their own use and for a project which does not exceed a certain threshold (a net built floor area (SHON) of 170 square metres in the case of non-agricultural buildings). The employer may also engage a quantity surveyor who measures the amount of work and materials necessary to complete the plans and sets this out in detail in bills of quantities.

**Builder’s liability**

*Ten-and two-year liability*

‘Builders’, who are defined by the Civil Code to include contractors, architects and other consultants involved with construction works or their design, are deemed liable towards the employer and any subsequent buyer for ten years from the handover of the works for the repair of any defects notified by the employer, which compromise the solidity of the works or effect their constituent elements (services, foundations, structural, enclosed or covered areas), or fixtures and which make the building unfit for its normal use.

During a period of two years from handover of the works, the builder is similarly liable for the repair of any defects notified by the employer, which effect fixtures that are detachable from the constituent elements of the works.

Such presumed liability is mandatory: it is not possible to contract out of it. But it is possible to rebut the presumption. If the builder can establish that she/he was not liable, she/he can avoid liability.

The builder may also be liable under the contract for negligence.

*Liability for apparent defects*

During the period of one year from handover of the works, the building contractor is liable for the repair of any defects notified by the employer, either through the réserves
(reservations) procedure or by written notification in the case of damage arising after handover of the works. The employer and contractor agree by when the defects must be remedied, failing which the court can determine this.

**Insurance**

**Builder’s insurance**

The builder is required to take out insurance to cover their liability for defects covered by the ten-year defects liability period (‘responsabilité décennale’ insurance).

In addition, an employer will want to ensure that a builder has taken out adequate professional indemnity insurance to cover their liability arising through negligence.

**Employer’s insurance**

The employer is required by law to take out insurance, for the benefit of itself and future owners, to cover the cost of remedying defects covered by the builder’s ten-year defects liability period (‘dommages-ouvrage’ insurance). Neither a company over a certain size (as defined by article R.111-1 of the Insurance Code), nor the State is obliged to take out such insurance if the building works are carried out for its own use and do not relate to residential buildings.

The builder is required to take out insurance to cover its liability for building works, which are covered by the ten-year defects liability period (‘responsabilité décennale’ insurance).

These insurance requirements are mandatory. Insurance should be taken out before the works are carried out.

The purpose of the ‘dommage-ouvrage’ policy is to enable the owner to receive insurance money quickly to make good the insured defects. The insurer paying under that policy will then seek to identify who, among the builders and consultants, was liable, and their respective share. The liable builders will be covered by their respective ‘responsabilité décennale’ policy.

It is prudent to ensure that extra cover is taken in both types of policies, i.e. to cover damage to adjoining buildings, defects covered by the two-year defects liability period, incorporeal loss resulting from insured loss, liability for errors from omissions and the cost of clearing rubble.

In addition, an employer will typically require the builder to have professional indemnity insurance, covering negligence and contractual liability and will take out site insurance to cover any damage to the works.

**Security in favour of the builder**

Article 1799-1 of the Civil Code requires the employer to provide the builder with security for payment of the price where the amount due exceeds a certain threshold. If the employer has recourse to a loan, the sole purpose of which is to finance the entire cost of the works, the lender cannot advance monies under the loan to anyone other than the contractor, until all monies due to the contractor have been paid. If there is no such loan or the amount is insufficient, and in the absence of any other security, a guarantee from an appropriate financial establishment must be granted.
**Subcontracting**

Subcontracts are governed by the French Law dated 31 December 1975, the provisions of which are mandatory. If a contractor subcontracts all or part of the work, the identity of the subcontractor and the T&C of payment must be approved beforehand by the employer. If not paid by its principal contractor, the subcontractor has a right to seek direct payment from the employer under the conditions provided by the law.

**Tax aspects**

**VAT**

Value added tax (VAT) at the standard rate (currently 19.6%) (20% as from 1 January 2014) is charged on the provision of construction services and works.

The developer can recover the input VAT in accordance with the ordinary rules, as follows:

- If the purchaser intends to use the building for its professional activities, VAT will be recoverable according to the purchaser VAT recovery ratio.

- If it is envisaged to let the building, the landlord may elect to charge VAT on the rents on unfurnished and unequipped premises. The election is made for a ten-year period on a building-by-building basis, and not on a lease-by-lease basis. The election is effective even in the case of leases to tenants, which are exempt from VAT, provided the lease expressly refers to the landlord’s VAT election. The election should be made as soon as is possible to secure input VAT deduction rights.

- Absent of any VAT-able activity, or if the election to charge VAT on rents is made lately, the rights of the investor to recover input VAT could be seriously jeopardised or even eliminated.

It is therefore critical that VAT elections be implemented from the very beginning, to improve the net performance of the investment. Lost input-VAT recovery would qualify as a fixed asset or as an expense only depreciable or deductible against corporate tax, i.e. a maximum 36.1% recovery instead of 100%.

**Corporate tax**

The construction of a building does not raise any specific issues as regards corporate tax. Until completion the constructions will be booked as ‘assets in progress’ so that no depreciation will be possible before being fully accounted for as fixed assets.

**Office premises development tax**

There is a specific tax for development of office premises within the Paris area (redevance pour création de bureaux en Ile-de-France) whose rates vary from district to district from EUR 94.45 to EUR 377.79 per square metre.

It is paid only once, and is not allowed as a deduction in computing rental income because it is deemed to be part of the acquisition cost of the land (neither deductible nor depreciable); it will, therefore be taken into account only in computing taxable gains upon a disposal.
Financing the acquisition of French real estate

**Legal aspects**

**Loans**
If the purchase price is financed by means of a loan, the lender will usually require security over the property. There are various kinds of security available.

**Mortgages**
A mortgage (‘hypothèque’) created by contract must be recorded by a notarised deed, so that it may be registered at the land and charges registry. A mortgage may also arise from a judgement or by virtue of a statutory right.

Mortgages take effect from the date on which they are registered at the land and charges registry. Duty at the rate of 0.715% is payable, calculated on the amount secured.

A mortgage can be granted by the owner at any time, and so can be provided by the buyer to a lender to secure any loan she/he may need after the acquisition (for instance, to finance the cost of works).

‘Privilèges’
Certain creditors have the benefit of a special charge known as a ‘privilège’. These include the seller of a property for the payment of the price if not fully paid on completion (‘privilège de vendeur’) and a person who advances the funds to the buyer to finance the purchase price, provided certain conditions are satisfied (‘privilège de prêteur de deniers’).

A ‘privilège’ is a charge over the real estate in the same way as a mortgage, save that the ‘privilège’ takes effect retroactively from the date on which the deed of conveyance is executed. The ‘privilège’ must be registered within two months from the date of the conveyance, failing which it becomes a mortgage, with no retroactive effect. The registration of a ‘privilège’ is not subject to the 0.715% duty.

**Antichrèse**
This is a real property interest (interest in rem) where the owner transfers possession of the real estate to a creditor by way of security. The creditor receives the income derived from the real estate, which is used to pay off the interest, and any surplus is deducted from the principal outstanding under the loan. The agreement must be in the form of a notarised deed so that it may be registered at the land and charges registry. This form of security is very rarely used. The registration triggers the payment of duty at the rate of 0.715% unless the ‘antichrèse’ is granted to the creditor under the loan agreement.

**Leasing agreements (‘crédit-bail’)**
Leasing agreements have often a 12- to 15-year duration, the lessee having the right to exercise its option to acquire the property at the end of the lease, or earlier as may be provided under the contract.
Minimum equity funding requirements

Besides thin capitalisation rules for tax purposes described hereafter, there are minimum share capital requirements for certain French companies.

- **SA**: EUR 37,000, of which at least 50% must be immediately paid-up, and the remainder within five years.
- **SAS**: no minimum share capital is required but at least 50% must be immediately paid-up, and the remainder within five years.
- **SARL**: EUR 1 to be paid-up on incorporation.
- **SCI or SNC**: no legal minimum.

French company law also requires certain companies, such as an SA, SAS and SARL, to have a minimum level of net equity (‘capitaux propres’). When the net equity falls below 50% of the issued share capital, the company will need to restore such a situation within two years.

Such a thin capitalisation rule does not apply to partnership type vehicles such as an SCI or SNC.

**Tax aspects**

Finance lease

The tax regime of these contracts has been totally amended for those concluded as of 1 January 1996. The current rules are set out below (other rules apply for contracts concluded before this date).

Publication of the contract

If the lease is granted (usually by a dedicated financing company) for a period exceeding 12 years, the contract must be registered at the Land Registry and this gives rise to registration duty at the rate of 0.715% levied on the total rents (minus that part of the rent that corresponds to the financing costs) payable over the entire duration of the lease (subject to a cap of 20 years if the lease exceeds that duration).

Rental tax or VAT on rents

Rents are either subject to VAT (at the standard rate of 19.6%) (20% as from 1 January 2014) if the rented premises are professional furnished ones or if the lessor has elected for VAT. Otherwise, rents are liable to a rental tax equivalent to 2.5% of the annual rent if the building is over 15 years old.

Tax deductibility of the rents paid by the lessee

In principle, rents are tax-deductible, except for the portion that corresponds in fact to non-depreciable assets (i.e. essentially the land), with several specific rules for office premises located in the Paris area and completed after 31 December 1995. The financing company itself communicates the amount of the rent that is deductible to the tenant.

Purchase of the building at the end of the lease

The purchase of the building by the tenant at the end of the finance lease gives rise to registration duty at an effective rate of 5.09%, which is calculated on the option price only. However, VAT may apply instead of registration duty in the rare cases where
the option is exercised within five years from the date on which the building was completed.

In the case of finance leases signed since 1 January 1996, the rate of duty will be calculated on the market value of the property, appraised as of the date of the purchase by the tenant, if the finance lease was granted for more than 12 years and the contract has not been filed at the Land Registry.

From a corporate tax point of view, the lessee must, in principle, add back to its income an amount equal to the following:

The value of the building at the date of the conclusion of the finance lease contract, less:

- the price payable under the option
- the amount of the depreciation which could have been recorded by the tenant had it been the owner of the premises minus the part of the rents which were not tax-deductible.

**Loans**

*Tax deductibility of interest on loans*

Under French law, there is no mandatory debt-to-equity ratio with regard to the means through which a French company may manage its indebtedness.

However, the French tax authorities tend to look more and more closely at the level of indebtedness of companies. A French company should not borrow from a company within the group to which it belongs, an amount which it could not have obtained from a third-party lender and it should always be in a position to pay all its financial charges as they fall due.

The financial charges borne by a French company in consideration for a loan contracted for the needs of its activity (e.g. in order to purchase assets) are tax-deductible, providing that the T&C of the loan are on an arm’s length basis.

In addition, new thin capitalisation rules apply to fiscal year opened after 1 January 2007.

**Barrier on deductibility of financial expenses**

As developed above, a new cap on interest expense deductions for companies subject to CIT in France. Companies with net interest expenses over EUR 3m are subject to a limitation on their full interest expense, capping the deductibility at 85% of the interest for financial years closed as of 31 December 2012, and 75% of the interest for financial years opening as from 1 January 2014.

**Thin capitalisation rules**

The thin capitalisation rules apply for the computation of the tax results of all the companies subject to corporate income tax and, according to the French tax authorities (FTA) Guidelines dated 31 December 2007, tax transparent entities owned by companies subject to corporate income tax, French PEs of foreign entities.

Foreign entities owning French real estate are also subject to these rules when computing their taxable income.
The tax deductibility of the interest paid on loans granted by related parties is subject to following limits:

**First limit: Interest rate limitation**

The interest paid to related parties is limited to the highest of:

- interest computed on the basis of the average yearly interest rate granted by credit institutions to companies for medium-term loans of more than two years (e.g. 3.39% for FY 2012)

- interest rate that the borrower could have obtained from an independent bank under similar conditions.

**Second limit: Debt-to-equity ratio**

Tax deductibility of interest charge is denied when the interest exceeds cumulatively all of the three following limits during the same financial year:

- Interest relating to financing of any kind granted by related parties paid in excess of 150% of the net equity of the borrower. This limit is to be estimated (to the convenience of the borrower) either at the beginning or at the closing of each relevant fiscal year. Interpretative guidelines from the FTA allow the borrowing entity to use the share capital (fully paid up) when it is higher than the net equity.

- Interest expenses exceeding 25% of the current result before tax, before interest owed to related parties, before amortisation allowances and before a portion of financial leasing charges.

- Interest received by the borrower in connection with financing granted by the borrower to related parties.

The portion of interest exceeding the highest of these three thresholds is not deductible during the relevant fiscal year except when this portion is lower than EUR 150,000.

Furthermore, under a safe harbour provision, thin cap rules should not apply if a French borrowing entity demonstrates that the overall debt-to-equity ratio of the group to which it belongs (including foreign parent and foreign subsidiaries) is higher.

Specific thin cap rules apply to tax consolidation.

In addition, when interest is paid on a third party’s financing, and a guarantee for the repayment of that financing is provided either by a related party, or by a party whose commitment is itself secured by another company (which is also related to the borrowing entity), then the proportion of interest that is payable on the secured part of the financing is treated as interest paid to a related party and, therefore, subject to the thin capitalisation limits of article 212 of the French Tax Code.

When repayment of the loan is secured by a personal guarantee, the portion of interest that would be reclassified as related-party interest would correspond to the amount of interest paid in relation to the secured portion of the third-party debt.

When repayment of the loan is secured by a guarantee *in rem*, the same principle would apply, except that the portion of the loan which is guaranteed would be determined according to the following ratio: value of the asset at the date on which
the security has been constituted against the initial amount of the financing. Accordingly, the interest payable in relation to this secured portion of the third-party debt would be reclassified as related-party interest for thin cap purposes.

The term ‘guarantee’ is not defined. As a result, any kind of guarantee is covered, whether personal guarantees or guarantees in rem (for instance, mortgage on a property).

However, the new provisions provide some exceptions where although the financing is guaranteed by related parties, thin capitalisation rules do not apply. This would notably be the case if:

- the financing takes the form of a bond issued by way of a public offering or under equivalent foreign regulations;
- the loan is guaranteed by a related party solely by way of a pledge of shares against the borrowing entity;
- the loan has been obtained in connection with the acquisition of shares or its refinancing; or
- the loan is obtained in the context of a refinancing to allow the debtor to complete the mandatory repayment of a pre-existing debt, which is required as a result of a direct or indirect takeover of the debtor. This exclusion should allow the refinancing of secondary LBOs without the refinanced loans falling within the scope of the new provisions.

**Withholding tax on interest**

No WHT applies on interest paid to a foreign lender provided that such lender is not located in a non-cooperative country (in this case, a 75% WHT applies). The terms ‘non-cooperative States or Territories’ refers, under French tax law, to any State or country which does not comply with international measures against tax fraud and tax evasion. The list published by the French tax authorities of the ‘non-cooperative States or Territories’ as of 1 January 2012 includes: Guatemala, Montserrat, Philippines, Brunei, Nauru, Marshall Island, Niue and Botswana.

**Remuneration of shareholders**

**Limited liability companies**

After-tax profits distributed to its shareholders by a French limited liability company qualify as dividends. When distributed to non-resident shareholders, dividends are, in principle, subject to WHT, deducted at source, at a rate of 30% for the entities, 21% for the individuals resident in the EU, Iceland and Norway, and 75% if paid in a non-cooperative State or territory.

Applicable tax treaties may however provide for a reduced rate or no taxation in France at all, where certain conditions are met.

In response to the European Court of Justice (ECJ) decision Denkavit rendered on 14 December 2006, the French tax authorities have amended the tax treatment of the French source dividends paid to European companies (Administrative guidelines dated 10 May 2007). Accordingly, as of 1 January 2007, dividends paid by a French company to an European company benefit from a WHT exemption if:
• the parent company has held more than 5% of the share capital of the French company during a minimum two-year period; and

• the parent company cannot deduct the French WHT in its resident state.

**Unlimited liability companies**

Profits distributed to the shareholders of a tax look-through partnership-type vehicle, such as a SCI or SNC, are not treated as dividends and are not subject to French WHT on dividends.

Also, more generally, and regardless of the place of residence of the parent company, the mere ownership of shares in a French partnership vehicle does not constitute in itself a PE in France and, therefore, no branch tax liability is due in France in consideration for the profits repatriated. However, these issues need to be checked on a case-by-case basis.

**Managing French real estate**

*Legal aspects*

**Management**

Typically, an investor will engage a managing agent to deal with the collection of the rents and with the day-to-day management of the property.

The activity of purchase and resale of real estate property for third parties is governed by the French Loi Hoguet dated 2 January 1970, under which it is mandatory for any real estate agent or real estate asset manager to obtain a professional card from the French ‘préfecture’. This card mentions the permitted activities of the holder and is delivered by the administration, subject to specific conditions to be met by the applicant, such as:

• Professional skills

• Financial guarantee

• Professional insurance

• Civil conditions (no civil incapacity, interdiction measures etc.)

This card is delivered for a ten-year duration and can be cancelled at any time by the administration if the holder does not satisfy the above-mentioned conditions anymore.

This procedure does not apply if those activities are performed in a group of parent companies.

**Commercial leases**

*Introduction*

Commercial leases in France are, in principle, governed by a decree (law) dated 30 September 1953, which is now codified under articles L.145-1 et seq. and R. 145-1 et seq. of the French Commercial Code.
The statutory provisions give the tenant certain protection, in particular with regard to rent reviews and a so-called right of renewal. But not all commercial leases benefit from these statutory provisions. Where the statutory provisions would not normally apply, it may be possible for the parties to contract into its provisions.

**Conditions to be met for the statutory provisions to apply**

To benefit from the statutory provisions, the requirements to be satisfied may be summarised as follows:

- The lease must be granted for a commercial, industrial or craft activity.

- The business must have been effectively carried out in the leased premises during a three-year period prior to the end of the lease or the date of renewal.

- The business must belong to the tenant.

- The tenant must be (whether incorporated or unincorporated) either registered at the Trade and Companies Registry or at the Arts and Crafts Registry for the premises in question. The registration must exist on the date on which (i) notice is given by the owner, or (ii) the application to renew is sent by the tenant to the landlord.

- The tenant must be a member of the EU or, if he is a French resident, must at least (since the law dated 24 July 2006) hold a temporary residence permit authorising him to carry out a professional activity. If the tenant is not a French resident, a simple declaration to the French ‘préfecture’ is sufficient.

The statutory provisions may also apply to leases of schools and some other cases.

**Characteristics of a commercial lease**

**Term**

Commercial leases must be granted for a minimum nine-year term, but the parties may agree on a longer period.

Leases granted for a term exceeding 12 years must be registered at the Land Registry (‘conservation des hypothèques’) and so must be executed as a notarised deed. Due to the costs involved (cadastral tax) commercial leases for more than 12 years are very rare.

The tenant has the right to terminate the lease at the end of every three-year period subject to a six-month prior notice. But the tenant may also waive their right to terminate, particularly during the first period of the lease and agree to remain in the premises for the first six years.

This is likely to be in consideration for accommodating a tenant’s request during negotiations, for instance, for a reduction in rent or a rent-free period or for a contribution towards the cost of the tenant’s fit out works.

**Renewal**

Under a statutory commercial lease, the tenant benefits from protected tenancy rights. She/he has a statutory right of renewal at the end of the lease. The landlord has the right to serve notice of non-renewal or refuse to renew a commercial lease, but this entitles the tenant to compensation from the landlord. The lease is renewed on
the same T&C as the previous lease for another nine-year period unless the parties expressly agree on a longer term.

The lease may be renewed, even if the parties have not yet agreed on the amount of the rent of renewal.

If the parties remain silent after the expiry of the lease, it is automatically renewed for an undetermined term (all the other conditions of the lease remain the same). In this case, each party is entitled to terminate the lease at any time.

Rent
The rent is freely determined by the parties at the outset. For retail premises, it is not uncommon for the parties to agree for the rent to be calculated by reference to the tenant's turnover, subject to a minimum annual rent (which itself is usually set up at the market value). This now tends to be the rule in shopping centres and is becoming frequent in certain retail streets.

The rent is usually paid quarterly in advance or in arrears.

Indexation
It is usually provided that the rent is indexed annually. The index chosen by the parties must either be the INSEE cost of construction index (ICC), which is usually the one chosen, or an index that is in relation to the activity of one of the parties, failing which the indexation clause is void. The parties may also choose the new commercial rents index (ILC, composite index published quarterly by the INSEE), which has been implemented by a Decree dated 4 November 2008. This index is applicable to all the new commercial leases or may be chosen by the parties at the renewal of the lease.

Guarantee
A landlord will invariably ask for some form of security. This may be a security deposit (equivalent to three or six months’ rent). In this case, interest may be payable to the tenant if the amount of the rent payable in advance and the amount of the deposit together exceed six months’ rent.

A bank guarantee, in the form of a statutory guarantee or a first-demand guarantee, is commonly required (this guarantee may be transferred to the purchaser of the property unless otherwise stipulated). A parent company guarantee may also be required.

Subletting
Prohibited, unless the lease provides otherwise.

Transfer of the right to lease
The lease generally prohibits assignments. However, a landlord cannot prohibit a tenant from assigning their lease to the purchaser of their business. But the lease may lawfully provide formalities to be complied with (e.g., a requirement to inform the landlord in advance), or conditions to be satisfied (e.g., the landlord to be satisfied that the assignee is solvent) to assign the lease to the purchaser of the business.

Permitted use
Such clauses are now standard. The tenant may not use the premises for any other activity than the activity described in the lease without obtaining the landlord's prior consent. The statutory provisions set out the procedure to be followed for extending
the permitted use to ancillary activities, or to add to, or change the permitted use if the parties cannot agree.

**Improvement of the premises**

Usually, the landlord will have the contractual right to keep the tenant’s improvements at the end of the lease without having to pay any compensation to the tenant. However, the landlord is entitled to require the premises to be reinstated.

**Determination of rent on renewal**

The parties may freely determine the rent on renewal but the rent on renewal must correspond to the rental value of the premises.

If the parties do not agree, as is often the case, either party may apply to the court to fix the rent. The court will, in principle, apply the market rent. The following are taken into account in determining the market rent:

- The characteristics of the leased premises.
- The use for which the premises may be employed.
- The parties’ obligations under the lease.
- Local commercial factors that have an effect (positive or negative) on the business (these include the importance of the town, area or street where the business is located, the location of the business itself, the nature and whereabouts of the other businesses in the vicinity, the means of transport, the particular attraction of the location for the business in question, and permanent, durable or temporary changes to these factors).
- The current rents in the area.

If the lease to be renewed was granted for a nine-year term, the statutory provisions require the increase (or decrease) in rent to be capped.

If the rent is capped, the rent payable under the new lease cannot exceed the initial rent under the expired lease, as adjusted to take into account the variation of the cost of construction index published quarterly by INSEE (national institution of economic statistics) over the expired nine-year period. The rent payable under a new lease will, as a result, often be less than the market rent, and this can in the course of time add considerable value to a lease.

Capping will not apply if one of the parties can prove that, during the lease to be renewed, there have been substantial and significant changes to the premises, to their use, to the parties’ obligations under the lease, or to the local commercial factors used to set the initial rent.

As an exception, the capping rules do not apply to the following situations:

- Leases of land
- Leases of premises required to be used as offices only
- Leases of premises built for a specific single purpose (cinemas, hotels and theatres will often fall into this category)
• Leases with a term of more than 9 years or entered into less than 9 years, but having effectively lasted for more than 12 years (tacit renewal)

In the case of offices, the market rent will apply. For single purpose buildings, the rent is calculated essentially on the basis of a theoretical turnover derived from the number of seats or beds. The rules for land are also different, but it is essentially a market rent that will apply.

**Compensation for non-renewal: eviction indemnity**

As has already been mentioned, the landlord has no obligation to renew the lease. If the landlord refuses to renew the lease of a protected tenant, she/he will be under an obligation to pay them an eviction indemnity, unless the tenant has failed to remedy a breach of a fundamental provision of the lease after a formal notice to remedy the situation has been served, or if the premises are about to be totally or partially demolished because they are considered by the authorities insalubrious or dangerous. The purpose of the eviction indemnity is to compensate the tenant’s loss suffered by the non-renewal of their lease.

The following will be taken into account to determine the amount of the eviction indemnity:

• The loss of business
• The removal costs
• Relocation, moving expenses
• The price and costs relating to the acquisition of a similar business with an equivalent value

But the amount of the eviction indemnity may be reduced, if the landlord is able to establish that the tenant’s loss is less than that determined by these factors.

If the parties are unable to agree, the courts determine the amount of the eviction indemnity.

**Rent review**

Both the tenant and the landlord are entitled to ask for the rent to be reviewed after at least three years have run from the commencement date or from the previous rent review. The new rent takes effect from the date on which one of the parties has made a proper request for the rent to be adjusted. The request must be made by *huissier* (bailiff), or by letter sent by recorded delivery and must specify the new rent sought by the applicant.

If the parties fail to reach agreement on the new rent, the matter may be referred to the courts.

If it can be established that since the rent was last agreed or reviewed there has been a material change in the local commercial factors, which has alone caused the rental value of the premises to vary upwards or downwards by at least 10%, the judge will fix the rent according to the new rental value of the premises, applying the same criteria as those applicable for the determination of the rent on renewal. The new rent can theoretically be lower than the initial rent.
If, as is usually the case, there has not been any material change in the local commercial factors (or if the rental value of the premises has changed by less than 10%), the new rent will be capped, as the increase or decrease in the rent cannot exceed the variation of the ICC index over the same period. Furthermore, if there has not been any change in local commercial factors, the rent cannot be decreased, even if the rent is higher than the rental value.

It should be noted that in determining the market value of the premises, where relevant, the judge would, in practice, tend to rely on the report of the expert appointed by the court. In the absence of meaningful published figures, the appointed expert will deduce the appropriate rent from other decided rent review cases. Consequently, rents fixed judicially tend to be far less than the true market value. A situation is developing whereby judicially fixed ‘market rents’ and open market rents are drifting apart.

The statutory rent review provisions are mandatory. The parties cannot, therefore, contract out of these. However, certain mechanisms are available to avoid these statutory provisions applying.

**Professional leases**

Leases of premises to a tenant carrying on a professional activity are governed by the Civil Code and also by article 57A of a law of 23 December 1986. Professional leases must be granted for a minimum term of six years. The tenant has no right of renewal but has the right to terminate the lease at any time by giving at least six months’ prior notice. There have been a number of attempts to introduce new measures, but so far these have been abandoned.

**Tax aspects**

**Taxation of rental income**

**Corporate tax**

Under current tax provisions, tax losses can be used as follows:

- The carryback of tax losses is limited to the fiscal year in which the losses arise – any surplus would only be available for carryforward;

- The carryforward of tax losses is limited when the taxable result exceeds EUR 1m. In this case and for the portion that exceeds EUR 1m, companies are entitled to use tax losses to shelter only 50% of taxable profits (i.e. corporate income tax would be payable on at least 50% of the taxable result). Tax losses that were not used in a given year can be carried forward in their entirety (i.e. there is no forfeiture of unused tax losses).

The taxable income is equal to the gross rental fees less deductible expenses, both determined on an accrual basis such as (provided that they clearly relate to the French rental activity):

- Employee costs.

- Local taxes (e.g. local real estate taxes).

- Registration duty borne on the acquisition of the property which may either be fully deducted as an expense for the financial year in the course of which the acquisition was made, or be depreciated with the property over the useful life of the property.
• Irrecoverable VAT, i.e. VAT borne on purchase of services, or goods that are related to a non-VAT-able activity.

• Other general expenses such as management fees and insurance premiums.

• Interest on a loan contracted in order to purchase and/or refurbish the French property (subject to limitations on related party loans).

• Depreciation allowances (excluding the land element, which is non-depreciable) provided that they are recorded in the accounts.

Since 1 January 2005, French generally acceptable accounting principles (GAAP) have been amended, and therefore, rules governing depreciation of buildings have been changed. Permanent assets are to be split into ‘components’ and depreciated accordingly. Main structure and elements subject to replacement at regular intervals, having different uses or providing the company with economic benefits and following different rhythms, require proper rates and depreciation methods, e.g. for a building, structure/elevator/plumbing are depreciated over the life duration of each of these components. However, the French tax authorities admit that the structure can be depreciated on the basis of the standard rates provided in administrative guidelines before 2005 (i.e. depreciation rate between 2% and 5% for commercial premises, 4% for offices and 5% for industrial facilities/warehouses).

The depreciation of the property has a direct negative impact on the capacity of the company to distribute dividends: the accounting result may be lower than the amount of available cash. Consequently, should the shareholders have minimum cash repatriation requirements, it is necessary to identify other means for repatriation of the excess cash, e.g. shareholder loans and/or share premiums that can be easily reimbursed.

For properties held by a look-through entity (such as an SCI or a société en nom collectif (SNC)), the deductible depreciation charge can be limited by the amount of the net rental income generated by the property (difference between the rents and all the property-related costs, interest included).

**Personal income tax**

Non-treaty-protected individuals owning a property in France without renting it out on an arm’s length basis, are subject to personal income tax on the basis of three times the rental value of the property. Tax treaty protected individuals are not subject to this minimum taxation and are only taxable in France if they let their property.

Non-French individuals who rent out their French property are subject to French income tax on rentals. In accordance with domestic rules, the taxable income is equal to the rental income (including expenses that are paid by the tenant but which should have been borne by the landlord) less deductible expenses such as (provided that they clearly relate to the French property):

• Repairs, maintenance and improvements (other than construction expenses).

• Employee costs.

• Local taxes.

• Managing agent’s fees.
• Insurance premiums for loss of rents.

• Interest on a loan contracted to finance the purchase and/or refurbishment of the French property (provided that the property is rented to a third party).

Registration duty paid upon the acquisition is not tax-deductible from rental income. It is deductible from any taxable capital gain generated by the sale.

Real estate losses, excluding those generated by interest charges, can be set off against the landlord’s other taxable income up to EUR 10,700 and carried forward over six years.

**VAT on rents and rental tax**

The letting of furnished or unfurnished lettings for dwelling purposes is, in principle, exempt of VAT, but subject, if the building is over 15 years old, to a rental tax at the rate of 2.5%, which is levied on the annual rental income.

The letting of furnished professional premises and parking lots is liable to VAT at the standard rate of 19.6% (20% as from 1 January 2014).

Finally, the letting of unfurnished professional premises is, in principle, exempt of VAT and subject to the 2.5% rental tax. The lessor can, however, elect for VAT within 15 days after the beginning of the rental activity (in such a case, rents are exempt of the rental tax).

A VAT election is valid until it is revoked. It has to be made building by building and is possible when the tenant is liable to VAT and uses the building for its commercial activities – the VAT election is also possible when the tenant is not subject to VAT (e.g. an administration that will use the building for its administrative activities), but in such a case, the VAT election must be expressly stated in the lease contract.

**The 3% annual tax**

**Scope**

French or non-French entities, with or without legal personality, including trusts and similar vehicles, owning either directly or indirectly (and whatever the number of companies interposed between the building and the ultimate shareholders) real estate properties located in France, which do not perform a professional activity other than a rental one, fall within the scope of a 3% property tax levied annually, for assets owned on 1 January, on the fair market value of the real estate property located in France.

**Exemptions**

The 3% tax does not apply to:

• Sovereign States, public bodies and entities with or without legal personality held for more than 50% by a sovereign State or a public body.

• Entities with or without a distinct legal personality (including trust and similar entities) owning directly or indirectly real estate properties located in France where the fair market value is below 50% of the total value of the French assets held directly or indirectly by the entity. The French properties that are allocated to a professional activity (other than a pure real estate activity) are not included for
purposes of computing the 50% ratio, including where the professional activity is carried out by a related party.

- Entities with or without a distinct legal personality (including trust and similar entities) where the stocks are admitted to negotiation on a regulated market and are regularly and significantly traded and their wholly owned subsidiaries (held directly or indirectly).

- The following entities with or without separate legal personality (including trusts and similar entities) having their registered office in France, in an EU Member State or in a country that has concluded a double tax treaty (DTT) with France that includes an administrative assistance or a non-discrimination clause:
  - Entities owning directly or indirectly French properties, where the share ownership value in said French properties does not exceed either EUR 100,000 or 5% of the fair market value of the French properties.
  - Pension funds (or charities publicly recognised as fulfilling a national interest) whose activity supports the need to own French properties.
  - Non-listed French open-ended real estate funds (SPPICAV and FPI) and foreign funds subject to equivalent regulations.
  - Entities that file each year by 15 May, or undertake to disclose to the FTA at first request, information on shareholders owning more than 1% of share capital. The undertaking to disclose must be filed in principle upon the acquisition of the French property or upon the acquisition of a stake leading to indirect ownership in French properties.
  - Entities that file every year by 15 May, information on shareholders (owning more than 1%) about whom they have detailed information.
  - In all cases, foreign entities must be able to produce tax residency certificates proving that the local tax authorities consider that they are genuine tax residents.

Consequently, the use of entities located in either tax haven countries or which are excluded from tax treaty benefits (or which do not wish to reveal the names of their own shareholders) in order to hold directly or indirectly buildings located in France must be avoided. Otherwise, the 3% annual tax will be due. During years 2010 and 2011, a great number of exchange of information treaties have been entered into with former tax havens (e.g. Jersey, Guernsey, Liechtenstein) enabling companies resident in those countries to be exempt from the 3% tax provided that they meet the exemption requirements (filing/undertaking to disclose information).

It should be noted that the French tax authorities has stated that companies that have failed, in good faith, to file the required documentation, but which could otherwise have benefited from an exemption, may regularise their situation vis-à-vis the 3% tax either spontaneously or upon request, without incurring the risk of having to pay the tax.

**Wealth tax (Impôt de Solidarité sur la Fortune (ISF))**

Under French domestic law, a non-resident individual, owning directly or indirectly, a French real estate property is liable to French wealth tax if the global net value of all

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his/her French assets exceeds EUR 1.3m as of 1 January 2013; the rates are those of a progressive bracket scale, which range from 0% to 1.5%.

The indirect ownership test is met either when (i) an individual owns shares in a company, French or not, whose assets mainly consist, directly or indirectly, of French real estate properties or, (ii) in the case where the interposed company’s assets do not consist mainly of French real estate properties, if said individual, together with his/her spouse, parents, children, sisters and brothers, holds, directly or indirectly (and whatever the number of interposed legal entities or organisations) 50% of the capital of a legal entity or organisation owning a French real estate property.

The application of these provisions will, of course, depend on the terms of the applicable tax treaty, if any, from which said individual may seek the protection.

In this respect, it must be noticed that not all tax treaties deal with wealth tax issues, and in such a case, French domestic tax provisions will apply unilaterally.

The ISF will be levied either on the value of the property if it is held directly, or otherwise up to the value of the shares held directly by the taxpayer and deriving from the French property.

**Business licence tax (Contribution Économique Territoriale)**

As of 1 January 2010 the existing business tax has been replaced by the so-called ‘Cotisation Économique Territoriale’ (‘CET’). CET will consist of two elements: (i) the ‘Cotisation Foncière des Entreprises’ (‘CFE’), assessed on the rental value of properties and (ii) the ‘Cotisation sur la Valeur Ajoutée des Entreprises’ (‘CVAE’), computed on the basis of value added.

The CET will impact real estate investors who rent unfurnished properties in France as this type of activity was so far kept outside the scope of business tax as it did not constitute a professional activity for these purposes.

The main changes are as follows:

- Under the new provisions, renting unfurnished real estate (excluding residential property) expressly falls into the category of a professional activity and hence within the scope of the new business tax. Before 2010, where a property was rented out, the rental value of the real estate was assessed to business tax in the hands of the tenant who undertakes the professional activity in the property.

- The CFE will be due by the tenant on the same basis as before and therefore the landlord will not be subject to CFE.

- What is new is that CVAE will now be payable by the landlord of the property that is let and the landlord will be taxable, based on the value added derived from the rental activity. CVAE will be payable by the landlord of the property if their turnover exceeds EUR 500,000.

- The CVAE rate has a progressive rate, which will go from 0.5% for turnover of EUR 500,000 up to 1.5% for turnover exceeding EUR 50m.

- The percentage of revenues and expenses earned in relation to the rental activity and taken into account in order to calculate the value added will be reduced to 10% in 2010, 20% in 2011, 30% in 2012, increasing to 90% in 2018.
Local real estate taxes (rates)
The two main local taxes are the dwelling tax (*taxe d’habitation*), payable by the individual who disposes of a furnished residential property, and the real estate tax (*taxe foncière sur les propriétés bâties*), payable by the real estate owner. Generally, leases will provide that the tenant is to reimburse the landlord the *taxe foncière*. The *taxe d’habitation*, in the case of residential leases, is borne by the occupant.

Both taxes are based on the cadastral rental value of the property (which is lower than its real rental value) and their rates are fixed, on a yearly basis, by the local authorities.

Tax on ownership of office premises, commercial premises and warehouses
The tax on the ownership of office premises, commercial premises and storage space in the Paris area (*taxe annuelle sur les locaux à usage de bureaux, les locaux commerciaux et les locaux de stockage en Île-de-France*) is due annually by the owner of buildings (this tax, which is deductible from the taxpayer’s income, is often recharged to the tenants).

For office premises, the amount of tax varies from district to district from EUR 4.96 to EUR 17.48 per square metre (office premises under 100 square metres are exempt from this tax). For commercial premises, the tax varies from district to district from EUR 1.99 to EUR 7.70 per square meter (commercial premises under 2,500 square metres are exempt from this tax). For warehouses, the amount of tax varies from district to district from EUR 1 to EUR 3.97 per square metres (commercial premises under 5,000 square metres are exempt from this tax).

Sale of French real estate

*Legal aspects*
The sale of the investment must be carefully examined beforehand, as the methods used to dispose of a real property may totally differ from the methods used to purchase it.

The various investigations sought by the buyer will be made during an audit and preparatory stage. During this stage, the commitment of sale or the agreement of sale (*promesse unilaterale ou synallagmatique de vente*) and other preliminary contracts will need to be executed, and once again, because they are time-consuming, they should be prepared in advance if a given deadline needs to be met for the implementation of the disposal.

The precautions for the seller will mainly be implemented through warranties securing the total payment of the price, which is deemed net of any fees and expenses that are supposed to be borne by the buyer.

There is no warranty provided by the seller except for the declarations and representations mentioned in the notary deed (ownership, etc.). These declarations and representations would not apply if the seller sells shares of the company that owns the property.
**Tax aspects**

**VAT and registration duty**

As previously mentioned, the sale of real estate and/or shares of real estate companies are subject either to VAT or to registration duty calculated on the price, or the value of the shares, if higher.

**Taxation of capital gains**

In principle, based on French domestic tax provisions, any non-resident is liable to a WHT on capital gains arising from the sale of either real estate in France or the shares in a real estate company whose assets mainly consist of French properties.

This WHT will not be levied if it can be considered that the investors carry out a business in France and use the real estate for the purpose of their business (a mere rental activity will not be eligible).

However, the application of this WHT will mainly depend on the provisions of the relevant tax treaty since some of them do not attribute to France the right to tax such capital gains, but this exclusion mainly concerns the sale of real estate company shares.

**Sale by non-resident companies**

If France has the right to tax the gain, a withholding will be levied, the said WHT being deductible against the company’s liability to corporate tax in France, and any excess WHT is refundable.

**Sale of the real estate**

For the purposes of the WHT payable by a company, the taxable capital gain is equal to the difference between the sale price and the purchase price. The rules differ depending on the country of residence of the company.

If the company is located in the EU, Iceland and Norway, the rules to determine the taxable capital gain are the same than the ones applicable to French resident companies.

Otherwise, the taxable capital gain is reduced by 2% per year of ownership (this 2% reduction only applies to the portion of the acquisition price of the buildings, i.e. excluding the land).

The net capital gain will be subject to a one-third WHT.

The one-third WHT must be paid when the notarised deed of conveyance is filed at the Land Registry and the French tax authorities. The notary will collect the tax from the seller. An accredited French tax representative must be appointed in order to file a tax return and pay the tax on behalf and in the name of the seller. The transfer of the real estate is subject to the payment of the WHT.

**Sale of the shares in a real estate company**

The taxable basis is equal to the difference between the sale price and the purchase price of the shares.

The net capital gain will be subject to a one-third WHT.
If the real estate company is a French SARL or SCI, the sale of its shares must be filed with the Commercial Registry which, in practice, may refuse to register the sale if, beforehand, the seller has not succeeded in having the share transfer agreement registered with the French tax authorities.

**Sale of the shares in a SIIC or a listed real estate company**

The sale of the shares in a SIIC or a listed real estate company on regulated French or foreign market is subject to a 33.33% WHT if the seller holds directly or indirectly at least 10% of the share capital of the company where the shares are transferred. If the seller is an EU tax resident, the WHT rate is decreased to 19%.

**Sale by non-resident individuals**

If France has the right to tax the gain, the WHT is paid in full and final settlement is made of all tax due in France on the gain made by the non-resident.

The below described regime applies to the sale of:

- the real estate;
- shares in in a tax transparent real estate company;
- shares in real estate company subject to CIT;
- shares in a SIIC, a listed real estate company or a SPPICAV

The capital gain is equal to the difference between the sale price and the purchase price. In the sole cases of a direct sale of the property by the non-resident individual or the disposal by a French transparent entity held directly by a non-resident individual the capital gain is increased by (i) the acquisition costs effectively borne (or set at 7.5% of the acquisition price), and (ii) the real cost of all the improvement and maintenance works carried out (or set at 15% of the acquisition price if the real estate has been held for more than 5 years).

The gain is reduced by 2% per year between the 6th and 17th year of ownership; 4% per year between the 18th and 24th year; and finally 8% annually after 24 years. Accordingly, after 30 years of ownership, there is no WHT payable on the gain. Capital gains may also benefit from exemptions such as the capital gains tax exemption applying to sales of French residences of non-residents upon specific conditions.

If the seller is an EU tax resident, the net capital gain will be subject to a 19% WHT (same rate as for a French resident), while if the seller is a non-EU tax resident, the net capital gain will be subject to the one-third WHT except when the seller is located in a non-cooperative State or territory (Guatemala, Montserrat, Philippines, Brunei, Nauru, Marshall Island, Niue, Botswana) where the rate is 75%.

The effective rates of taxation are the following:

- as from 17 August, capital gains realised by non-resident individuals upon the transfer of real estate property in France are subject to social security contributions (CSG/CRDS). As result the effective WHT rates currently are 34.5% (19+15.5), 48.8% (33.33+15.5), or 90.5% (75+15.5);
• as from 1 January 2013, a surtax on real estate capital gains greater than EUR 50,000 on sales property applies to non-resident individuals so that the effective taxation rate will be:
  - between 36.5% and 40.5% if the seller is an EU tax resident;
  - between 50.8% and 54.8% if the seller is a non-EU tax resident;
  - between 92.5% and 96.5% if the seller is located in a non-cooperative Country.

This surtax does not apply to capital gains benefitting from an exemption as property hold for more than 30 years or residence in France of a non-resident.

**Sale by a French limited liability company**

**Sale of the real estate**
The taxable capital gain, usually equal to the difference between the sale price of the building and its net book value, is taxed at the standard corporate tax rate (increased by the surtaxes). Clearly, there is a full clawback of the depreciation allowances previously deducted.

**Sale of the shares in a non-listed real estate company**
The capital gain, usually equal to the difference between the sale price of the shares and their net book value, is taxed at the standard corporate tax rate.

**Sale of the shares in a listed real estate company**
The capital gain, usually equal to the difference between the sale price of the shares and their net book value, is taxed at the standard corporate tax rate or at the reduced tax rate of 19% if the seller has held a 10% ownership for at least two years.

**Inheritance and gift tax**
Under French domestic law, a non-resident individual who directly or indirectly owns real estate in France is liable to French inheritance and gift tax on that property (tax rates, which vary according to the kinship existing between the deceased/donor and the beneficiary and the amount of the gift, range from 5% to 60%). The indirect ownership test is met either when an individual owns shares of a company, whether French or not, whose assets consist, directly or indirectly, mainly of real estate in France or, where the interposed company’s assets do not consist mainly of real estate in France, if the individual, together with his/her spouse, parents, children, sisters and brothers, holds, directly or indirectly (regardless of the number of interposed legal entities or organisations) at least 50% of the capital of a legal entity or organisation owning real estate property in France.

The application of these provisions will, of course, depend on the terms of any applicable tax treaty for the avoidance of double taxation on inheritance and gifts. However, very few tax treaties deal with gift tax issues.

The inheritance or gift tax will be levied on the value of the property, if it is held directly, or on the value of the shares, if the real estate is owned through a company.
F-REIT or sociétés d’investissements immobiliers cotées (SIIC)

Main tax rules

A specific tax regime is offered to listed real estate companies (sociétés d’investissements immobiliers cotées).

By virtue of said provisions, companies, whose main activity is the leasing of properties as well as the subletting of properties under certain circumstances, which have a share capital at least equal to EUR 15m and are listed on a French regulated market or on a foreign stock market, which meets the requirements set forth by the EC Directive 2004/39/CE dated 21 April 2004, can, together with their subsidiaries (subject to corporate income tax) held at more than 95%, elect for the regime provided for by article 208 C of the French Tax Code, whereby, said companies are exempt of corporate income tax on: (i) their rental income (or the rental income realised by their tax transparent subsidiaries); and (ii) the capital gains triggered by the sale of their properties (or the properties owned by their tax transparent subsidiaries), or the sale of the shares of their subsidiaries; and (iii) the dividends received, provided the following conditions are met:

- At the time of the election for this tax regime, a 19% exit tax is paid on any latent gain existing on their real estate assets or on the shares of their tax transparent subsidiaries (the payment of said exit tax being in fact spread over a four-year period).

- At least 85% of the tax profits deriving from the rental income realised by the company, which has elected for the SIIC regime (and by its tax transparent subsidiaries), must be distributed before the FY of their realisation ends.

- At least 50% of the tax profits deriving from the sale, by the company, which has elected for the SIIC regime (and by its tax transparent subsidiaries), of buildings or real estate companies shares, must be distributed before the end of the FY following the FY of their realisation.

- 100% of the tax profits deriving from the dividends received by a company, which has elected for the SIIC regime (and by its tax transparent subsidiaries) from a subsidiary itself subject to the SIIC regime or from another listed SIIC held for at least 5% since at least two years, must be distributed before the FY of their reception ends. The Finance Bill for 2008 extended the exemption to dividends received by a SIIC from a SPPICAV or a foreign company that has a similar statute to a SIIC, provided that the SIIC that received the dividends holds at least 5% of the share capital of these entities for at least two years.

Opportunities offered by the regime

In 2011, there were around 40 French SIICs.

Whether or not an existing company and its subsidiaries can elect and/or have an interest to elect for such a regime is to be reviewed taking into account the following elements:
• The dividends distributed out of the exempt profits will not benefit from the parent company EU Directive. Therefore, non-French shareholders may be subject to a 30% WHT at source on the dividends received (said rate may be reduced by the relevant treaties).

• Because the companies that elect for this tax regime cease to be fully subject to corporate income tax, the election to the said tax regime could entail significant tax consequences, such as the termination of an existing tax group, which could induce costly tax consequences;

• The business plan of the group vis-à-vis its French portfolio;

• The level of tax liability on latent gains, which has already been booked by the group in its consolidated balance sheet, etc.

Since 1 January 2010, it is possible for SIIC to set up joint venture (JV) entities with OPCI (see section ‘OPCI’). In other words, the SIIC regime is now available to French subsidiaries that fulfil the requirements to elect for the SIIC regime, subject to corporate income tax, that are at least 95% held by one or several SIICs or one or several SPPICAVs or jointly held by one (or several) SIIC and one (or several) SPPICAV.

The anti-captive provision
As of 1 January 2010, the financial and voting rights in a listed SIIC must not be held, directly or indirectly, at any moment during the application of the SIIC regime, at 60% or more, by one or several shareholders acting jointly (‘action de concert’). In principle, where this ratio is not met, the tax-free regime will not apply in the future (definitive exit). However, under certain circumstances, the tax-free regime can only be suspended for a given financial year (temporary exit).

In addition, a minimum 15% free float needs to be respected (free float being defined as a maximum of 2% per shareholder).

The ‘anti-Spanish’ route provision
SIIC dividends paid to French corporations are fully subject to corporate income tax (CIT), whereas SIIC dividends paid to a Spanish parent company may not be subject to any tax in France and in Spain. This distortion has created a certain level of emotion. Accordingly, for dividends distributed as of 1 July 2007, SIICs are subject to a 20% tax on distributions made to shareholders (other than individuals) owning, directly or indirectly, 10% of the share capital, where said shareholders are not subject to CIT on their SIIC dividends, or are subject to CIT for an amount lower than one-third the amount of CIT, which would have been paid in France. The tax is equal to 20% of the dividends paid, before WHT if any. This provision does not apply where the shareholder of the SIIC is a SIIC vehicle or a foreign company with similar status, i.e. with a full distribution requirement, and provided that the shareholders of the said intermediate vehicles own at least 10% of the share capital, would in turn be taxable on subsequent distributions.

The 20% tax is presented as an autonomous tax, but is assessed and collected as CIT. The compatibility of the 20% tax with EU legislation and existing DTT is still being evaluated. One could follow up on how the 20% tax would apply to distributions made to French pension funds, which traditionally are tax-exempt on French source dividends.
OPCI (French non-listed REITS)

The French Government has introduced under French law a new estate investment vehicle, called ‘OPCI’ (‘Organisme de Placement Collectif en Immobilier’).

The OPCI regime is available through two alternative vehicles, which are the ‘Fonds de Placement Immobilier (FPI)’, having no legal personality (tax transparency) and the ‘Société de Placement à Prépondérance immobilière à capital variable (SPPICAV)’ which has a legal personality (subject to CIT).

OPCI have to be at least 60% invested in real estate properties and have a 50% maximum indebtedness. Moreover, SPPICAV may not exceed a 9% maximum investment in real estate listed companies and may benefit from a corporate income tax exemption available if 85% of rental income and 50% of capital gains are distributed.

Actually, regulatory issue has to be managed with the AMF.

Tax aspects of SPPICAV

- SPPICAVs benefit from a CIT exemption on the entirety of their income/capital gains.
- Dividend distributions from SPPICAVs to companies subject to CIT do not benefit from the parent/subsidiary exemption on dividends and are taxed at the standard CIT rate. Capital gains are subject to corporate income tax.
- Dividend distributions from SPPICAVs are not subject to the new 3% tax on dividends.
- Distributions from SPPICAV to French individuals are treated as dividends. They are subject to a 21% WHT upon their payment to the French individual. Then, the dividends are subject to personal income tax at progressive rates (of up to 45%) accrued by 15.5% of social contributions and the French individual is entitled to use the 21% WHT as a tax credit against its personal income tax liability. As from 1 January 2013, Capital gains (after the application in certain cases of a tax allowance for holding period) on the repurchase of shares are to personal income tax at progressive rates (of up to 45%) accrued by 15.5% of social contributions.
- Retail SPPICAVs benefit from a 3% tax exemption.

The conversion of a company subject to CIT into a SPPICAV benefits from a reduced 19% CIT rate on the latent gains existing on real estate assets (the payment of this tax being in fact spread over a four-year period). The shareholders of the company transformed are not taxable on the surplus on a winding-up.

Tax aspects of FPI

- Rental income collected by FPI (directly or not) and capital gains realised are taxed at the shareholders’ level.
- Shareholders subject to CIT are taxed at a standard rate on these gains.
- FPIs attribute mainly rental income and capital gain on real estate that are taxed in France the same way that if the non-resident individual had realised the same income directly. Please refer to our comments above.
• Individual French tax resident shareholders are subject to income tax on rental income and taxed at progressive rates (of up to 45%) accrued by 15.5% of social contributions.

• Non-residents are subject to WHTs on dividends (30% for the entities and 21% for individuals), and capital gains (33.33% subject to the application of DDTs but no WHT applies on interest

• Retail FPIs benefit from a 3% tax exemption

Furthermore, the transfer of OPCI’s shares is exempted from registration taxes, except in certain cases where a 5% transfer tax is levied, when, following the acquisition:

• an individual holds (directly or indirectly) more than 10% of the OPCI shares;

• a legal entity holds (directly or indirectly) more than 20% of the OPCI shares.

The Amended Finance Bill for 2007 extends this exemption from registration taxes to the repurchase of OPCI’s shares in the case where the repurchaser is itself an OPCI (subject to both exceptions above).

The Finance Bill for 2010 has amended the SIIC and the OPCI regime in order to facilitate the setting-up of JV entities between SIIC and OPCI.

**Municipal tax system in France**

There are four main taxes that depend on French local government (regions, departments and municipalities), which are as follows:

• Business tax

• Real property tax on undeveloped land

• Real property tax on buildings

• Habitation tax

**Business tax overview (BT)**

As of 1 January 2010 the existing business tax has been replaced by the so-called ‘Cotisation Economique Territoriale’ (CET). CET will consist of two elements: (i) the ‘Cotisation Foncière des Entreprises’ (CFE) assessed on the rental value of properties and (ii) the ‘Cotisation sur la Valeur Ajoutée des Entreprises’ (CVAE) computed on the basis of value added.

The CET will impact real estate investors who rent out unfurnished properties in France as this type of activity was so far kept outside the scope of business tax as it did not constitute a professional activity for these purposes.

What is new is that the CVAE will now be payable by the landlord of the property that is let and the landlord will be taxable based on the value added derived from the rental activity. CVAE will be payable by the landlord of the property if their turnover exceeds EUR 500,000.
The CVAE has a progressive rate going from 0.5% for turnover of EUR 500,000 up to 1.5% for turnover exceeding EUR 50m.

The percentage of revenues and expenses earned in relation to the rental activity and taken into account in order to calculate the CVAE will be reduced to 10% in 2010, 20% in 2011 and to 30% in 2012, increasing to 90% in 2018.

**Real property tax and habitation tax**

Property tax and habitation tax are based on the real estate rental value of developed land and undeveloped land, according to specific returns filed by the owner of related properties.

The rental value is computed by the real estate tax administration, and is used to compute property tax, habitation tax and part of the business tax.

Owners of properties used for habitation are liable for real estate tax on a real estate rental value basis, computed by the French real estate tax administration, according to a square metre value (EUR/square metre).

Users of habitations are subject to habitation tax on the same real estate rental value as for real estate tax, but with specific rules and some reductions/exemptions, according to the tax status of inhabitants.

Properties used by entities subject to corporate income tax and performing a commercial activity are liable for real estate tax on developed and undeveloped land on a real estate rental value basis, computed by the French real estate tax administration, according to a square metre value (EUR/square metre).

Properties used by entities that are performing industrial activities are subject to real estate tax on developed land and undeveloped land on the real estate rental value basis, computed by the French real estate tax authorities, according to the gross book value of the immovable assets.

The real estate rental value is to be modified on 1 January of each year following an addition/removal of building. Then, any square metre increase/decrease induces an increase/decrease of the real estate rental value for commercial buildings, and any addition/removal of assets should normally be declared to the tax authorities (by the lesser or even the lessee).

Tax rates are levied for the benefit of the regions, departments and municipalities (i.e. public entities that have administrative and taxing powers), so the global property tax rates are then very different from one site to another.

**Miscellaneous taxes**

Other miscellaneous taxes linked to real estate are levied for the benefit of local governments, such as the following:

- Registration duties on transfer of real estates
- Duties for use of public streets/places
- Mining fees
• Accommodation fees
• Garbage cleaning fees

In addition, several additional municipal taxes have been recently introduced (‘taxe d’aménagement et du versement de sous-densité’) or extended and should therefore be carefully considered before implementing any investment in France.

Conclusion

It will be clear from this introductory guide that any real estate investment in France has to be considered carefully, both from a legal and tax aspect, to optimise the investment.

The choice of the proper vehicle for the acquisition will take into account the following factors:

• The tax impact of the registration duties to be paid both at the time of the purchase and on resale.
• The possibility of reducing the level of payable tax on the rental income (via indebtedness for instance).
• The cash-flow repatriation.
• The ways of avoiding the additional CIT on dividends.
• The ways of avoiding the 3% annual tax.
• The possibility of reducing the future taxation of the capital gains on the resale of the property or of the real estate company.

The most suitable structure will vary from one investment to another, depending on the investment profile, the investor, the country of origin and the envisaged exit plan.

Even if a ‘one-size-fits-all’ target is often sought, we do believe that only tailored structuring will fully fit one’s goals and perhaps allow for those tax and legal opportunities that can, sometimes, be one of the competitive advantages of a deal.

An investor, whether French or foreign, would be well advised to seek professional advice from local advisers from the very beginning of a deal.
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