FRENCH TREATMENT OF FOREIGN TRUSTS

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INTRODUCTION

The centuries-old Anglo-Saxon legal concept of trusts, which allows assets to be held by trustees on behalf of beneficiaries, does not exist, *per se*, under French law.

Legal and tax treatment from the French perspective is uncertain since French law identifies one single person as the owner of property, except in the specific case of segregation between a life interest and bare legal ownership. Consequently, assessing taxes has been difficult for the French Tax Administration ("F.T.A.") when dealing with a trust where the settlor does not have the full control of assets, the trustee is managing assets on behalf of the beneficiary, and the beneficiary has an uncertain right to income and capital.

In the view of the F.T.A., legislation was needed to prevent trusts from being used as an instrument for tax avoidance purposes. The Finance Amendment Law no. 2011-900 of July 29, 2011 (the "2011 Law") was enacted to ensure that a taxpayer would be identified who would be responsible for the payment of French taxes. In order to ensure that the F.T.A. would have full knowledge of existing trusts in order to tax income and assets when and as due under the 2011 Law, reporting duties have been implemented and a French Trust Register has been created.

This article provides a general overview of the Trust Register, including access to confidential information, filing duties of the trusts, and the imposition of French tax in various circumstances.

FRENCH TRUST REGISTER

Characteristics of the French Trust Register

Implementing the Trust Register

The French Trust Register was introduced in December 2013 by a law[1] enacted to stop "tax fraud and serious economic and financial crimes." Once the law was enacted, an implementing decree was adopted by the Government on May 10, 2016,[2] making the Trust Register effective.

1 Law no. 2013-1117, December 6, 2013.

2 Decree no. 2016-567, May 10, 2016.

“[O]n October 21, 2016, the French Constitutional Court ruled that public access to the Trust Register was, unconstitutional because it infringed the fundamental right to privacy.”

Information to be Reported in the Trust Register

The Trust Register is managed by the F.T.A.[3] The Trust Register contains information provided in annual returns and returns that are due upon the happening of a specific event. It includes the following information on trusts that file returns:

- The trust’s name and address
- The date of establishment, and where appropriate, the date of termination
- The identification of the settlor, the beneficiary, and the trustee, based on the following standards:
    - If the settlor and the beneficiary are private individuals, the first name, last name, date, place of birth, and where appropriate date of death must be provided for the individual.
    - If the trustee is a private individual, the first name, last name, date of birth, and place of birth must be provided for the individual.
    - If the settlor, beneficiary, or trustee is a legal person such as a corporation, the legal name and the incorporation number must be provided for the corporation.

This information remains in the Trust Register for the duration of the trust’s existence and for ten years thereafter.

No information regarding the market value of the assets owned by the trust or the tax residence of the settlor, beneficiaries, and trustees is mentioned in the Trust Register.

Access to the Trust Register

Public access to the Trust Register originally was scheduled to begin as of July 4, 2016. Persons who were not tax residents of France were to be denied access to the Register. However, on October 21, 2016, the French Constitutional Court ruled that public access to the Trust Register was, unconstitutional because it infringed the fundamental right to privacy.[4] The data used to compile the Trust Register was supplied for tax purposes in good faith by affected persons who gave no permission for the information to be made public. In addition, the French Trust Register was deemed to be a disproportionate measure as it contained no limitations regarding access. No protection was offered regarding details of vulnerable beneficiaries such as children or elderly people.

Consequently, Article 10 of the ruling no. 2016-1635 of December 1, 2016[5] restricted access to the Trust Register to several government agencies authorized to combat money laundering and terrorist financing. Agencies that have access include Tracfin (the anti-money laundering unit), officers of the tax administration and customs officials having tax responsibilities, the Prudential Supervision and Resolution Authority (“A.C.P.R.”), and the Financial Markets Authority (“A.M.F.”).

3 The Public Finances Directorate General (“DGFiP”).

4 Cons. Const. October 21, 2016, no. 2016-951 QPC.

5 Rules which entered into effect on 3 December 2016.

Wider Access to the Trust Register and to Information on Beneficial Owners

In ruling no. 2020-115 ("the Ruling"), issued on February 12, 2020, unrestricted access to the Trust Register was given to police officers. In addition, tax and customs officials were given broader access to the Trust Register and can access it within the framework of duties other than tax collection.

The Ruling also provides restricted access to beneficial owner information to a wider range of people. As a result, any person may have access in the following set of circumstances:

- The person files a written request about a trust or any similar legal entity that holds a direct or indirect controlling interest in any company or other legal entity formed outside the European Union; control may exist through the ownership of bearer shares or arrangements of any kind, even if effected by means other than a shareholding.
- The person has a legitimate interest in the combatting money laundering or terrorist financing, such as journalists and non-governmental organizations.
- The person is a professional that is subject to compliance duties in terms of combatting money laundering or terrorist financing. Examples are banks and other financial institutions.

According to the French Tax Code ("F.T"C."), included as beneficial owners are the trustee, settlor, beneficiaries, protectors, and any other person having effective control of the trust, whatever that may mean. Information about beneficial owners include the following:

- Last name, first name, usual name, and alias
- The month and year of birth
- The country of residence
- Nationality
- A description of the beneficial interests held, which is yet to be defined

REPORTING REQUIREMENTS

Scope of Reporting Requirements

The 2011 Law introduced two mandatory reporting obligations for a trustee. One is an annual return and the other is a return triggered by the happening of an event. These returns must be filed in any of the following fact patterns that demonstrate a connection to France:

- The settlor or at least one of the beneficiaries is a French tax resident.
- Some of the assets held in trust are located in France.
- The trustee is established in France.

Amendments to the Filing Duties as From the Year 2020

The Ruling provides additional reporting duties for trustees established or located outside the European Union. The duties apply in each of the following circumstances:

- The trust purchases real estate located in France.
- The trust enters into a business relationship in France within the meaning of Article L. 561-2 of the French Monetary Code.

The French Monetary Code provides that the term "business relationship" refers to a professional or commercial relationship when the client is a professional that has a responsibility to prevent money-laundering and terrorist financing. and when the business relationship is meant to continue over a certain period of time. The contact may result from the execution of a contract or a pattern of activity that relies on the professional's participation in several transactions or a single transaction that is carried out over time.

Information provided through the annual return or a return upon the happening of an event will make its way to the Trust Register, thereby providing access to a broader class of user.

Yearly Filing

An annual return of the fair market value on January 1 of each year of the assets, rights, and capitalized income of the trust (and not only value of French real estate assets) must be filed by the trustee before June 15 of each year.

The annual return provides updated information[6] relating to the following items:

- The main characteristics of the trust, such as whether it is revocable or irrevocable
- Whether the trust is discretionary or the interests of the beneficiaries are fixed
- The governing law of the trust
- The names of the settlor, the beneficiary, and the trustee
- The allocation of the trust assets among beneficiaries

If the settlor or the beneficiaries are residents in France, all assets of the trust no matter where located must be declared. If none of the settlors or beneficiaries are residents in France, only French assets must be reported.

Filing Upon the Happening of a Specific Event

A return must be filed upon the setting up of the trust and upon any modification or termination of the trust. This return should be filed within one month following the event. Trustee should adopt internal procedures to ensure compliance with this short deadline for filing.

6 Art. 369 A of Annex II of the F.T.C.

> *"Broadly speaking, it appears that distributions of income are taxed, but distributions of the initial capital are not taxed. However, the F.T.A. has not formally addressed the distribution of original capital. . ."*

The term "modification of the trust" includes, *inter alia*, any changes in (i) the terms of the trust, (ii) the way it is managed, (iii) assets owned, (iv) source of income, and (v) any other item that has an impact on the trust structure.

The obligation to file a return upon the happening of an event is separate from the obligation to file the annual return.[7] The following information must be disclosed in the return triggered by an event:

- The nature and date of the event generating the reporting obligation
- A precise description of assets and rights held in trust
- If the event is the transfer of assets or rights to the trust, the full identity of the contributing
- In the event of a distribution to a beneficiary, the identity of the beneficiary[8]

Penalties

In the event of a failure to comply with the reporting obligations, penalties may be imposed. They include

- the assessed tax may be increased by 80%,[9] and the minimum penalty is €20,000, and
- a penalty of up to €20,000 per year, per return not filed.

The statute of limitations for the reporting obligations is four years following the year of the filing. The settlor is jointly and severally liable with the trustee for the payment of the penalty. The penalties provide a negative incentive for trustees to report information that has a link to France. Trustees should consider the revision of client mandates to allow for compliance.

FRENCH INCOME TAX

Distribution of Trust "Proceeds"

Distributions of proceeds to a French resident beneficiary are subject to a 30% flat-rate tax consisting of a 12.8% income tax and a 17.2% social charge. Broadly speaking, it appears that distributions of income are taxed, but distributions of the initial capital are not taxed. However, the F.T.A. has not formally addressed the distribution of original capital, and might conclude that all distributions by a French resident beneficiary should be taxed even if they represent the initial capital contribution. Official guidance would be helpful. Until guidance is issued, it may be prudent (i) for the trust to maintain separate accounts for income and capital and (ii) for distribution resolutions to specify the source of the distribution.

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7 The inventory of assets and their respective market value only need to be reported in the annual return.

8 Art. 369 of Annex II of the F.T.C.

9 Art. 1729-0 A F.T.C.

Risk of Application of French C.F.C. Rules

France has enacted rules regarding Controlled Foreign Companies ("C.F'C.'s") that are owned by French resident individuals.[10] These rules apply when

- a French tax resident owns a participation of at least 10% in a foreign entity that may be a company, a trust, or any similar structure;
- the assets of that entity consist mainly of financial assets; and
- the entity benefits from a preferred tax regime. A tax regime is considered to be preferred if it leads to an actual tax burden that is less than 40% of the tax that a corporation would pay in France in the same circumstances.

When these conditions are met, the French tax resident is liable to tax with respect to all profits of the foreign entity, even if not distributed.

When a person is a beneficiary or a settlor of a foreign trust, questions arise as to the way the 10% participation condition applies and whether different results are realized when (i) the trust is revocable or irrevocable or (ii) the interests of the beneficiaries are fixed or discretionary. The Paris Administrative Court of Appeal recently ruled that a person who is a beneficiary of an irrevocable, discretionary trust could not be considered as having a 10% participation pursuant to Article 123 *bis* of the F.T.C.[11]

FRENCH INHERITANCE AND GIFT TAXES

Prior to 2011, the F.T.A. faced difficulty in characterizing transfers made through a trust as a taxable transfers subject to inheritance tax. In certain fact patterns, the transfers of assets were exempt from inheritance tax because they could not be characterized as gifts during life or transfers at death under the rules in effect at the time including applicable case law.

The 2011 Law introduced *sui generis* transfer duties in respect of inheritance tax applicable on the death of the settlor. These *sui generis* transfer duties apply upon (i) the transfer of property, (ii) a modification of rights, or (iii) accumulated income tis allocated to capital.

Inheritance and Gift Tax Rules in France

Regarding inheritance and gift taxes, French law[12] targets assets or rights held in a trust, as well as the income that has been accumulated and allocated to capital in the trust. Subject to applicable inheritance tax treaties, French inheritance tax is imposed on

- all assets and all accumulated income when (i) the settlor is resident in France or (ii) the beneficiaries are residents in France and have been residents during six or more years over the most recent ten years; or
- only assets and accumulated income located in France when the settlor and the beneficiaries are not residents in France.

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10 Article 123 *bis* of the F.T.C.

11 Paris Administrative Court of Appeal, 24 June 2020, case no. 19 PA00458.

12 Art. 750 *ter* F.T.C.

The 2011 Law identified the death of the French resident settlor as the triggering event. The tax is triggered even if the assets are not actually distributed to beneficiaries. Moreover, where the initial French resident settlor is dead, the French resident beneficiaries become deemed settlors and when the deemed settlors die, the French resident beneficiaries at the time become deemed settlors. In this way, where the assets remain in the trust for several generations, each generation of French resident beneficiaries is subject to inheritance taxes.

Two situations must be distinguished:

- The first involves a transfer from a trust that can be treated as a gift or inheritance under French law. Most advisers are of the opinion that a gift or an inheritance occurs only when assets are distributed outright to the beneficiaries at the time of death. Here, French gift of inheritance taxes apply according to standard rules. The surviving spouse or civil union partner is exempted from death duties. A progressive scale of up to 45% applies to heirs that are descendants of the settlor.
- The second involves a transfer from a trust that cannot be treated as a gift or inheritance under French law. Under that assumption, a *sui generis* transfer tax applies in accordance with the terms of transfer provided for by the trust deed. This is addressed in the appendix to this article.
    - Where a specific share of the trust assets is due to a single designated beneficiary, the inheritance tax is levied according to the family link between the beneficiary and the dead settlor.
    - Where a specific share of the trust assets is payable to a class of persons, such as descendants of the settlor, without any possibility to allocate the assets among such descendants, the gift or inheritance tax will be calculated at the rate of 45%.
    - In all other cases, if the assets pass to a trust whose beneficiaries are unascertainable, the gift or inheritance tax will be calculated at the rate of 60%.

Consequently, it is essential for trustees to pay very close attention when drafting the trust deed specify shares of specific beneficiaries to provide results achieving the lowest possible taxation.

Avoidance of Double Taxation

In fact patterns where the imposition of French inheritance and gift taxes are subject to the France-U.S. Inheritance, Estate and Gift Tax Treaty ("the Treaty"), a question arises whether the *sui generis* transfer duties are covered by the Treaty.

In this respect, the tax authorities have confirmed that whether or not the transmission qualifies as a gift or inheritance, the existence of the trust does not affect the application of international tax treaties[13] in case of juridical double taxation (*i.e.*, the same inheritance is taxed in more than one Member State). The F.T.A. relies on the

[13] Tax treaties on inheritance or gift taxes: BOI-ENR-DMTG-30 no. 40; 16/10/2012. Moreover, the Treaty provides that the latter applies to French inheritance and gift duties and to any *substantially similar taxes* on estates, inheritances, and gifts that either country may subsequently impose.

concept of juridical double taxation to determine if the elimination of double estate taxation (Article 12 of the Treaty) can apply. As a rule, double taxation can only be eliminated when a person is taxed in respect of the same assets by more than one State.

The Treaty does not contain any specific provisions on trusts. Consequently, many advisers believe that the treaty rules on the allocation of the right to tax must apply in the same way as if the assets were held directly by the settlor. The Treaty provides that immovable and tangible assets (other than cash) should be taxed in the State where physically located. Intangible assets such as securities and cash are taxable in the State of domicile of the decedent.[14] Thus, intangible assets held within a trust should be taxable in the U.S. as long as the settlor was domiciled in the U.S. at the time of death.

FRENCH REAL ESTATE WEALTH TAX

"French wealth tax may be imposed on the settlor or the deemed settlor of the trust. Wealth tax applies only to the value of real estate held directly or indirectly."

French wealth tax may be imposed on the settlor or the deemed settlor of the trust. Wealth tax applies only to the value of real estate held directly or indirectly. Actual taxation occurs if the overall net taxable value of the real estate ultimately held by the individual exceeds €1.3 million.[15] Wealth tax is calculated by applying a progressive scale of up to 1.5%. When the settlor is a French tax resident, wealth tax applies to his real estate assets located in France or abroad, including all real estate assets held directly or indirectly through a trust.

When the settlor is not resident in France, he is liable to French wealth tax only with respect to real estate located in France. When the assets are held in France and abroad, segregation must be made between French and non-French assets.

A settlor who is liable to French wealth tax must file a French wealth tax return on a yearly basis. If the settlor does not comply with these filing duties, a specific tax equal to 1.5% is assessed on the real estate's net market value and is due by the trustee. However, there is no cumulation of the 1.5% tax and the real estate wealth tax on the same assets.

In principle, French real estate wealth tax is subject to applicable tax treaties. In practice, only a few treaties deal with wealth taxes. One such treaty is the France-U.S. Income Tax Treaty.[16] It provides that US citizens that move their residence to France would be liable to French wealth tax in respect to foreign real assets only following five years of residence in France.[17]

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14 Art. 8 of the France-U.S. Estate, Inheritance and Gift Tax Treaty. Special rules apply to U.S. citizens domiciled in France.

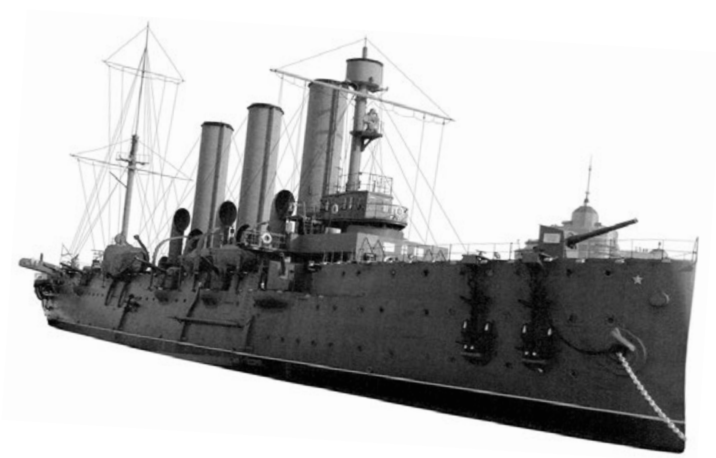
15 Art. 964 F.T.C.

16 See paragraph 1(b)(iv) of Article 2 (Taxes Covered) of the France-U.S. Income Tax Treaty.

17 See paragraph 6 of Article 23 (Capital) of the France-U.S. Income Tax Treaty.

CONCLUSION

For years, French law contained no provision to integrate the concept of a trust into its tax laws. Whether income, inheritance, or wealth taxes, the identities of the settlor and the beneficiaries were held in confidence. This changed beginning in 2011 when France enacted the Trust Resister. In the intervening 10 years, much has happened. Information must be reported, nongovernment persons have access to information, inheritance and gift taxes can be imposed each time property passes from one generation to the next, and wealth taxes were imposed. Clearly, major changes have occurred over a relatively short period of time.



APPENDIX

Summary
Trust Inheritance Taxation According to French Law

Legal Classification		Taxation Rate	Trustees' Liability for Tax Payment
I. Legal classification of gift or inheritance		Tax rate according to the family ties between the settlor and the beneficiary.	Not Liable
II. **Sui Generis Levy:** Applicable when the transfer cannot qualify as gift, or inheritance, or when the assets remain in the Trust after the death of the settlor(s).	a) **Transfer of a defined share** of assets, rights, or income capitalized in the trust to a defined beneficiary	Tax rate according to the family ties between the settlor and the beneficiary.	Not Liable
	b) **Global transfer of a defined share** of assets, rights, or income to the trust to several descendants	45%	Liable
	c) **Other cases**	60%	Liable