PLANNING FOR NONRESIDENT INVESTMENT IN FRENCH REAL ESTATE – THE CHOICE OF COMPANY MATTERS

Author
Sophie Borenstein

Tags
Capital Gain
France
Dividend Withholding
I.F.I.
Profit Making Activity
Real Estate
Société Civile Immobilière
Wealth Tax

Sophie Borenstein is a Partner in the Paris office of Klein Wenner, where she heads the firm's Tax Department. She advises clients on French and international tax matters, with a focus on wealth management and tax management.

INTRODUCTION

It is common for nonresidents to own a secondary residence in France through a company. One of the recurring questions posed to a French tax adviser relates to the type of company to choose. Should it be (i) French or foreign and (ii) subject to corporate tax, or not? This article focuses on the French tax consequences for a nonresident individual who owns French real estate through a French or foreign company that is subject or not subject to corporation tax.

OWNERSHIP THROUGH A FRENCH COMPANY

The *société civile immobilière* (an "S.C.I.") is a real estate holding company frequently used by nonresident individuals and foreign corporations. An S.C.I. is a pass-through entity used to hold French real estate.[1] It may carry out an ancillary commercial activity, provided that the income from that activity does not exceed 10% of the total income of the S.C.I.

An S.C.I. is not subject to French tax unless it opts to be liable to corporate income tax or unless it carries out a commercial activity in more than a *de minimis* amount. Although an S.C.I. is a pass-through company, the S.C.I. is not fully transparent for French tax purposes since taxable profit is computed at the entity level before being taxed in the hands of its shareholders. Each shareholder is taxable according to its own tax regime on its *pro rata* share of the profits derived by the S.C.I. This means that the portion of the S.C.I.'s profits that are attributable to corporate shareholders at December 31st of each year, is computed in accordance with the tax provisions applicable to corporate income tax.

The choice of tax regime for the S.C.I. should be made in advance of the purchase of the property. The alternatives are the pass-through tax regime that is common for an S.C.I. (which is recommended when the residence is used for private reasons by the S.C.I. partners) or by expressly opting for corporation tax ("C.I.T."). This choice will depend in part on the existence of a tax treaty and the tax treatment of rental income and capital gains from French sources. Rental income will generate lower taxes in France when the S.C.I. is subject to corporate income tax, due to a lower tax base reflecting the tax benefit of depreciation. However, that benefit will be offset by higher taxation of the capital gain on the sale of the property, assuming the relevant income tax treaty assigns the exclusive taxation right to France based on the location of the property.

---

[1] This article addresses the tax character of an S.C.I. from a French viewpoint. A nonresident should seek advice from a home country tax adviser regarding taxation in his or her country of residence.

The choice will also depend on the use of the property. Generally it is not advisable to hold a secondary residence via a company subject to C.I.T., at least when the property is made available exclusively and free of charge to the partners of the S.C.I. The economic benefit from housing which the taxpayers reserve for themselves is normally exempt from taxation. However, this exemption is reserved for natural persons or partnerships with natural persons as partners. It does not extend to the taxable profits of companies that are subject to C.I.T. When these advantages are provided without the payment of consideration to the company, the company will be deemed to have taxable income for C.I.T. purposes and the partner will be deemed to have received a benefit.

OWNERSHIP THROUGH A FOREIGN COMPANY

Nonresident individuals often hold a secondary residence in France through foreign companies having a registered office outside France. These nonresident companies are often located in the individual's country. Typically, these companies take the form of a commercial company with limited liability for shareholders. In their state of residence, they are subject to tax on profits at rates equivalent to French corporation tax.

The corporate tax status of the foreign company holding French real property must be determined under French tax concepts, especially when the French property is made available to shareholders on a rent-free basis. Different tax results will be result based on the character of the company. In comparison to an S.C.I., a foreign company does not have a choice as to the tax treatment of profits

It is therefore necessary to compare the foreign entity with a French company to determine whether those characteristics allow the foreign entity to be considered translucent – and therefore its income will be passed through to its partners and taxed at that level – or opaque – and therefore it will be the taxpayer and its income will be subject to C.I.T. The principal factors that are taken into account are free transferability of shares and limited liability of shareholders. French case law relates mainly to U.S. L.L.C.'s. that provide limited liability to members while being tax transparent, and Delaware corporations that may have a civil purpose rather than a commercial purposes. In at least one case, the French administrative Supreme Court ruled that a multimember L.L.C. should be treated as a corporation because of its limited liability.

When a foreign entity's form does not cause it to be subject to French C.I.T., it may be subject to C.I.T., nonetheless, because it carries on a "profit-making activity." In making a determination, no bright line exists as a guide. In principle, the provision of free housing by a foreign entity to its principal owner and members of his family would not necessarily cause the entity to be viewed as carrying on a profit-making activity. However, an anstalt and a Liechtenstein *stiftung* were held to carry on a profit-making purpose when a building in France was left at the disposal of their beneficiaries or third parties.

INCOME TAXATION

Rental Revenues

Individuals not resident in France are taxed in France on their French-source rental income, whether the property is held directly or indirectly through a French S.C.I. or an equivalent foreign company, as determined under French law. The investor has the choice between two tax regimes with radically different consequences, income tax or C.I.T.

Case Where the Company is Not Subject to C.I.T.

When the S.C.I. does not opt to be subject to C.I.T., the income from the rental of bare dwellings is taxed directly at the partner level, regardless of tax residence. Here, care is required to avoid double taxation – one in France as rental income is realized – and a second time in the country of residence, either at the same time income is realized in France or in a later year when distributed as dividends.

These issues of double taxation are governed by income tax treaties concluded by France. Most of these tax treaties attribute the right to tax to the state where the real property is located. In some instances, the right to tax is attributed exclusively to that state. In other instances, the right to tax is concurrent. In these instances, the right to tax that is reserved by the state of residence is subject to provisions in the income tax treaty that are designed to eliminate double taxation.

When the property is located in France directly or through an S.C.I. by a nonresident individual, the nonresident's tax is computed under two methods. The one that produces the lower tax is the method that is used.

- Under the first method, a split rate is applied. Up to a certain amount of income, the rate is 20%. On income in excess of that amount, the rate is 30%. In 2020, the switchover occurred when net income amounted to €25,710.
- Under the second method, the nonresident computes the effective French tax rate on income from sources in France and outside of Franc based on graduated rates ranging up to 45%. The effective rate is applied to the French rental income.

In addition to the income tax, income from real estate is subject to social contributions. The rate is 17.2% for tax residents of a country outside the E.E.A. and Switzerland, and for tax residents of an E.E.A. country or Switzerland who are affiliated to a compulsory French social security system. For tax residents of an E.E.A. country or Switzerland who are not affiliated to a compulsory French social security scheme, property income is subject to a "solidarity levy" at a rate of 7.5%.

Case Where the Company is Subject to C.I.T.

If the company is subject to C.I.T., the tax base in France the net rental income. The company will also be liable, where applicable, for the rental income tax ("C.R.L.") at the rate of 2.5%. C.R.L. is imposed on income derived from the rental of buildings that have been completed for at least fifteen years as of January 1 of the tax year. If the rent is subject V.A.T., either by right or by option, it is not subject to the C.R.L.

In the event of a distribution by a French company subject to corporate income tax, a withholding tax will be due. The rate is 21% if the shareholder is resident in a Member State of the European Economic Area, 30% if the shareholder is resident outside the E.E.A., or 75% if he is resident in an noncooperative country or territory. The rate may be reduced by income tax treaty and can be eliminated if the Parent Subsidiary Directive is applicable under E.U. law. In practice, most tax treaties concluded by France reduce the rate of this withholding tax. In the event of an actual or deemed distribution of profits by a foreign company, the rates applicable to distributions from French permanent establishment will apply.

Capital Gain

French tax law allows France to tax capital gains on the sale of real estate located in France. The right to tax is subject restrictions, if any, under an applicable income tax treaty.

In the case of a sale of shares of the company, the capital gains tax regime for private individuals will apply in the case of a French company with a majority of real estate assets established in a Member State of the European Union or the European Economic Area. The tax is 19%, and is accompanied by social contributions of 17.2% or 7.5%. In other cases, the standard capital gains tax regime applies. The tax is 12.8% and is accompanied by social contributions of 17.2% or 7.5%.

France retains the right to tax the capital gains from the sale of shares only where the company is considered to be real estate company ("S.P.I.") as a result of its asset mix. In broad terms, a company is treated as an S.P.I. if more than 50% of the value of its gross assets at the close of the three financial years preceding the transfer consists of real estate, shares in other S.P.I.'s, or real estate rights not allocated to its own professional activity, whether such assets are located in France or other states.

In practice, most of the tax treaties concluded by France follow the model treaty proposed by the O.E.C.D. and do not remove France's right to tax these capital gains.

In the case of a sale of real property directly held by a company, two separate tax regimes apply. If the company is subject to C.I.T., C.I.T. will be due. The tax rate is 26.5% in 2021 and will be 25% in 2022. If the company is foreign the tax is collected by means of withholding, subject to adjustment in a final return. If, on the other hand, the company is a translucent company, whether French or foreign, it is the partner who is taxed on the capital gain, according to the tax regime of capital gains on real estate for individuals.

In addition to the levy, nonresidents subject to income tax (individuals or partnerships) are subject to a surtax on capital gains in excess of €50,000 and to the taxes on the sale of land that has become buildable.

Taxation of the Real Estate Assets

3% Tax

Subject to two exceptions, companies that own real estate in France must pay an annual tax of 3% of the market value of the property. It does not matter whether the company maintains its head office in France or outside France. Nor does it matter whether the real property is held directly or through intermediary companies.

The exceptions to the 3% tax are as follows:

- Companies are not subject to the tax if they file Declaration no. 2746-SD each year indicating (i) the location and designation of the buildings, (ii) the value of the real estate as of January 1st, (iii) and the identity of all partners holding more than 1% of the capital.
- Companies are not subject to the tax if, within two months of the acquisition of French real estate, they undertake to report (i) information concerning the real estate and (ii) the names of shareholders holding more than 1% of the share capital at the first request of the French tax administration.

An S.C.I. that is engaged in bare rental activities is required to file Declaration no. 2072 each year. Providing this declaration exempts the company from making the undertaking described in the second bullet above.

Real Estate Wealth Tax ("I.F.I.")

Nonresidents of France are subject to a real estate wealth tax ("I.F.I.") on real estate assets located in France. This includes shares in domestic or foreign companies that own directly or indirectly real estate in France. Regarding tax on shares of companies, the tax is levied only on the portion of the value of the company's shares attributable to the real estate assets. If the nonresident owns shares representing less than 10% of the voting rights and capital of the company, the wealth tax does not apply, unless he or she controls the foreign company. In determining whether control exists, the shares held by a spouse and by children are treated as if owned by the nonresident.

In the case of a chain of companies, the taxable value is assessed on the basis of the real estate owned by all member companies in the chain and by all structures in which chain members participate.

As with income tax, a nonresident of France potentially faces wealth tax in two jurisdiction – France and the person's country of residence. Double taxation may be eliminated by an applicable income tax treaty that covers wealth taxes. Most income tax treaties addressing wealth tax allow both states to impose wealth tax. Double taxation is avoided by a tax credit. Some income tax treaties assimilate the shares of real estate companies to real estate. The state in which the real estate is located has exclusive right to tax. Other income tax treaties do not distinguish between real estate companies and other companies. The right to impose wealth tax is allocated exclusively to the state of residence of the person owning the shares.

As a planning point for nonresidents, the tax base on which I.F.I. is imposed will be reduced when real estate in France is held by an S.C.I. that has financed the holding through the issuance of debt. The debt reduces the value of the shares.

Donation and Successions

Inheritance or gift tax is levied on the market value of shares received as a gift or as an inheritance. When computing the fair market value of the shares, the amount of the company's debt obligations will reduce the value of the shares. As with the I.F.I., holding the real estate assets through a company carrying a significant debt load will reduce the value of the shares given away during life or at its conclusion.

CONCLUSION

Foreign investors choosing to own real estate assets in France are well served to plan the structures by which French real estate is held in advance of the purchase and to monitor the structure after an acquisition has been completed. There is no miracle solution, but choosing the proper structure may minimize the taxes that are paid in France during the period of ownership and at the time of sale.

“Foreign investors choosing to own real estate assets in France are well served to plan the structures by which French real estate is held in advance of the purchase and to monitor the structure after an acquisition has been completed.”

Disclaimer: *This article has been prepared for informational purposes only and is not intended to constitute advertising or solicitation and should not be relied upon, used, or taken as legal advice. Reading these materials does not create an attorney-client relationship.*