France Revises Transfer Tax Rules for Foreign Companies With French Real Estate Holdings

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France's amended 2009 Finance Law has significantly changed the transfer tax territoriality rules applicable to transfers of shares in foreign companies with French real estate assets. As a result of the reform, transfers that previously were tax exempt have become subject to a 5 percent transfer tax effective as of January 1.

Transfer Tax Regime Before January 1

Under French domestic rules, transfers of shares in French real estate companies are usually subject to a 5 percent transfer tax unless the companies are listed on a regulated market. A nonlisted company is deemed to be a real estate company for the purpose of the 5 percent transfer tax if its assets are mainly composed, at any time during the year before the transfer, of French real estate assets or shares in companies of the same kind.[1]

Despite guidelines published by the French tax authorities that provide for the opposite, most observers have concluded that the French territoriality rules governing the transfer tax before the reform did not allow France to levy the 5 percent transfer tax on transfers of shares in foreign real estate companies. As a result of this situation, and as long as the transfer deed was executed outside of France, investors usually took the position that they did not have any legal obligation to pay the 5 percent French transfer tax on purchases of shares in foreign companies predominantly owning French real estate assets.

This practice led to some tax reassessments by the French tax authorities but, so far, various jurisdictions have confirmed the taxpayers' interpretation.[2] Nevertheless, the French tax authorities have published new guidelines confirming their refusal to change their broad interpretation of the territoriality rules governing the 5 percent transfer tax.[3]

New Transfer Tax Regime Applicable as of January 1

Article 43 of the amended 2009 Finance Law created article 718 *bis* of the French Tax Code to broaden the territoriality of the transfer tax in order to tax transfers of

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[1] Article 726 of the French Tax Code.

[2] *See* September 27, 2007, judgment from the Nice tribunal, September 9, 2008, judgment from the Grasse tribunal, and November 19, 2009, decision from the Court of Appeal of Aix en Provence confirming the Grasse judgment.

[3] Guideline 2008/22 of October 14, 2008.

shares in foreign companies predominantly owning French real estate assets (regardless of where the transfer deed is executed). In addition, the definition of real estate companies provided under article 726 of the Tax Code has been amended to expressly include foreign companies.

To prevent double taxation, France will grant a tax credit equal to the amount of transfer tax effectively paid (if any) in the country of incorporation of the foreign company. Any tax credit in excess of the amount of the 5 percent transfer tax will not be refundable. The tax must be paid within 30 days following the transfer and will be legally due on the higher of either the sale price or the fair market value of the share. The seller will be jointly liable for the payment of the transfer tax.

In practical terms, this new transfer tax regime means that the sale[4] of shares in foreign companies, such as Luxembourg, Belgian, or Dutch companies, that are often used to hold French real estate assets (or shares in French entities that own such assets), now will be subject to the 5 percent French transfer tax unless appropriate restructuring is effected. As an example, such structuring can aim at diversifying the assets of the foreign company in order to avoid classification as a real estate company or, alternatively, to minimize the taxable basis of the transfer tax. In that respect, it should be noted that the assignment of a shareholder's loan is not subject to the transfer tax.

As far as lenders are concerned, according to the French Supreme Court, the exercise of a pledge on the shares of a borrower that is in default qualifies as a taxable transfer for the purpose of the 5 percent transfer tax.[5] As a result of the reform, the exercise of a pledge on the shares of a foreign real estate company by lenders would trigger the 5 percent transfer tax on the value of the shares attributed to the lenders.

A side effect of the reform is that it will facilitate the collection of information by the French tax authorities with respect to foreign companies owning French real estate assets (such as the sale price of the shares and the amount of the gain, if any, realized by the shareholders). This situation should further encourage foreign investors who carry out real estate investments through foreign holding companies and who rely on tax treaties with France to carefully monitor tax residency and their substantive connections to their countries of incorporation.

If one also takes into account that, as of January 1, rental activities carried out in France (other than for residential purposes) are subject to a new French business tax that can represent up to 1.5 percent of the added value derived from such activities,[6] 2009 will not be remembered as an attractive tax year for real estate investment in France.

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[4] Including share exchanges and contributions of shares in exchange for liabilities.

[5] Cass. Com. January 25, 2000, *Caisse Centrale des Banques Populaires.*

[6] In practice, this new tax (cotisation sur la valeur ajoutée), introduced in the 2010 Finance Law, will become progressively applicable from 2010 to 2019.