Tax Alert

United States Investment in French Real Estate: Refund Opportunities On Capital Gains Taxation

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Over the past 10 years the aggregate fair market value of real property located in France has almost doubled, attracting a range of U.S. investors including equity funds, real estate companies and wealthy individuals. Most of them are in a position to realize a substantial capital gain should they now decide to sell their French properties.

Until December 31st, 2014, capital gains realized upon disposal of real property located in France (or shares in a French real estate company) by non-European residents were subject to a 33.33% tax (plus a 15.5% Social Contribution that applies to individuals). During the same period, similar capital gains realized by Europeans (including French residents) were subject to a 19% tax (plus the 15.5% Social Contribution). Therefore, a total tax burden of 48.83% used to apply to non-Europeans (including U.S. individuals) selling French properties compared to 34.5% for residents of Europe[1].

Since January 1st, 2015 and the coming into force of the Rectifying Finance Law for 2014, dispositions made by individual investors residing outside the European Economic Area ("EEA"[2]) are subject to a 19% tax[3].(plus the 15.5%

[1] To be precise, a 6% Surtax might even apply in addition to that when the gain itself exceeds certain thresholds, maximum rates reaching 54.83% for US residents and 40.5% for European residents. French resident high income earners are in addition potentially subject to an additional 4% Surtax, in which case the marginal rate attains 44.5%.

[2] The European Economic Area is comprised of the European Union (currently 28 Member States) + Island, Liechtenstein and Norway

[3] With the exception of those residing in one of the 8 Tax Havens as listed by the French government in its 2014 blacklist for whom the tax on the gain amounts to 75%. The 33.33% tax remains applicable to foreign companies.

Social Security Contribution) - a total tax of 34.5%, the same rate as for French and EEA residents.

This change was made in response to a recent French Administrative Supreme Court case (*Conseil d'Etat*, October 20th, 2014 #367334), in which the Court ruled that the 33.33% Tax applicable upon the disposition of French real property by a French real estate pass-through entity ('*Société Civile Immobilière*') fully owned by individuals residing outside the EEA violated the Freedom of Capital Movement enshrined in Art. 63 of the Treaty on the Functioning of the European Union. The Court further considered that such a provision of the French Tax Code created a difference of treatment between EEA residents and non-EEA residents, dissuading the latter to invest in the French real estate market. It was the Court's opinion that non-EEA residents should pay the 19% tax that applies to French and EEA residents.

The Court denied the right of France to benefit from the standstill clause granting EU Member States the right to maintain a domestic tax law violating EU law, when such domestic legislation was enacted prior to 1994 and involves 'direct investments.'

The legislation imposing the 33.33% tax to French real estate partnerships owned by non EEA residents was enacted after 1994.

Consequently, non-EEA residents who owned French properties via a French real estate partnership should request a reimbursement of the difference between the 33.33% tax that was paid upon the disposal of such properties before January 1st, 2015 and the 19% tax, which should have been applied when the partnership sold its properties.

It is important to note that the scope of the French Administrative Supreme Court's decision cannot be extended with certainty to capital gains realized directly by non-EEA residents – i.e. when no French partnership is interposed between the foreign investor and the property located in France. Indeed, the specific legislation that introduced the taxation of capital gains at the rate of 33.33% in the case of direct ownership by non-EEA residents was enacted prior to 1994 and might therefore be covered by the standstill clause.

However, strong arguments exist in support of the position that the 19% tax should have been applied to gains derived in the context of direct ownership as well. Indeed, the French Administrative Supreme Court decided in 2013 in a separate case pertaining to another provision of the French Tax Code, that the acquisition of a secondary residence by a foreign resident could not be considered a 'direct investment' as defined by European Law and therefore could not be covered by the standstill clause.

As a consequence, it may be advisable for U.S. residents who sold a property located in France before January 1st, 2015 and who paid the 33.33% tax to file a claim with the French tax authorities as a protective measure ('*Service des Impôts des Non-Résidents*'). Such claims should be sent as soon as possible.

In addition, the European Court of Justice ("ECJ") ruled in a recent case (ECJ, Feb. 26, 2015, C-623/13 - De Ruyter) that the imposition of Social Security Contributions on French source rental income and on real estate gains realized by non-residents introduced in 2012 violates EU law to the extent that a non-resident cannot be forced to pay Social Security taxes in more than one Member State. Additionally, payment by non-residents of French Social Security Contributions should enable access to French Social Security benefits, which is not the case.

Since then, the 15.5% Social Surtaxes ceased to apply to individuals residing in an EU Member State. It remains to be seen whether the French government is ready to revoke the law in its entirety, in which case even non EEA residents - such as individuals residing in the U.S. - could benefit from the exemption of French Social Contributions on real estate gains (effectively decreasing the tax rate to 19%). As a protective measure, a claim could be filed with the French tax authorities in regard to this.

Finally, please note that the tax treaty concluded between France and Luxembourg on April 1st, 1958 was amended on September 5th, 2014 to authorize France to tax capital gains realized by a Luxembourg resident upon disposal of the shares in a French real estate company. The amendment should go into force on January 1st, 2016 once the protocol is ratified by both countries. Starting in 2016, U.S. residents who invested in the French real estate market via a Luxembourg holding structure must be aware that the gain made by such a Luxembourg company, when selling shares of the French real estate company, will be taxed in France at the rate of 33.33%.

Certain strategies are still available to avoid the 33.33% capital gains tax in France by using intermediary countries other than Luxembourg, but such strategies need to be carefully evaluated before implementation.

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