

DE PINNA

N O T A R I E S

NATHALIE TROUSSET-FAWCETT

The Use of Gifts of Interests in French Residential Properties in Anglo/French Tax Planning

^(L)[Keywords to Follow]

English owners of French residential property, whether of secondary homes or principal residences, can in certain circumstances use French gifts of interests in French property to reduce French inheritance tax applicable on death.

From the French point of view, if a property owner dies, his worldwide assets are subject to French tax if his main home was in France. But if the person who has died had his main home outside France, only his French assets would be subject to French tax on his death. French inheritance duties (*droits de succession*) provide rates of tax which vary depending on who the beneficiaries are and, after the appropriate nil-rate band, are levied at between 5 per cent and 60 per cent on each recipient of assets.

The use of *inter vivos* gifts can often reduce the incidence of French succession duty if used sensibly. In France it is often the case that property interests are split—known as a *démembrement de propriété*—between life interest and remainder, a very popular technique used in French tax planning arrangements to produce a lower amount of tax overall.

Types of inter vivos gifts of French property

Traditional methods of splitting property interests between life interest and remainder

There are three main variations whereby French property interests can be split between life interest and remainder:

- a gift of property in full ownership (*pleine propriété*), which means the donor gives the full and unfettered use and ownership of the property to the donee with immediate effect and retains no interest in it;

PRIVATE CLIENT BUSINESS

- a gift of remainder (*nue propriété*). The donor retains a life interest (*usufruit*) in the property and gives what in England we would call the remainder to the donee. Unlike in the United Kingdom, the life interest will extinguish on the death of the life tenant, *usufruitier*, without charge to tax; and
- a gift of life interest only (*usufruit*).

New concepts of gifting French property

A new French law dated June 26, 2006 which came into force on January 1, 2007 widened the scope for gifts of French property and introduced some new concepts:

1. *Donation graduelle* (gift in stages), wherein the donor gifts the property to the donee, but the donee must comply with two obligations:
 - (a) the donee has to retain the property for his or her lifetime, and
 - (b) the donee must transfer the property on his or her death to an individual appointed by the donor. For example, a father can gift his French property to his son with the obligation for his son to transfer it to his sister when he dies.
2. *Donation résiduelle* (residual gift), wherein a donor gifts a property to the donee and the donee has a duty to transfer the property to an individual appointed, but the donee does not have a duty to retain the property in his ownership.
3. *Donation trans-générationnelle* (generation-skipping gift). It is now possible as a matter of French law (which was not previously the case) for donors to gift property to their grandchildren in the lifetime of their children, although the children of the donor must agree to the gift being made, which is called a "*donation partage*".

French taxation of gifts and formalities

The general principles on the French taxation of gifts

On death, unlike the United Kingdom which has a general nil-rate band for the estate, each beneficiary has a personal nil-rate band depending on the relationship with the deceased. Thus, between surviving spouses and civil partners there is now an unlimited nil-rate band on death; for each child of the deceased it is €150,000; between brothers and sisters €15,000 and for more distant relatives and strangers in blood, it is merely €1,500. The rate of tax can vary between 5 per cent and 60 per cent, depending on the donee's relationship with the donor.

French law does not have the concept of potentially exempt transfers (PETs) and consequently a gift of property made *inter vivos* is taxed immediately on the

value of the gift, but at reduced rates which are available by concession based on the age of the donor.

The gift must be registered and this must be done before a French *notaire*. Thus, for example, a parent can give a child a gift of up to €150,000 without paying tax on that gift. After six years have passed the parent has a new allowance of €150,000 in relation to that child. If the parent dies within the six years, he has used up his allowance for that child.

Finally, there is a further reduction for an *inter vivos* gift of full ownership or of a life interest by a reduction of 50 per cent on the taxable gift if the donor is less than 70 years old when the gift is made, and a reduction of 30 per cent if he is between 70 and 79 years of age. However, no reduction is given if the donor is over 80 years of age.

French taxation of gifts of life interests

The French have two concepts of what we call in England a life interest: (1) *usufruit* which more or less equates to the life interest or (2) *droit d'usage d'habitation*, a right to use, which is personal to the recipient of the gift.

It is generally accepted that an *usufruit* equates to a life interest for UK purposes (although the matter is not free from doubt) and is therefore considered as an interest in possession for English purposes. It is arguable however that a *droit d'usage d'habitation*, being a lesser right than a *usufruit*, is not an interest in possession for English purposes.

If a *droit d'usage d'habitation* is given rather than an *usufruit*, reductions are 35 per cent if the donor is aged less than 70 years, 10 per cent if the donor is aged between 70 and 79, but no reduction if over 80.

Gifts of *usufruit* permit the reduction in the base calculation of the value of the property which in accordance with Art.669 of the French Tax Code determines the capitalised value of a life interest, which in turn depends on the age of the beneficiary of a life interest. As an example, a gift in *usufruit* of an apartment valued at €500,000 by a donor aged 70 would be valued at 60 per cent of the full ownership value in accordance with art.669 of the French Tax Code—thus €500,000 × 60 per cent = €300,000 and taxed on that basis.

A discount in value of approximately 20 per cent is available if the right to use (*droit d'usage*), rather than a *usufruit* is given.

In what circumstances should *inter vivos* gifts of French property be made?

To sum up, therefore, from a French perspective there are many tax savings to be had in using *inter vivos* gifts of interests in French properties, but the interaction



PRIVATE CLIENT BUSINESS

between French and English law is not so advantageous in many cases, as there may be PETs, gifts with reservation, pre-owned assets and the creation of life interest trusts which may need to be taken into account. Therefore UK advice should always be taken if the donor is still domiciled or deemed domiciled in the United Kingdom.

Where, however, clients have emigrated to France and lost their UK domicile and tax residence status, the use of French *inter vivos* gifts of interests in French properties, sometimes coupled with other French techniques such as the use of French life insurance, can produce significant tax savings.