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**SOCIETE CIVILE
IMMOBILIERE
(2008)**

**An introductory guide for clients.
Number 4 of a series published by the
French Law Department of De Pinna.
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NOTE

Substantially revised since recent changes in French and English Tax law, every care has been taken in the preparation of this publication which is believed accurate as at February 2008, but professional advice must be sought in all cases and no responsibility will be accepted by the Firm for the consequences of failure to do so.

YOUR ATTENTION IS DRAWN TO THE NEED FOR UNITED KINGDOM RESIDENTS TO TAKE UK TAX ADVICE ON THE USE OF A FRENCH SOCIETE CIVILE IMMOBILIERE TO HOLD FRENCH PROPERTY.

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LEGAL FORM AND OBJECTS

1.1. LEGAL FORM

A *Société* is a legal entity in French Law.

There are two classes of *Société*, the *société commerciale* which is governed by the *Code de Commerce* and the *société civile*, which is governed by the *Code Civil*.

Commercial companies can be either limited (*sociétés de capitaux*) or unlimited (*sociétés de personnes*) but a Civil Company is always unlimited.

Whilst commercial companies are trading entities, a *société civile* may engage only in "civil" activities. The *société civile immobilière* is therefore an unlimited liability civil property partnership.

1.2. OBJECTS

The objects of a *société civile immobilière* will be restricted to the "civil" activities of acquiring, holding, managing and improving property exclusively for the personal benefit of the members. These activities are classed *actes de gestion de patrimoine* (acts of personal asset management), as opposed to *actes de commerce* (business activity).

An SCI may also let property unfurnished (*location nue*) as this is classified as a civil activity, but should **NOT LET FURNISHED** as this is classified as a commercial activity and that the SCI MIGHT BECOME **LIABLE TO CORPORATION TAX**.

Similarly, when a property is acquired by an SCI there must be no suggestion of speculative intent (defined as the intention to resell at the time of purchase); thus there will be no power of sale in the *statuts* and repeated property transactions should be avoided.

1.3. TAX STATUS

The SCI is tax transparent. That is, for the purposes of taxation of income, gains, wealth and inheritance tax, the individual members are in principle in the same position as they would have been had they owned a share in the underlying property direct.

There are however a number of provisos to this basic rule.

2.1. PROPERTY OWNERSHIP

The SCI is intended primarily as a method of holding property in partnership and avoids a form of shared title called *indivision*, which applies whenever title to a property is held by two or more individuals direct.

The rules of *indivision* enable any joint owner to demand a division at any time and require unanimity for acts of disposal. Whilst the original joint owners can vary these rules by agreement, such an agreement must be periodically renewed and will not bind their heirs .

If title to a property is held by an SCI, not only are decisions taken by an agreed majority, but there is no automatic subdivision of the shares on a death.

In other words, seen through French eyes it offers the advantages of corporate structure (flexibility) without the disadvantages (corporate taxes)

2.2. COMMERCIAL PROPERTY

An SCI may also hold commercial property, such as shops, offices and factory premises. Many businesses which own freehold property will separate the ownership of the property from the trading company, under an arrangement whereby the property is held by an SCI, which lets unfurnished to the trading company.

This kind of structure is commonly encountered in France.

2.3. TAX & INHERITANCE PLANNING

The structure of an SCI is such that shares may safely be passed to intended beneficiaries without loss of control. There are also sometimes substantial tax advantages associated with lifetime transfers.

It is these advantages which have given a powerful impetus to the development of the "*Société Civile Immobilière*" as an inheritance and tax planning instrument in France.

3 OVERSEAS INVESTORS

3.1. INHERITANCE LAW

So far as the overseas private investor is concerned there are some additional considerations

Firstly, since title is held by the "*Société Civile Immobilière*" there can be no danger of a minor inheriting title to French land under the compulsory heir-ship rules, as can otherwise happen, creating an impasse which can only be broken by an Order of the High Court.

Secondly, where the shareholders in the SCI are domiciled outside France, the devolution of the shares is governed by the law of the testator's domicile and not French law. In other words the legal reserve rules do not apply.

Thirdly, because the shares are moveables, and their devolution governed by the law of domicile, the powers of Executors and Trustees under the Will of the deceased will be recognised in France, and they will be able to assume control of the assets.

3.2. USE OF THE SCI FOR COMPANY AND TRUST INVESTMENTS

French tax law makes the acquisition of French property by companies or legal entities incorporated outside France extremely unattractive. (French tax law tends to regard a trust as a *structure* [legal entity] even if it is not). There are two main reasons for this.

- Firstly the **3% annual tax** (see **FRENCH TAX FACTS**) on the value of the French property held by such company (which can be avoided if the company or legal entity is established in a jurisdiction having a double tax treaty with France).
- Secondly **punitive taxation of gains on disposal** (see **FRENCH TAX FACTS**) regardless of the jurisdiction of incorporation.

The solution to this problem can sometimes lie in the use of the French SCI where overseas shareholders may make such arrangements in respect of those shares as are permitted under the laws of their own country.

4.1. CAPITAL REQUIREMENTS

There is no minimum or maximum capital requirement for a "*Société Civile Immobilière*".

Where an SCI is being formed specifically to purchase a property it is often suggested that the capital be the same as the purchase price and the shares issued as fully paid. The reasoning behind this is that relief for capital gains tax purposes will then be the same whether the shares in the SCI or the property it owns are subsequently sold.

However, there are powerful arguments for a relatively nominal capital, with associated tax benefits in the event of share transfers, and sometimes in the context of wealth tax planning which make the nominal capital approach infinitely to be preferred. The tax treatment of share transfers is dealt with in section 10.

4.2. "STATUTS"

A *Société Civile* is incorporated by the subscribers signing articles of association, called *statuts*. These will always include the name, an objects clause, the duration of the partnership, not exceeding 99 years, a registered address, the partnership capital, shareholdings, a provision for the management of the SCI, a procedure for transfers and transmissions of partnership shares, and clauses dealing with annual general meetings, the keeping of accounts and liquidation.

4.3. FORMALITIES OF REGISTRATION

These are:

- *enregistrement* (presentation of original copies of the *statuts* for stamping at the stamp office)
- *publication légale* (publication of a notice of the creation of the proposed SCI in the legal Gazette)
- *immatriculation* (registration) at the *Registre du Commerce et des Sociétés* (Commercial Registry) for the district where the SCI has its registered office (there is no central companies registry in France).

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STATUTORY DOCUMENTS

5.1. CERTIFICATE OF INCORPORATION

Upon *immatriculation*, the Commercial Court will issue a certificate of incorporation (called a *certificat Kbis*) setting out the main particulars of the SCI and giving a registration number.

5.2. STATUTORY BOOKS

The SCI must by law keep, at the registered address:

- a stamped copy of the *statuts* showing them to have been registered,
- a consecutively numbered minute book
- a "*certificat Kbis*"

5.3. OTHER REQUIREMENTS

These are:-

- to open a French bank account in the name of the SCI to enable outgoings to be paid and where relevant, rentals to be received
- for books of account to be kept
- to have letter paper printed showing the name, form, capital and SCI number as follows:
"SCI (name)"
Société Civile Immobilière au capital de (capital) €.
RCS de (court) n° (number)

6 MANAGEMENT

6.1. THE GERANT

An SCI is managed by a "*gérant*" (managing partner/chief executive) and may have joint *gérants*. Insofar as third parties dealing with the SCI at arms length are concerned, the *gérant* or, if several, each individually, is deemed in French law to have full power to bind the SCI in respect of any transaction which is not *ultra vires*, but these powers are usually restricted internally in the *statuts*.

More pertinent perhaps, is the fact that the *gérant* can be given virtually unlimited powers, including that of approving any proposed share transfer, and thus, in effect, control of the company.

6.2. DUTIES OF THE GERANT

The duties of the *gérant* are to manage the business and affairs of the SCI, to convene the annual general meeting, ensure minutes of meetings and books of account are kept, and to report any changes in registered particulars of the SCI to the Registry of Commerce and Companies.

6.3. LIABILITY OF GERANT TO MEMBERS

Although the members are bound by and have unlimited liability for any dealing of the *gérant*, made in the name of the SCI, which itself has unlimited liability, a *gérant* acting in breach of internally agreed limitations on his powers is liable in damages to the members, and may be dismissed.

6.4. BOOKKEEPING

If the *gérant* fails to have a bookkeeping following the French rules, in fact rather simple, the tax administration can claim that the SCI is fictitious. The bookkeeping is also necessary to establish the value of the share when current accounts exist.

7 MEETINGS OF MEMBERS

7.1. ANNUAL GENERAL MEETINGS

The *statuts* will provide for annual general meetings to be held. It is the responsibility of the *gérant* to prepare a report on the SCI's activities (if any) in the preceding year and to present the accounts for the approval of the meeting. Minutes of meetings should be recorded in the loose-leaf consecutively numbered minute book to be kept at the registered address.

7.2. OTHER MEETINGS

Any change to the *statuts*, or dealing with the property of the SCI will require a members' meeting; however circular resolutions are an alternative method of dealing with these matters, following the procedure laid down in the *statuts*.

Generally, ordinary resolutions are carried by simple majority, and extraordinary resolutions are carried by two thirds majority, but the latter in particular can be varied in the *statuts*.

8 PROPERTY ACQUISITION BY SCI

8.1. PURCHASE

The *notaire* dealing with the purchase will require a copy of the *statuts*, a copy of the *Extrait K-bis*, and a resolution of the members in order to ensure title is correctly conveyed into the name of the SCI.

Since registration (*immatriculation*) of an SCI takes several weeks, it is not always possible to register the *statuts* before the completion of the purchase. If the SCI is not registered at completion, the conveyance into the name of the SCI will be conditional upon *immatriculation* taking place and, most importantly, the fact of *immatriculation* being recorded by the *Notaire* and published. If for any reason the *immatriculation* is refused or publication overlooked, the conveyance will still take effect, but the property will vest in the names of the various partners in the proportions set out in the *statuts*.

The stamp duty and other costs on purchase will be the same as would be the case had the property been bought by the individual members personally

8.2. SUBSEQUENT TRANSFER OF PROPERTY TO AN SCI

Where the owners of a property form an SCI to which the property is to be transferred, the *notaire* dealing with the transfer must also prepare the *statuts* of the SCI and deal with the registration formalities. This

transfer is called an *apport*, and will attract the following costs and taxes:

- fees of *notaire* (approximately 1.50% of the value of the property),
- capital gains tax on the difference between the original acquisition value and the transfer value.

9

SALE OF PROPERTY OWNED BY AN SCI

9.1. PROCEDURE

The procedure for the sale of a property owned by an SCI is in practice no different from a sale by individual owners, except that the *statuts* of the SCI, the *Certificat Kbis*, and a resolution of the members authorising the sale will be *required* by the notaire officiating the sale. The decision to sell will be taken by the majority specified in the *statuts*.

9.2. TAXATION OF GAINS

The SCI is fiscally transparent. That means that it is not the SCI, which is taxed on the gain, but each member of the SCI separately.

The method of calculation of the gain is to take the purchase price and add the actual costs of purchase or 7.50%. Then, after 5 years construction or reconstruction and enlargement costs for which bills can be provided may be added. If no bills are available 15% of the purchase price may be added. This revised figure is subtracted from the selling price and is the gross gain. 10% per annum after the fifth is then deducted to give the net gain. The rate of tax is then 16% for EU resident individuals, or 33.33% if not EU resident. Corporate members are treated on an entirely different (and punitive) basis, both in terms of calculating the gain and the rate of tax, making corporate membership of an SCI generally undesirable (see our **FRENCH TAX FACTS**).

10 PARTNERSHIP SHARES

10.1. FORM & SHARE TRANSFER PROCEDURE

The partnership shares, called *parts sociales*, are not normally represented by certificates, the holdings of the members being recorded in the *statuts*.

Share transfers require a separate share transfer agreement called a *cession de parts* to be executed and registered at the Registry of Commerce and Companies following the same procedure as that laid down for the original registration of the SCI. It is usual for share transfers to be restricted by the *statuts* to prevent shares being sold to outsiders without prior approval of the members or the *gérant*.

10.2. SHARE TRANSFER DUTY ON SALE OF SHARES

The share transfer duty (*droits d'enregistrement*) payable by the purchaser is 5% of the value of the shares.

If the SCI has a low share capital, with the remaining funding represented by shareholders loans (*comptes courants d'associés*), the value of the shares, as against the value of the underlying property held by the SCI will be correspondingly less.

If on the other hand the SCI is fully capitalised, then the costs to the purchaser of buying the shares, as against buying the underlying property, will be virtually identical (5% in the former case; 5.09% in the latter case)

- (i) note that interest earned on shareholders loans to the SCI must be returned as income to the UK revenue authorities, even if not actually paid.

10.3 CAPITAL GAINS TAX ON SALE OF SHARES

If the shares (for an SCI "*à prépondérance immobilière*"), as opposed to the underlying property, are sold, the tax is 16% of the net gain where the vendor is an EU resident and 33.33% if not an EU resident. The remarks at 9.2. above apply in relation to calculating the gain and corporate members.

INHERITANCE OF PARTNERSHIP SHARES

11.1. APPLICABLE LAW

In the event of the death of a non French domiciled partner, the partnership shares will devolve in accordance with the law of domicile of the deceased . That is, the devolution of the partnership shares is unlikely to be subject to the entrenched heirship rules.

The statutes of the SCI can provide for a procedure whereby the remaining partners may decide not to accept the heir(s) of the deceased partner, as a new member of the SCI, in which case, the estate must be paid the value of the deceased member's share within a given time. This is a complex area of the law, but the essential points are that the situation where a minor inherits land cannot arise, nor can a minority owner make mischief under the "*indivision*" rules.

11.2. INHERITANCE TAX

The SCI being tax transparent, the individual members will be liable to French IHT on their holding at the relevant rate. (see **FRENCH TAX FACTS**). Where appropriate advantage can be taken of lifetime rates and the survivorship rules to transfer shares to intended beneficiaries quite tax effectively, although it must be borne in mind that if the shareholder is UK domiciled there will also be UK IHT, subject to double taxation relief.

In other words the use of an SCI does not of itself confer any inheritance tax benefit.

11.3. SOLE SURVIVING MEMBER

If, for any reason only one member remains in the SCI, it will not be necessary to bring in a further partner unless "an interested party" so requires. An interested party means any person with a pecuniary interest in the SCI and includes the French Revenue. If the interested party so demands, then the surviving partner has 6 months in which to decide either to bring in another partner or wind up the SCI.

Therefore in the case of a husband and wife SCI with provision in the Will of the deceased for the surviving spouse to inherit - the surviving spouse may continue to hold the property as a single partner SCI, unless and until notice is served as explained above.

12

RETURNS TO THE AUTHORITIES

12.1.

RETURNS TO REGISTRAR ON CHANGES

Changes in particulars of the SCI, namely the name, the form, the address of the registered address, the appointment, resignation, death or dismissal of *gérant*, any change in the objects of the SCI, any change in the duration of the SCI or alteration to the statutes, any transfer or transmission of shares must be minuted and notified to the Commercial Court where the SCI is registered.

12.2.

RETURNS TO THE TAXATION AUTHORITIES

There are a variety of these depending on whether or not the SCI lets and whether there are loans to the SCI from outside France.

Return **2072** is a reporting requirement, disclosing information about the SCI, the property and the members, must be filed in the year following acquisition, or annually if there is rental income or there are changes in the SCI

Return **2062** is another reporting requirement, and discloses loans (including shareholders' loans to the SCI) made by entities or individuals based outside France.

Return **2044** is the income tax return to be filed by members of the SCI who receive income through the SCI. See above use of the SCI 2.1. AND 2.2.

Return 2746 relates to the 3% annual tax payable by all legal entities holding property in France. In the case of an SCI with members who live for tax purposes in a country which has an appropriate double tax treaty with France, either an exemption must be claimed annually, or an undertaking given to the authorities at the time of purchase, to disclose information on demand. In either case there will be **no 3% annual tax payable provided these rules are followed.**

13 LIQUIDATION

13.1.

MEMBERS VOLUNTARY LIQUIDATION

The *statuts* will provide for the appointment of a liquidator, either a member of the SCI, or an outside party; upon the liquidator being appointed by members' resolution, the all management powers will vest in the liquidator, and the SCI must show the words "société en liquidation" on the letterhead

The liquidator will realise all assets and discharge all liabilities, make up the accounts and present these for approval by the members.

13.2.

COMPULSORY LIQUIDATION

The Court may order the SCI to be wound up where the life of the SCI has expired, the purpose for which the SCI was incorporated no longer exists (for example following disposal of the only asset of the SCI), a member defaults in his obligations to the SCI, only one member remains in the SCI, or the members cannot agree, making continuation of the SCI impossible.

13.3.

FORMALITIES OF LIQUIDATION

Procedurally speaking, notice of these various steps must be filed in the same manner as occurred on incorporation meaning: *enregistrement*, *publication légale*, and notification to the commercial court.

13.4.

TAXATION UPON LIQUIDATION

In all cases, a fixed stamp duty is payable: 375€, or 500€ if the share capital is equal or up to 225,000€.

If the SCI is wound up when still holding property and the property therefore vested in the former members direct, duty of 1.10% is levied on the value of the assets so vested.

Capital gains tax will be payable, the criteria being, value of property at liquidation value of property when acquired by the SCI, but subject to special provisions which apply where there has been a change of partners during the life of the SCI.

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SUMMARY

The SCI is often the vehicle of choice for large or complex transactions, offering inheritance and tax-planning opportunities if properly used.

However the use of an SCI also implies a disciplined approach to the keeping of Statutory Books, the preparation of accounts, the filing of returns and continuing administration, the importance of which should not be underestimated.

SCIs and their tax status in the UK

Since 2001 approximately, there have been some potential risks of a taxation nature in using an SCI in England as HMRC might have thought to raise a tax assessment of benefit in kind and/or claim that your SCI might be considered as a company for UK purposes.

Since 2001 we have lobbied and had discussions with the HMRC:

1) In the 2007 Budget, the Government announced that no benefit in kind charge would be made on individuals for any private use of property abroad purchased through a company, and therefore, by assimilation, an SCI. When, and if, enacted, this will have retrospective effect.

2) Although this initiative by the Government is broadly positive and is to be welcomed, in that, unless there is a *volte face*, the threat of a benefit in kind assessment on SCI members is largely removed, the exemption is limited. We need to await the draft Finance Bill 2008 but it seems that it will only apply to potential benefit in kind charges.

3) There are a number of conditions initially proposed for the exemption from benefit in kind charge, as follows:

- The property must be owned by an SCI which itself is owned by individuals;
- The SCI's only activities are ones that are incidental to its ownership of the property;
- The property is the SCI's only or main asset; and
- The property is not funded directly or indirectly by a connected company.

4) However the exemption is limited and would not, in my view, prevent HMRC from arguing, for example, that SCIs are companies in the English sense, especially if they are managed and controlled from the UK, which in turn might lead to a UK corporation tax/capital gains charge on disposal of the property by the SCI. If therefore the French Tax Authorities were to levy personal CGT on resale on SCI members and HMRC levy corporation tax on resale, there would be a mismatch of reliefs and therefore the risk of double taxation.

5) It is recommended therefore *inter alia* a) to make sure that control and management of the SCI is carried out outside the UK, and arrangements should be made for all management decisions (cheque signing, arranging insurance, paying utilities, holding AGMs, making decisions about refurbishments, etc) to be made outside the UK and b) to do all that you can to ensure that the SCI is considered as a transparent entity in the UK.

6) The Budget initiative is also unclear on the situation where the property is rented out.

7) Draft legislation will be published for consultation to be included in the 2008 Finance Bill and it is to be hoped that the wider issues referred to above are dealt with, clarified or resolved in that legislation.

8) There is also the question of Section 13 TCGA which can operate to include foreign entities as if they were close companies in the UK.

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