

France – to die for...?

French inheritance laws & tax - 2013

By Lindsay Kinnealy, Pannone LLP Solicitors

Nearly a quarter of all potential foreign property buyers say they favour la belle France and it remains the most popular destination for UK residents looking to buy overseas. This, despite exchange rate fluctuations and a double- (almost triple-) dip recession. The perceived quality of life, climate and relative stability, not to mention properties offering value for money, attract millions of overseas buyers to invest or move there.

But how many of them will have planned ahead sufficiently for their twilight years or the devolution of their estate? Perhaps, without a moment's thought, they may inadvertently and seriously complicate their legal affairs for their loved ones in relation to inheritance and tax issues at home and abroad.

With better and cheaper travel connections and multinational families, many people now have considerable assets in more than one jurisdiction, but never stop to think about where they should be paying tax or what will happen to their property upon death. It is certainly worth knowing more about the local succession laws and taxes if they own property in France.

Inheritance Planning

To the foreign eye, French inheritance laws often appear to be complicated and inflexible, particularly for owners more used to a system that allows them to dispose of their property as they wish and in accordance with a will.

So what happens if you die owning property in France? At present, for an individual who is not domiciled (i.e. a habitual resident) in France, only his real property (bricks and mortar) located there is subject to French succession laws. However, for those domiciled in France at the time of death, all their assets (except real property outside of France), are likely to be subject to French law.

One of the main issues of concern for foreign owners of property in France is the fact that a surviving spouse or civil partner will not automatically become the legal beneficiary in the event of the partner's death.

Major reforms were introduced in August 2007 by then-president Sarkozy, but mainly concerned French inheritance tax (IHT). Unfortunately, the restrictions on who could inherit under French law were largely unaf-

ected. Therefore, despite the reforms, children still inherit in priority to a spouse, and have specific and entrenched rights of inheritance. Consequently, owners of property in France do not have absolute testamentary freedom to dispose of their property, unless their desired provisions do not contravene French law.

Upon death, French assets vest immediately and directly in the heirs. Even where there is a will dealing with the distribution of the French assets, French law may well override any provisions that do not conform to French law. The will is not necessarily invalid, but its effects could be reduced to take account of French law, principally that children cannot be disinherited and have an entitlement to a minimum share of a deceased parent's estate.

Reserved and Disposable Portions

In France, an individual's assets on death consist of a reserved portion (*réserve légale*) and a disposable portion (*quotité disponible*). The *réserve légale* protects the interests of children (*réservataires*) who survive a parent and the reserved portion must pass equally between them, regardless of the wishes of the deceased or of any will. This *réserve légale* and the *quotité disponible* are allocated as follows:

Réservataire	Réserve (minimum)	Disposable Portion
1 child	½	½
2 children	² / ₃ equally between them	¹ / ₃
3+ children	³ / ₄ equally between them	¹ / ₄

On the death of a parent, the children automatically receive a share in the estate, leaving a percentage that is freely disposable according to the deceased's wishes. If no alternative wish is expressed in a will or if the deceased died intestate, the entire estate would normally be divided between the children and spouse.

If the deceased had children, the surviving spouse has no *réserve*. But since January 1, 2007, where there are no children, a surviving spouse is able to take all of the estate, in preference to the deceased's parents. Prior to this change in the law, the parent would have inherited a considerable portion of the estate. A surviving spouse may also benefit from a temporary right to remain in residence, plus a *right en viager*, if the property was the home of the married couple at the date of death.

Under current legislation, where the spouses had a child or children in common, the surviving spouse is entitled to a life interest in the whole of the estate or one-quarter absolutely of the estate. However, where the deceased had one or more children who are not children of the surviving spouse, the survivor is only entitled to one-quarter absolutely of the estate.

Parents and other relatives are not protected heirs and can be disinherited. But if you die intestate, in the absence of children, they do retain residual rights. Surviving parents may be the legal *réservataires* to part of the estate, that is one-half if two parents survive or one-quarter if one parent survives. The surviving spouse is entitled to the other half or three-quarters absolutely of the estate. This is an improvement on previous times when s/he was only automatically entitled to half in life interest only.

If the deceased had no children but does have one or more surviving parents, those parents have no automatic entitlement and the surviving spouse can inherit the entire estate. Therefore, if you have no children and want your spouse to inherit everything, make a valid will and/or take other specific measures to protect his/her interests. If resident in France, you may be able to choose between the laws of your habitual residence or your nationality to apply to your worldwide estate under new EU legislation to take effect after August 17, 2015.

Where the deceased's only surviving family are siblings, the surviving spouse may receive the entire estate absolutely. However, brothers and sisters retain a right over property in kind which the deceased received as a gift or inherited from parents. In such circumstances, the spouse and the siblings are each entitled to receive half absolutely of the estate.

If a property is jointly owned equally, only the deceased's 50% would fall into his French estate.

For those who are not married or are married with children from previous relationships, it is even more important to consider inheritance planning if you wish to ensure a smoother, less troublesome transfer of your estate and to minimise any potential inheritance tax liability for your heirs.

Considerations when buying a property in France

Much of the above information relates principally to an intestate inheritance or in the absence of suitable prior estate planning measures. It is often possible to improve the position of a spouse or partner and/or minimise your heirs' inheritance tax liability by taking appropriate steps, some of which are only available prior to completion of a purchase and others which can be adopted at a later date. Invariably, the latter will incur higher costs and taxes.

When buying a property, various options may be possible. For example, purchasing as individuals en indivision or en tontine. The former is similar to a UK tenancy in common where each party owns his own share, which would devolve on death to his heirs. A pacte tontinier – more similar to a UK joint tenancy – allows a property to pass in its entirety to the surviving owner(s). This may or may not be tax-efficient or suitable and could even have undesirable results in some cases.

A company purchase is sometimes an option, as shares in a company are movable property

that may be governed by the law of the deceased's domicile but it does not avoid inheritance tax.

A French Société Civile Immobilière (SCI) is usually the vehicle of choice. It has no direct equivalent in the UK, but is more akin to a property-holding partnership which is non-trading, has unlimited liability and is usually fiscally transparent.

Many years ago, "off-the-shelf" UK limited liability companies were considered suitable and mooted as a relatively cheap option, but the capital gains tax disadvantages on a resale make it inadvisable for most buyers. As well, translation of the Memorandum and Articles of Association and preparation of a Certificat de Coutume make it less cost-effective at the time of purchase than it might appear.

Offshore vehicles are rarely attractive from a fiscal point of view for the ordinary second homeowner, being taxed annually on the market value of the property and liable to French corporation tax on any rental income.

Be wary of using trusts for French property ownership. These legal vehicles commonly used in many countries for the purposes of inheritance planning generally offer no advantages in France with regard to inheritance law or tax and have long been viewed with suspicion there.

It is generally not advisable to own real estate via a trust as the concept of trusts does not exist in French law. Where a trustee held the property, he was traditionally treated as being the beneficial owner and taxed as such. It is now even less advisable as very recent legislation makes them less effective and less attractive for many. They are now subject to tougher annual taxation, filing and disclosure requirements and potentially high rates of inheritance tax.

Trustees have specific filing obligations with the value and all assets and rights within the trust being disclosed, if the Settlor and/or at

least one of the Beneficiaries of the trust are resident (for tax purposes) in France and/or conversely, if a trust comprises assets situate in France, even if the Settlor and/or the Beneficiaries are not tax resident in France.

Should they fail to comply, the penalty is a fine of €10,000 or 5% of the value of the assets, whichever is more. The Settlor and the Beneficiaries might ultimately be jointly liable to settle the tax. If you fall into these categories, obtain expert advice before terminating a trust or excluding a Beneficiary, to ensure the consequences would not be even worse than the current position.

Inheritance Tax

With regard to inheritance tax (IHT); unlike in the UK where the entire estate is taxed, IHT is paid in France by each individual beneficiary. The tax-free allowances, taxable inheritance and rate applicable vary, depending on the relationship of the beneficiary to the deceased.

Spouses, Pacsés and civil partners now benefit from an IHT exemption, but the tax-free allowance for children inheriting from parents was recently reduced by M. Hollande from €159,325 to just €100,000 per child from each parent. After that, they pay IHT on a sliding scale of 5% to 20%, up to €552,324, and a maximum IHT rate of 40% for inheritances of more than €1,805,677.

Brothers and sisters fare even worse, benefiting from an allowance of just €15,932 tax-free and the balance being taxable at 35% up to €24,430 and 45% for the remainder, unless the sibling is incapacitated and had been living with the deceased for at least five years, in which case the tax-free allowance is increased to €159,325.

If that seems punitive, the situation does not improve for nieces and nephews who are entitled to a relief of just €7,967 before a tax of 55% is applied. The hardest hit are heirs who are neither married nor blood relatives of the

deceased. These “strangers in blood” are liable to 60% IHT on any value in excess of €1,594.

To avoid a worse financial situation, the estate of a person non-resident in France should be settled within 12 months of death, failing which late payment penalties and interest may be applied. Where the deceased was resident in France, the timescale is just six months.

Another consideration is your place of domicile for tax purposes – not just residence. In common law jurisdictions (including for UK nationals), domicile and residence are different legal concepts and can have a significant impact on your tax liability.

If any of the information in this article should cause you concern, it would be advisable to seek suitable professional assistance to see if there is a solution available to achieve your wishes and offer you peace of mind.

Lindsay Kinnealy is a Legal Director in the International Property Department at Pannone, one of only a select number of solicitors' practices specialising in overseas' property and succession matters. With almost 25 years' experience in this field, Lindsay, together with her multilingual team (which includes a dual qualified Spanish abogado/solicitor), provides a bespoke legal service to private clients nationally and internationally. The International Property teams advises on a broad range of French and Spanish property law issues eg purchases, sales, gifts, transfers on divorce, Wills and inheritance (including minor heirs) and powers of attorney.

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