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Société Civile Immobilière

THE PREPARATION OF ANNUAL ACCOUNTS FOR A FRENCH SCI IS REQUIRED FOR TAX REASONS

The question of preparing annual accounts for an SCI (Société Civile Immobilière) appears to be clear under French domestic tax law. Some foreign and French resident clients contacted us wondering whether accounting should be held for a French SCI. These clients have had different replies from different practitioners. The purpose of this article is to show the necessity for tax purposes to hold annual accounts.

Over recent years an increasing number of people have purchased properties in France. Many clients have purchased French real estate through a French SCI. The question that arises is whether the SCI must hold a French accounting and prepare annual returns.

If accounts and returns for an SCI are prepared, the Company has substance and questions from the French tax authorities on the SCI's real existence are compromised, whereas if accounts and statutory books are not maintained, this may lead to an audit from the tax authorities who will consider the SCI is non-existent with resulting consequences.

The risk would be the application of the abuse of law's theory (abus de droit), based on section L64 of the French General Tax Code. This article is used to cancel a legal scheme that has been established solely for tax purposes. Under these circumstances, the French tax authorities are entitled to ignore the legal framework of the scheme completely. This also may include any normally allowable expenses.

One has to keep in mind that the abuse of law legislation is based on material facts. An SCI can be considered as a sham company under certain circumstances.

For example, an abuse of law case was proved involving an SCI that transferred all its benefits to one shareholder



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and had not held annual general meetings nor drafted any annual accounts (Conseil d'Etat March 23th, 1984). One has to underline that the lack of annual accounts was one of the indicative reasons for the abuse of law.

In another case, an SCI was considered as a sham company due to the lack of annual accounts, general meeting minutes and annual reports (Conseil d'Etat February 25th, 1981).

In a third case law, an SCI did not prepare any balance sheet. The income received by the SCI was credited to the shareholders' current account. However, only the SCI's general meeting could authorize this transfer (Cour Administrative d'Appel Nancy December 27th, 1990). As there was neither correct annual accounts nor any general meetings, the abuse of law's theory was applied by French tax courts.

Many advisors are not tax specialists and do not consider the consequences of the SCI to prepare annual accounts. This is despite the fact that the real estate is owned by the SCI and used by the SCI's shareholders. However, given the above case laws as well as tax obligations, it is essential that the annual accounts are prepared with the filing of appropriate tax declarations. This is necessary to avoid any potential tax audit with further consequences. The non-filing of returns can result in an annual tax of 3 percent of the value of the property as well as late interest. Over and above the 3 percent tax shares of an SCI allow the will in a foreign jurisdiction to apply to the wishes of the deceased. Direct ownership may follow FRENCH forced heirship rules. An illustration is the creation by the nonexistence of the company whereby the problem of forced heirship rules for estate planning becomes an issue defeating the purpose of the company. The director's loan account will no longer exist and therefore the debt is not deductible as there is no company and duty will accordingly be assessed on the demise and on the market value.

Others tax reasons can also be developed regarding tax audits.

Firstly, French SCIs are registered companies and must file specific tax forms. According to the French General Tax Code (Section 46 D of the 3rd part of the French General Tax Code), an SCI must provide the tax authorities with any accounting documents proving the reality of the figures mentioned in the annual tax forms filed by the SCI. Therefore, it is necessary to prepare annual accounts from a tax standpoint.

Secondly, in case of a tax audit, it is crucial that the SCI's annual accounts be held. In a case law (Conseil d'Etat June 1st, 1984), the tax authorities audited the accounts of an SCI. They tried to prove that the taxpayer hid some income. To prove this tax evasion, the tax authorities reassessed the taxpayer's personal income tax return and the income declared in the SCI's annual accounts.

An SCI's director's sole obligation is to present a report to the SCI's shareholders during the annual general meeting. However, it is not that simple. How does one prepare an adequate report without the supporting

documents? Advisors need to reflect further as to the reality of case law. Unfortunately, many professionals don't consider adequately the ramifications to their clients on non-compliance of not preparing tax accounts, filing and the tax implications as it is not their speciality.

"Directors of civil companies must, at least once per year, inform the company's shareholders of their management. A report has to be drafted, including the company's activity during the previous year, the gains and losses realized or forecasted".

Tax law and prudence recommend that formalities are carried out. Annual tax filing is obligatory. There is a new beneficial owner declaration which must be filed before March 31st, 2018 (for all French companies). Non-compliance with this new declaration will be subject to a fine of €7,500. Wealth tax declarations now known as IFI are also obligatory for market value assessed over €1,300,000. If the company is not recognised neither will the debt be deductible? It is impossible for a sale to calculate correctly capital gains tax without proper accounting. Finally, the non-filing of returns can result in a 3 percent annual tax on the market value of the property plus penalties and interest.

FOCUS - Interest to hold accountancy in an SCI

- Incomes justification and the benefit of the declaration 2072 for example
- Presentation of the annual accounts to the partners: need to draw up a balance sheet and an income statement
- Entry or exit of a shareholder and valuation of the shares (valuation of his current account, his debts, his claims in respect of the SCI)

It is clear that accounting in an SCI is useful in more than one way. This allows associates to keep themselves informed of the follow-up of their respective rights, to make it easier to bring in a partner and to answer questions from the tax authorities as well as future estate planning.

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