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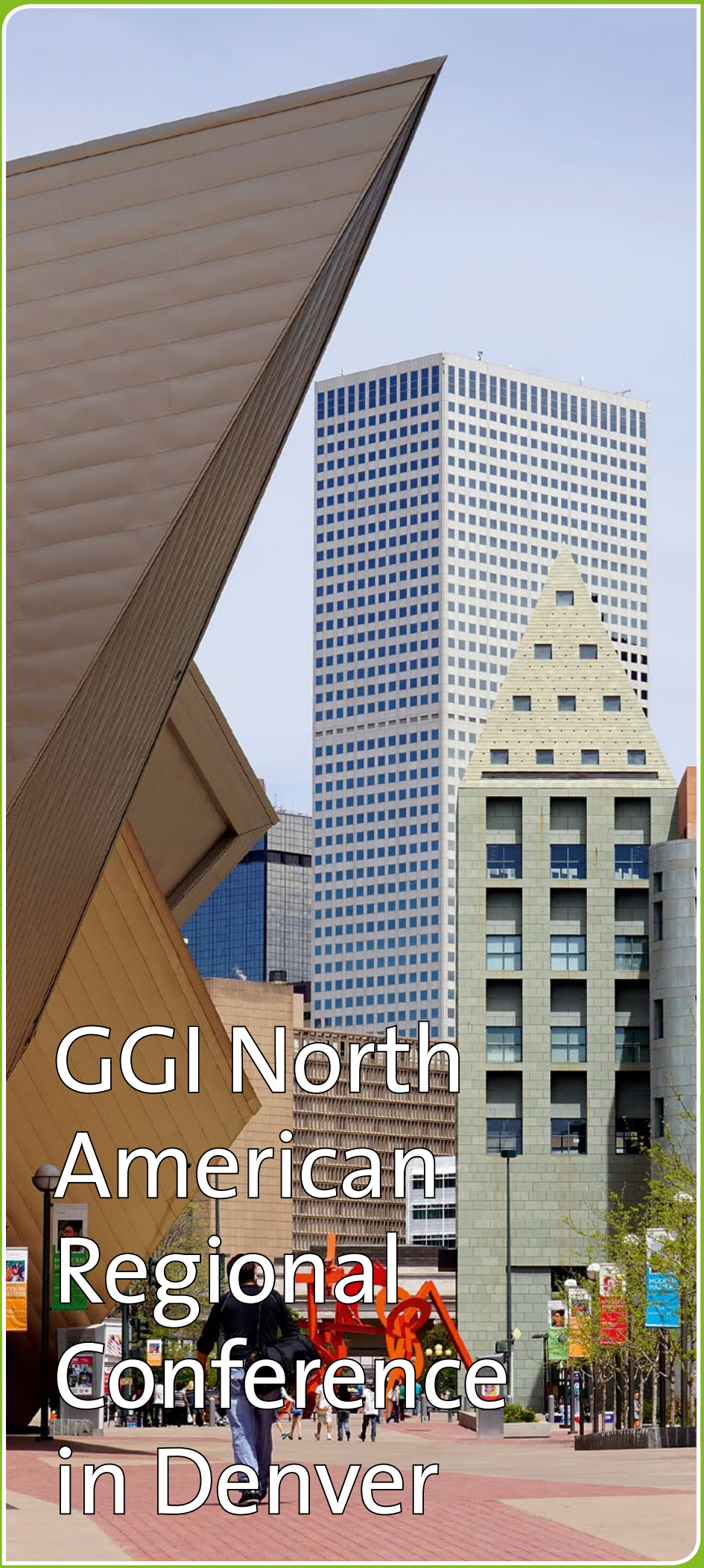

GGI North American Regional Conference in Denver

News and Information for Members and Friends of GGI

Issue No. 95 | May 2018

French Parliamentary legislation has to conform with the Constitution

The law may not be the law...

By Alexane Palide
edited by Prof Robert Anthony

The new French assessment on the effects of the tax reform provided by the project 2018 of the Financial Act highlights the introduction of the new property tax (IFI) based on the old methods. However, the project has been referred to the Constitutional Council for different reasons that we will now analyse.

After discussions with colleagues, we felt it was interesting to illustrate how most of the financial laws in France are not that easy to understand.

There is legislation which protects the public against new doctrines that are unconstitutional. Retrospective effects on new laws are considered unconstitutional. In other words, what appear to be the new Law may not be so after constitutional evaluation.

To illustrate this, we thought it useful to highlight a controversial point of the impact of the revised property wealth tax on property. Art.31 of the financial law removes the wealth tax (ISF) and creates the IFI.

This property tax has already been the subject of controversy and criticism when the draft was seen and referred

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to the Constitutional Court, as a certain part of the legislation was already considered unconstitutional. This was despite the fact that practitioners were not attacking it.

The old wealth tax has never been a popular tax and the new property tax has created substantial changes which will affect wealthy property owners.

The new tax code has two aspects for new lenders.

First, for the taxable value of the asset that exceeds EUR 5M, the debt is not all deductible, therefore leading to higher taxation. The other important change concerns lenders of 'Interest Only' loans; the debt is divided by the loan period and only the proportion that is deductible against tax is assessable for the balance of the years still left to run.

The problem arises of what happens to existing loans before the implementation of the new legislation? Is it constitutional for a new law to force existing loans prior to the 1st of January 2018 to be limited in their deductibility and to be forced to be depreciated? These are clearly aspects which will be seriously evaluated or possibly challenged.

We would like to detail a recent example of the constitutional court which declared the new law unconstitutional, unfortunately to the detriment of the tax payers relating to the separation of the ownership.

In French law, it is possible to divide

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the rights of a property title into three different parts. The first one is the right of use, the second is the ownership of a rent lease and the third one is the freehold title. The three aspects brought together allow the owner to benefit from unencumbered ownership.

In the case of the former wealth tax ISF, the taxation was different depending on whether the owner had the full rights of the ownership or just a part of it. Only the person who used the property long term was subject to wealth tax and not the freehold owner. In 2018, the new law required a certain distribution of the tax due between the full ownership owner and the owner of part of the rights to the property title.

The law applied this rule of the allocation of rights from 1st of January 2018 and we might expect that in the case of a change of division of the ownership they would not have to pay the property tax before December 2017 nor the wealth tax.

The Constitution Council pronounced on the conformity with the constitution and considered that by providing the new allocation rule between the usufructuary (owner of right of use and rent) and the full ownership owner only for those subsequent to 1 January, 2018, this treated the usufructure owner differently. This difference in treatment is neither justified by a difference of situation nor by a ground of general interest. Therefore, it is contrary to the principal of equality and must be declared unconstitutional.

The Constitutional Council has therefore stated that this law when implemented would have a retroactive effect.

By applying the new law on existing loans retroactively, this brings us back to the litigious position, which has not been addressed. It is clear that practitioners are likely to litigate to contest the validity of applying the new law in this way.

Will it ultimately apply under these circumstances? Is there a difference between the two cases? This remains to be seen. France tax offices, however, will probably apply the new rules and collect tax accordingly, unless indicated otherwise. It is not clear how to treat interest only loans nor what will happen if they are renewed. Most likely they will not be deductible upon renewal.

Another aspect that should not be overlooked is the commercial reason for the loan. Simply depositing funds in the treasury to create collateral for a loan has no substance and if audited by the tax office will be not be considered deductible for ISF or IFI. Deposits held as a guarantee need to have a real investment strategy to illustrate the commercial reason, meaning not cash deposits as there is no way to justify that they are not simply for tax purposes.

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