

GORDON S. BLAIR

LAW OFFICES

NEWSLETTER

June 2008 N°1

Summary

REAL ESTATE TRANSACTIONS-TAX PLANNING

- Individual income tax- Purchase of the principal residence
- Purchase of a secondary home in France by foreign citizens settled in Monaco
- Sale of a French real estate property indirectly held through a foreign vehicle
- French 3% tax reform and its impact on offshore trust
- French trust (Fiducie) and real estate transactions

FAMILIES

- New French inheritance and gift tax provisions

CITIZENS OF THE WORLD

- Stock options or the best manner to compensate executives and employees
- French Wealth tax new incentives
- French tax cap amended

MONEGASQUE CORPORATE ISSUES

- Disadvantages of branches against subsidiaries : garnishee proceedings out in France on assets held in a foreign country
- Contract of employment in Monaco at a glance
- Non-commercial partnerships in Monaco : easier rules on insolvency

REAL ESTATE TRANSACTIONS TAX PLANNING

Individual income tax - Purchase of the principal residence

Loan interest paid by a taxpayer to finance the purchase of his principal residence will have the benefit of a tax credit, whether the purchase is direct or indirect through an SCI, subject to the following conditions:

- the provision only applies to contracts signed after May 6, 2007;
- applicable to both direct and indirect (namely via an SCI) investment;
- the loan must be granted by a EU Bank subject to fixed or variable rate interest ;
- an indefinite loan, a " prêt in fine", is also allowed ;
- the loan must follow the special French legal provisions relating to loans under the French Consumer Code.

«The purchase of the principal residence now gives rise to a tax credit...»

The benefits of this provision will also apply if the loan is to refinance an existing loan. However, the tax credit will apply only to the first five monthly instalments. It is effective for interest paid from September 1st, 2007.

Bénédicte VINOT
Phone : + (377) 93 25 00 52
Fax : + (377) 93 25 58 92
benedicte.vinot@gordonblair.com

Simon HUXFORD - Solicitor
Phone : + (377) 93 25 85 25
Fax : + (377) 93 25 79 58
simon.huxford@gordonblair.com

Amount of the tax credit:

- First monthly payment: 40% of the interest paid up to € 7,500 for a married couple, i.e, maximum € 3,000 tax credit which may be offset against the couple's income tax bill;
- The following four monthly payments: 20% of the interest paid up to € 7,500 for a married couple, i.e, € 1,500 tax credit.

French tax issues on the purchase of a second home in France by foreign citizens settled in Monaco

Foreign citizens who settle in Monaco are generally attracted by the favourable tax regime, but care is needed when deciding to buy, rent, or generally hold a second home in France to avoid falling within the French tax net.

Under Article 164 C of the French Tax Code an individual who is not French tax resident and owns a property in France, whether directly or indirectly, for instance via an SCI, is liable to French income tax. The tax is calculated on the basis of a notional income equal to three times the rental value of their residence in France, unless the actual income in France is greater.

This provision does not apply to individuals resident in countries that have signed a double tax treaty with France (there are over 100 such treaties at the moment). While there is a treaty between France and Monaco it is not considered as a treaty preventing double taxation according to traditional OECD standards. For Monaco residents this provision may influence a decision to purchase property in France and their tax planning.

French and Monegasque citizens who are resident in Monaco are exempt providing they hold one property within the "PACA"

region around Monaco; though unfortunately this exemption does not apply to foreign citizens resident in Monaco.

«The purchase of a second home in France by Monegasque residents may entail French income tax...»

This law has come in for some criticism and a number of actions have been brought before the French administrative courts. The reported judgements have held that the non-discrimination clause in the tax treaties between France and (i) Italy, (ii) the United Kingdom, and (iii) Russia, prevent France from apply this taxation to nationals of these states who are Monaco resident.

The non-discrimination clause usually provides that a citizen of a country party to the tax treaty cannot be taxed differently to citizens of the other party to the treaty. However, in other cases involving US and Swiss citizens the courts held that the wording of the non-discrimination clause in the French-US and the French-Swiss tax treaties did not prevent France imposing this tax on American and Swiss citizens residents in Monaco.

In a recently reported decision, the court of appeal in Marseille held that the European principles of non discrimination and free movement of capital, prevented France from applying this tax to Portuguese and Belgian citizens residing in Monaco.

The latter two decisions represent a significant change, as the decision can be applied to every European citizen residing in Monaco. The situation for non EU citizens remains uncertain and considerable care is required when contemplating an investment in French real estate.

The sale of a French property held through a foreign vehicle is no longer liable to transfer tax

The French administrative court of Nice recently held that the transfer of shares in a Monegasque SCI "Société civile immobilière" that owned a property in France was not liable to pay French 5% transfer tax (previously 4,80%), as the share purchase agreement was signed and registered in Monaco.

«The sale of a non French company owning real estate in France is free of transfer tax...»

The French tax authorities asserted that such a share sale was, effectively, a direct sale of the property itself, thus requiring the payment of French transfer tax, pursuant to Article 726 of the French Tax Code. The court disagreed, considering the transfer of shares to be a transfer of intangible movable rights and subject to the principle of the territoriality of tax laws.

The French tax authorities have not appealed the decision.

As a consequence, and subject to the overriding condition that the sale both occurs and is also registered outside of France, every sale of French real estate through a foreign dedicated vehicle, would escape French transfer tax.

Even though one must remain careful with such a tax planning tool, the "look-through" approach of the French tax authorities now seems to have encountered strong opposition.

The French 3% tax reform and its impact on offshore trust

In a decision of October 11, 2007 (so-called the «Elisa» case), the ECJ held that the existence of an additional condition to be met by non-residents, as compared with French residents, to be able to benefit from an exemption from French 3% tax, was incompatible with the free movement of capital.

Further to this decision, the French Parliament adopted an amendment to the Amended Finance Act 2007 aimed at reforming the 3% annual tax.

The main changes to the 3% tax regime are the following:

- A clearly specified field of application specifically aimed at trusts (fiducies or comparable institutions).
- Application of an exemption threshold in two cases:
 - Companies owning directly or indirectly an interest valued at less than € 100,000 or 5% of the fair market value of real estate, are now exempt from the 3% tax;
 - A shareholder who owns less than 1% of the shares in a company that falls within 3% tax, is no longer obliged to file a tax return with details of his shareholding. This measure is good news for investment funds.
- Direct extension of the exemption to French SPICAV and foreign equivalent (REITs) and to companies directly and indirectly fully owned by a listed company.
- Identical treatment for French companies and legal entities having their headquarters in an EU Member State with regard to exemption from filing.

These new provisions came into force on January 1st, 2008.

The French trust (the "Fiducie") and real estate transactions

The French Law n° 2007-211 of 19 February 2007 created the "Fiducie", roughly equivalent to a Common Law trust.

«The French trust (so called «Fiducie») as an attractive real estate security...»

This is the first small step on the way to recognising trusts under French law but the opportunity to use such entity is not permitted by individuals.

The specific characteristics of the "Fiducie" are strictly defined :

- A "Fiducie" can only be created by legal entities that are subject to the corporate tax regime (under article 2014 French Civil Code),
- The "Fiducie" contract may not constitute a gift to the beneficiary,
- A resident of a State of the European Community or of a State or territory that has concluded a double tax treaty, which includes a provision for administrative assistance to prevent fraud and tax evasion is permitted to be a settlor or a trustee,
- The duration of the fiducie contract must not exceed 33 years.

For tax purposes this French trust is treated as an intermediate

transaction with neutral tax impact, with the result that the estate placed in the hands of the "Fiducie" will be considered to remain the property of the settlor. We consider that the French tax administration will have to find solutions to this difficulty if the "Fiducie" is to be attractive.

Nonetheless, the "Fiducie" is considered as an attractive manner to procure a real estate security in real estate transactions as the French civil law entitles the allocation of real estate property title as a security interest.

Furthermore, a certain flexibility makes this nature of security interest attractive : trust, rights and security interests may be transferred to the French trust and debts may be also transferable.

FAMILIES

New French inheritance and gift tax provisions

- There is now a complete exemption from inheritance tax on the succession between spouses (including life insurance indemnities).
- Gift tax: Changes in tax rebates on gifts made after August 22, 2007:
 - Gifts up to € 151,950 between lineal relatives are tax free every six years (a significant increase on the previous limit of 50,000 €);
 - Gifts between siblings of up to € 15,195 are tax free (previously the limit was € 5,000);
 - Gift to nephews and nieces of up to € 7,598 are now tax free.
- Gifts of up to € 30,390 cash between lineal relatives are exempt providing.
 - The donor is less than 65 years old;
 - The donee is over 18 years old;
 - The exemption only applies once and any subsequent gifts between the donor and donee will be taxed;
 - The gifts must be registered.

Application to family members who own French real estate : French real estate is normally subject to French inheritance tax, tax treaties being rare and/or not very protective in this respect.

A lifetime gift from parents to their children, can be advantageous considering the amount of the rebate (€151,950 to each child by each parent). The gift will not incur notary fees but a limited tax on the transfer of real estate.

«French government exempts succession between spouses and stimulates gifts...»

Such a gift can even be made with a split between the use and enjoyment, the "usufruct" to parents and the ownership, the "nue-propriété" to children, as the value of the nue-propriété is less than the value of outright ownership. On the parents death the transfer of the usufruct to the children will be realised free of French tax. This means can permit the transfer of French real estate to children without transfer duties, particularly as the rebates are renewed every 6 years.

the stock options from taxable corporate income.

While certain tax systems are neutral in their treatment on the grant of a stock option in comparison with the payment of a salary, other tax systems draw distinction between the two means of remuneration. In most countries stock options are treated for tax purposes in the same manner as salaried income.

CITIZENS OF THE WORLD

Stock option or the best manner to compensate executives and employees

International tax panorama

Incentive pay schemes are now an accepted part of an employee's compensation package. Various forms of equity-based compensation exist, including share incentive plans, cash-based profit sharing and stock purchase plans, but the most popular are stock options.

The tax treatment of options, as well as the other incentive schemes referred to above, differs from country to country; as does their potential liability to local social security contributions. In this summary, we consider the tax effect on such schemes.

In broad terms, a stock option will give an employee the right to buy a certain number of shares at a designated price (the "exercise price") during a predetermined period.

The tax treatment of such stock options currently raises various questions, which have not yet received a clear answer. Some guidelines, and proposals for amending the OECD's model double tax convention, were provided by the OECD's Committee on Fiscal Affairs in 2004.

Under the OECD's guidelines the appropriate tax treatment should have regard to :

- the qualification of the income - whether employment income or capital income;
- the applicable taxes and charges - ie income tax, capital gains tax and social security contributions;
- the timing of taxation - whether on the grant, exercise or disposal of the shares; and
- the possibility of the deduction of charges on

Cross-border tax issues and international mobility

The fact that the benefits from an employee's stock-option are taxed at different times in different countries is a clear source of difficulties.

The differences in the tax treatment of stock option schemes underlines a real problem of relieving double taxation when the tax does not bite at the same time in the country of residence and the country of the source. The question then arises, how to allow the applicable reliefs and on what income?

CROSS-BORDER INCOME TAX ISSUES	
Gain derived from the vesting of the	
Before the end of the tax holding period	After the end of the tax holding period
Income tax	
The position is discussed and some guidelines are suggested	
French rules : treated as a salary. Tax convention Model OECD - taxation applied in the country where the services are carried out. Report of the OECD Tax Affairs Committee of June 16th 2004 = treated as a salary.	Excepting excess rebate, capital gains on investment securities taxation (art 150 OA CGI). Taxation in the country of residence. Options granted as from June 20th 2007 : French tax position not very clear (there is no more reference to art 150 OA CGI).
Social contributions as CSG CRDS	
8% in case of French domicile and liability under a mandatory wealth insurance regime in France.	The solution will depend on the clauses of the applicable international tax convention (capital gain or salary). OECD report 2004 : treated as salary and taxations split between the countries of residence by proportion of the number of working days between the granting and the vesting dates. CSG (8,2), CRDS (0,5) + 2,3% ie 11%.
Remark : additional taxes	
Additional employer contribution of 10% (based on the value of the stock options). Additional contribution of 2,5% due by the beneficiary (based on capital gain).	
Social charges for employee and employer	
There is no specific rule in case of international mobility. However the charges will be due if the employer is affiliated to the French mandatory social security system at the date of the options' granting (general principle).	No social charges for employee and employer.
Gain derived from the sale of share	
Change of residence before the sale	Change of residence after the sale
No taxation in France	Taxation in France
International tax principle : taxation by the country of residence at the date of the sale	
CSG + CRDS + 2,3% (additional contribution) exemption	CSG + CRDS + 2,3% (additional contribution) liability

«...when the tax does not bite at the same time in the country of residence and the country of the source...»

Depending on the country a tax charge may arise when the option is :

- granted,
- vests or irrevocably vests,
- exercised or otherwise disposed of,
- free of any restrictions on the sale of the shares acquired under the option,
- or when the shares acquired under the option are sold.

Furthermore, conflicts of interpretation may arise where it is necessary to distinguish employment income from capital gains. The characterisation as employment income or capital gain will depend on the country where, and the timing when, the gains are realised upon the disposal of the stock option.

A further complication may arise if an employee is resident in different jurisdictions when the option is granted, vested, exercised or when the shares acquired via the option are sold and the tax treatment of the option differs between each jurisdiction; multiple residence taxation. For example a charge may arise in one jurisdiction on the grant, the second on vesting and the third on exercise.

The risk of multiple residence taxation may be compounded if there is an "exit tax" on capital gains.

The handing and timing of the various elements of the option will need careful consideration and expert local advice to minimise, so far as possible, the impact of any tax.

Impact on transfer pricing

Employee stock option plans may have an impact on the commercial and financial relations between the member entities of a multinational group of companies.

Stock options are often issued not by the beneficiary's employer but by the listed parent company. This can give rise to issues of transfer pricing, including whether, under the arm's-length principle, there should be a charge for the provision of those stock options.

Monaco

Specific Monegasque rules do not exist on the taxation of share options.

However the Monegasque authorities have noticed the increasing popularity of the grant of share options to employees in the Principality, and it is possible that there might in the future be a change in the rules which could impose conditions for the payment of social security contributions on the share options.

France

Various preferential tax systems exist, but in the adjoining table we have focused on the options granted from April 27th 2000 and those granted from October 16th 2007.

Two new rules that came into effect in 2007 increased the taxation and social charge on share options in France.

EMPLOYEE STOCK OPTIONS AS FROM APRIL 27TH 2000 (ONE FRENCH SCHEME)				
Employee taxation				
Options granted as from April 27th 2000				
Taxation of the gain derived from the exercise of options				
Excess rebate	Taxed as a salary at progressive standard rates Social security contributions liability			
Annual gain	Gain up to € 152,500		Gain over € 152,500	
Sale before the end of the four-years holding period bearer holder conversion	Taxation at the progressive standard rates Social security contributions liability			
Granting date of the option	Before October 16th 2007	As from October 16th 2007	Before October 16th 2007	As from October 16th 2007
Sale after the four-year holding period without an additional two-year holding period (1) (2)	Income tax : 30% Social contributions : 11%	Income tax : 30% Social contributions : 11% Additional social contribution : 2,5%	Income tax : 40% Social contributions : 11%	Income tax : 40% Social contributions : 11% Additional social contribution : 2,5%
Sale after six year including the additional two-year holding period (1) (2)	Income tax : 18% Social contributions : 11%	Income tax : 18% Social contributions : 11% Additional social contribution : 2,5%	Income tax : 30% Social contributions : 11%	Income tax : 30% Social contributions : 11% Additional social contribution : 2,5%
Gain deriving from sale of shares - Capital gains taxation regime				
Gain derived from the sale of shares	Income tax : 18% (with application of a tax rebate of one third for each holding year after the fifth year) Social contributions : 11%			

(1) Possibility to opt for the progressive rates taxation
(2) Taxation if the annual total gain exceeds € 25,000 (as from 1st January 2008)

Options granted after October 16th 2007 will be subject to an additional contribution from the employer of 10 % and an additional contribution of 2,5 % from the beneficiary.

French Wealth Tax new incentives

- From 2008, the wealth tax rebate on the value of a tax payer's principal residence will be increased from 20% to 30%;
- Also new for 2008, is the ability to offset up to € 50,000 against wealth tax for the following :

- 75% of the amount of the tax payer's capital contribution in an EU non-listed small company, invested after June 20, 2007. This relief excludes investments in property and investment companies.

To qualify as a "small" company (known as "PME" in French) it must have less than (i) 250 employees, (ii) a turnover of less than € 50,000,000 or no more than € 43,000,000 gross assets on its balance sheet, and (iii) must be independent, that is no more than 25% owned by a large company.

It should be noted that the shareholding can be either via a small company or via a personal holding. The shares must be held for a continuous period of 5 years.

- 75% of the value of gifts made to research and educational foundations.

- The statute of limitation applicable to registration duties and the failure to file wealth tax declarations is reduced to 6 years, with effect from June 1st 2008.

French tax cap amended

As from January 1, 2008, the total tax paid by an individual tax payer is now capped at 50% of the individual's income. Tax for these purposes includes personal income tax, wealth tax, real estate tax, dwelling tax and social contributions (CSG / CRDS / 2 % social levy).

Previously the cap was 60% and excluded social contributions paid on employment and income from legacies.

The tax cap only applies to those who are French tax resident and includes French nationals resident in Monaco.

MONEGASQUE CORPORATE ISSUES

Disadvantages of branches against subsidiaries: garnishee proceedings in France on assets hold in a foreign country

The French Supreme Court (Cour de cassation) held in a judgment of 14 February 2008 that a creditor could carry out from France an attachment on the foreign bank account of its debtor. In this case, the debtor had an account opened in the

«The long arm of French garnishee proceedings...»

Monegasque branch of a French Bank. His creditor decided to carry out an attachment in Paris, and not in Monaco. First, the French bank refused to pay, arguing the attachments could not reach assets held in a foreign country, under foreign law. The Court disagreed. According to the Court, the fact that the assets are held in a foreign country is irrelevant, as long as they are held within the same corporate body. The branch is not a distinct company but a foreign extension of the same corporation. As a result, French attachments reach all assets owned by the corporate entity, no matter where they are located. This is not a surprising conclusion as it confirms earlier jurisprudence. However this solution raises concerns about the accountability of the branch in case the debtor contests the attachment before the jurisdiction of the country where it is settled. The headquarters, having paid the creditor under a foreign law, could indeed have infringed the branch's state law and have given rise to liability on the part of the branch.

Contract of employment in Monaco at a glance

The Monegasque contract of employment may not be in the form of a contract stating the parties' rights and obligations. In Monaco, a form of agreement approved by the Labour Administration is used for an individual's employment contract. That document, called « demande d'autorisation d'embauchage » is filed by the employer with the basic information of the parties' identity, job title and salary. It is then sent to the administration which delivers a work permit on this basis. It is, however, possible to draft, in addition to that form, a complete contract with full details of the agreement between employer and employee.

«Contracts of employment in Monaco can include the full terms of agreement between the parties...»

In Monaco, the standard working week is 39 hours (unlike France where it is 35 hours), with a maximum of 10 hours per day - unless a specific exception is authorised by the Labour inspector. Overtime is authorised up to a maximum of 47 hours per week

with an uplift of 25% per hour for the first 8 hours and a 50% uplift for the following hours. Managers' overtime may be included in their remuneration package. Part time contracts are possible with reduced social benefits if the monthly working time is less than a certain limit. Annual paid vacations are earned at the rate of 2.5 days per month served, resulting 30 days' annual leave that equates to five weeks vacation.

Non-commercial partnerships in Monaco: easier rules on insolvency

In Monaco the insolvency of a non-commercial partnership i.e. « sociétés civiles », does not fall under common Insolvency law. Article 408 of the Commercial Code provides that only individuals and corporations that are engaged in commercial activity are subject to this legislation. Common insolvency law provides that creditors cannot personally sue for recovery of the debt but must lodge a

statement of claim with the creditors' representative against the insolvent company (failing which their claim will become irrecoverable).

«First come, first served on insolvency...»

The legislation also provides an order of priority amongst creditors. No such provision applies in the case of insolvency of a "société civile".

As a result, creditors can personally sue insolvent "sociétés civiles" and they are not hindered by a legal order of priority; the rule of 'first come, first served' will apply. However, Monegasque courts cannot order the commencement of reorganisation or a judicial liquidation of a "société civile", as they can for a commercial corporation.

They can only order certain formalities be performed or order the company to be de-listed from the "sociétés civiles" register, ie de-incorporated.

EVENTS

1/ Participation and exhibition at the 18th Monaco Yacht Show - 2008

From Wednesday 24 to Saturday 27 September 2008

For further information please contact Julie Chouamier
julie.chouamier@gordonblair.com

2/ Partnership between our Spanish desk and the Economic Development Chamber of Monaco to represent the Principality of Monaco in Spain at the following dates:

Malaga from 8th to 10th October 2008

Valencia from 8th to 10th October 2008

For further information please contact Elisa Trinchin.
elisa.trinchin@gordonblair.com