

**FRENCH WEALTH TAX TO BE REPLACED BY A REAL ESTATE WEALTH TAX IN 2018**

**Pursuant to the draft French finance bill for 2018, French wealth tax (*“impôt sur la fortune”*, hereafter the “ISF”) will be abolished and replaced by a new real estate wealth tax (*“impôt sur la fortune immobilière”*, hereafter the « IFI ») whose taxable base will be limited to non-business related real estate assets.**

Under the proposed draft legislation, IFI will be based on the same territoriality principles and according to the same taxable threshold and progressive rates as the current ISF.

However, additional restrictions will apply to the deductibility of debt, among which the exclusion of certain intra-family/shareholder loans, tax amortization of bullet loans repayable at maturity and a general limitation to any debt exceeding 60% of the value of real estate assets over 5 M€.

Already adopted by the French Parliament, it is to be reviewed before the French Senate and should be definitely voted at the latest by the end of the year.

If adopted, IFI will apply as from **January 1<sup>st</sup>, 2018**.

**This reform may therefore impact many non-residents who could enter into the scope of IFI or see their annual amount of wealth tax increase – notably with respect to the new restrictions of debt deductibility.**

**It is therefore urgent to review the holding structure of French real estate to identify any planning opportunities.**

***Most of the features of the proposed IFI are derived from the ISF***

- The territoriality rules governing IFI will be the same as those applicable to ISF:
  - French tax residents will be subject to the IFI in respect of their real estate assets located in France and outside of France;
  - Non-French tax residents and new French tax residents (i.e. who have been French tax resident for less than 5 years) will be subject to IFI in respect of their real estate assets located in France, whether held directly or indirectly through an entity established in or outside of France<sup>1</sup>.
- The taxable threshold (i.e. net value of 1.300.000 € as of January 1<sup>st</sup> of each year) and the progressive rates (ranging from 0.5% to 1.5%) will also be the same as those applicable to ISF.

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<sup>1</sup> Subject to the provisions of double tax treaties concluded between France and the countries of residence of the tax payer

**IFI taxable base will be limited to real estate assets**

IFI will be assessed on the net value of real estate assets held by the taxpayer, either directly or indirectly through one or several entity(ies).

Where real estate assets are held by the taxpayer through one or several entity(ies), the portion of the value of the shares directly owned by the taxpayers representing the value of the underlying real estate assets will be subject to IFI.

**With the exclusion of real estate assets used for the purpose of a business activity**

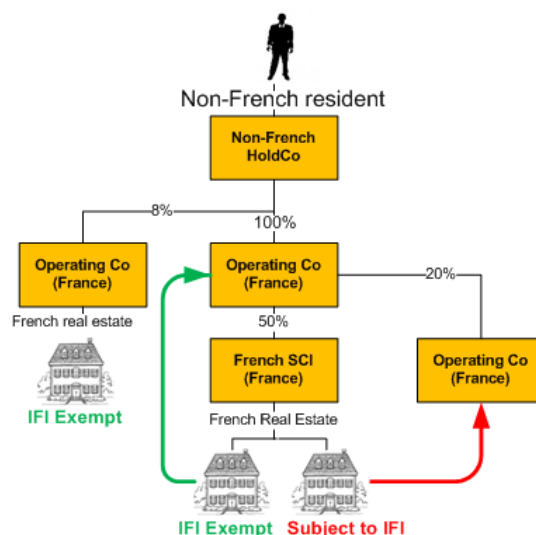
Real estate assets used by the taxpayer to carry out his professional activity, either as a sole trader, through a partnership, or through a company subject to corporate income tax will, subject to certain conditions, be exempt from the IFI<sup>2</sup>.

Furthermore, shares of an operating entity holding real estate assets, whether directly or indirectly, is not subject to IFI when these real estate assets are used for the purpose of the operating activity of either this entity, the one holding these assets or a group operating entity controlled<sup>3</sup> by this first operating entity.

The exemption also applies when the operating company holds real estate assets used for the purpose of its activities indirectly through a non-operating company, notably a French “SCI” (i.e. *société civile immobilière*). Hence, this is an advantage compared to the exemption of ISF related to professional assets the application of which is subject to many conditions, among which the exercise by the tax payer of eligible professional activity in the operating company using the real estate assets.

In any case, shares of an operating entity holding French real estate assets and in which the taxpayer holds directly or indirectly less than 10% of the share capital or the voting rights will not be subject to IFI, even if French real estate assets are not allocated to their business activity.

The situation will schematically be the following:



<sup>2</sup> For the purposes of this exemption, the conditions under which the taxpayer’s professional activity should be carried out are very similar to the one currently applicable to the ISF’s exemption related to professional assets.

<sup>3</sup> i.e. when the operating entity holds directly or indirectly more than 50% of the voting rights or control in fact this company.

***Assessment of the taxable net value: new restrictions to the deduction of debts will apply***

Debts contracted by the taxpayer for the acquisition, refurbishment, maintenance, construction or expansion of real estate assets subject to IFI will be deductible for the computation of the net value subject to IFI, subject to the following restrictions :

- **Bullet loan repayable at maturity (i.e. “in fine loan”)** will be subject to a **deemed straight line amortization** to reduce the amount of deductible debt over the years. *In fine* loan will therefore be deductible up to a portion determined by application of the ratio between (i) the remaining number of years before the end of the loan and (ii) the total duration of the loan.
- **Exclusion of interfamilial loans** : loans granted to the taxpayer by a member of his household, directly or indirectly through an interposed entity, will not be deductible.  
Loans granted to the taxpayer, directly or indirectly, by ascendants, descendants, brothers and sisters of a member of his household (the “**Family Group**”) or by a company controlled by the tax payer or by his Family Group, will only be deductible if they are subject to market practice conditions.
- **General limitations for debt exceeding 60% of real estate assets with an aggregate value exceeding 5 M€** : where (i) the value of all the taxable real estate assets owned by the taxpayer exceeds an aggregate amount 5 M€ and (ii) the amount of the debts related to such assets exceeds 60% of such value, the portion of the debts exceeding this threshold would only be deductible up to 50%.

As for the valuation of the shares of entities holding real estate assets, loans granted by the taxpayer, his Family Group or by a company that they control are deductible provided that they are subject to market practice conditions.

In any case, loans contracted to fund the acquisition of real estate assets owned by the taxpayer or a member of his household are disregarded if the acquisition is “mainly” motivated by tax considerations.

***Other points of interest***

The exclusion from IFI taxable base of high value movable assets (precious metals, yachts, sport cars) will be mitigated by an increase of the specific taxes applicable to such assets<sup>4</sup>.

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<sup>4</sup> More specifically (i) the creation of an additional tax due upon the matriculation of sport cars, (ii) an increase of the annual duties due in respect of yachts whose length exceed 30 meters and (iii) an increase of the tax due upon the transfer of precious metals from 10% to 11%