

New code of taxation of trusts in France: wealth tax aspects

1 Introduction

For the first time France is introducing a comprehensive code for the capital taxation of trusts, which are created under foreign law. The new code applies to succession duty (estate and gift taxes) and wealth tax.

2 Definition of a trust, trustees and settlors

2.1 The law now defines a *trust* as (in translation):

“The legal relationships created under the law of a state other than France by a person, having the status of settlor, either by deed *inter vivos* or by will, whose object is to place assets or rights under the control of an administrator, in the interests of one or more beneficiaries or to attain a specific objective”.

2.2 The *settlor* of a trust defined as being:

“Either the physical person who has created the trust or, when it has been created by a physical person acting in a professional capacity or by a company, the physical person who has provided the assets and rights”.

2.3 The law also defines a “settlor for tax purposes”, being a person other than the original settlor. This is so as to allow the taxing of the devolution of trust assets to successive generations of beneficiaries. After the death of the original settlor the then beneficiary is deemed to be the settlor of the trust assets. He is liable to tax upon the death of the settlor and to wealth tax on the trust fund.

2.4 In the case of a trust whose settlor is dead at the date of entry into force of this new law (July 2011), the beneficiary for the time being is deemed to be the settlor.

3 System of taxing trust assets on death of settlor or on changes in capital rights of beneficiaries

An explanation of these provisions is outside the scope of this paper (which is focused on wealth tax), but in essence the code seeks to tax trustees and/or beneficiaries upon the death of a settlor or whenever the trust terms are amended or appointments of capital made. These provisions apply from July 2011.

4 Wealth tax

4.1 Hitherto the assets held in irrevocable discretionary trusts have escaped taxation to wealth tax either on settlors or on beneficiaries. The new law requires the settlor (or a beneficiary who is deemed to be a settlor) to include trust assets in his own wealth tax return. This includes accumulations of income.

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4.2 This cumulation of trust funds with the personal estate of the settlor applies to all kinds of trusts, be they revocable, irrevocable, life interest or discretionary. It follows that no matter what the terms of the trust may be, and even if the facts of the management of the trust tend to show that a beneficiary is the effective owner of the assets, the trust fund is never taxed to wealth tax on the beneficiary, during the lifetime of the settlor.

4.3 Subject to any applicable double tax treaty, the following trust assets will be subject to wealth tax:

- All assets settled on trust where the settlor is French resident, irrespective of the country where the assets may be situated;
- Assets situated in France (except “financial assets”) settled on a trust whose settlor is not a French resident.

5 **Charitable trust**

Excluded from a settlor’s wealth tax returns are the assets held in irrevocable trusts whose beneficiaries are exclusively recognized charities and whose trustees are subject to the law of a country with which France has concluded an administrative assistance treaty.

6 **Special tax payable (unless trust assets have been declared for wealth tax)**

6.1 A new general rule states that tax at a fixed rate of 0.5% is payable on trust funds by settlors (or beneficiaries to be settlors), being physical persons. Exemption may be claimed where the assets have been included on a wealth tax return (i.e. the tax is prima facie payable: you have to claim the exemption).

6.2 Where the settlor (or beneficiary-deemed-settlor) is French resident, the tax is levied by reference to all trust assets, including capitalized income, on a worldwide basis.

Settlors resident outside France are only liable by reference to French situs assets held within the trust. Financial assets e.g. accounts, quoted shares, are exempt.

7 **Exemptions from the special tax**

- Assets properly declared on wealth tax returns;
- Assets in charitable trusts.

7.1. For exemption to apply, assets declared on wealth tax returns must have been declared at the outset. Inclusion following a wealth tax audit will not qualify for exemption and in that case both the special tax at % and normal wealth tax would be due, i.e. tax due twice over.

7.2 Exemption is available where the net wealth of the settlor (or deemed settlor) does not exceed the wealth tax threshold of €1.3 million, (calculated after taking account of the trust assets) and where the assets have nevertheless been declared to the tax office by the trustee (see § 8.3 below).

7.3 Assets in irrevocable charitable trusts are exempted from the special tax @ 0.5% provided the trustee is established in a treaty country..../...

- 7.4 Pension trusts set up by companies for their employees are exempt.
- 7.5 The trustee must declare annually the description and value of the trust assets and pay the special tax thereon on 15 June each year. Whilst the trustee is the principal person liable, the settlor and beneficiaries of the trust, (other than those who have made their own proper returns), are jointly liable with the trustee to pay the tax.
- 7.6 The new rules for wealth tax and the special tax apply from 1 January 2012.
- 7.7 Taxpayers newly-arrived in France continue to benefit from the general exemption from wealth tax on their non-French assets. This applies for the first five years of residence. It also applies to assets held in foreign trusts provided those assets are actually declared on a wealth tax return so that the special tax @ 0.5 % is not applicable.

8 Trustees' obligations to the French authorities

- 8.1 In cases where trust assets are likely to be taxable on a French resident settlor the law now requires the trustee to make an annual declaration to the French tax authorities. This will be the case where:
- The settlor or a beneficiary is a French resident for the year concerned;
 - The trust fund includes French assets, e.g. real property.
- 8.2. The new return will require the trustee to declare:
- The creation, amendment or termination of the trust;
 - The terms of the trust;
 - The market value of the trust assets potentially liable to the special tax of 0.5%, including those which may actually be exempt from that tax by virtue of their having been declared on the settlor's wealth tax return.

A subsequent decree will give more detail on the precise form of this return by trustees.

- 8.3 It is a condition of exemption from the special tax @0.5% that the trustees make this annual declaration.
- 8.4 Trustees who do not make the annual declaration are liable to a fine of € 10,000 or 5% of the trust fund, if higher. The settlor and any beneficiaries who may be liable for the special tax are also jointly liable for the fine.

Commentary

It will be seen from this note that the intention of the new law is to impose wealth tax on settlors as if they had never made their trusts in the first place. The law seems to start from a presumption that a principal reason for the making of a trust is the avoidance of wealth tax and estate taxes. This is clearly an unfair presumption, particularly in cases where settlors are not members of the trust beneficial class and have genuinely sought to hand assets down to the next generation of the family. It may be surmised that the French government will receive representations asking for changes to recognize the kinds of circumstances. In the meantime French resident settlors will be examining ways of placing themselves outside the ambit of the new legislation, notably through capital appointments to non-French resident beneficiaries, followed by suitable re-settlement.