

# Tax regime of trusts in France

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## Article 14 of the rectified finance law on 2011

**A**rticle 14 of the modified finance act for 2011 created a new system of taxation for foreign trusts of which the beneficiaries or the settlors are physical persons who are or were fiscal residents of France.

The correct application of these new regulations is based, at first, on the declaration/disclosure of trusts to the French tax authorities, and then, under the unique administrative and financial responsibility of the indicated trustee appointed as the manager of the trust.

In French tax law, the direct responsibility of a trustee is a new notion, while it already exists in a number of well known foreign jurisdictions.

The new fiscal legislation allows for any gifts and bequests prior to the publication of the law, to be settled without retroactive consequences.

The trust is frequently used, in the common law, to pass on assets to future generations. In particular, it is often used as part of the family company structure to ensure continuity for several generations. Under a "normal" legacy, for example, the heirs could destroy the family business.

In the civil law, however, the trust is not recognised, and one could say it is forbidden within the framework of article 1130 of the civil code, promulgated by the law of 7 February 1804, which bans agreements on future estate issues.

However, a small number of French residents established trusts, not resident in France, for the purposes of tax evasion. Buildings were even acquired in France by way of trusts.

The objective of the new legislation is to disclose the trust by subjecting the trustee to severe administrative and financial obligations.

## The absence of a fiscal definition of the trust in French law

In tax law, the trust has no equivalent definition and is subjected to the interpretation of the courts.

The extent of taxation, not defined by the administration, varies according to the nature of the trust and according to the decisions of the courts. Up until now, there was no general rule.

## The trust under the new fiscal law

Article 14 of the new law attempts to resolve the ambiguity of the current legal treatment of trusts, from a fiscal perspective.

This article applies specific tax treatment to trusts, and in particular, it applies inheritance tax and taxation on capital (wealth tax). Specific declaration obligations are imposed to ensure the effectiveness of these measures.

This definition is only a fiscal definition, which applies to all taxes included in the General Code of Taxes (CGI)<sup>1</sup>. The new article 792-0 bis CGI therefore does not apply outside of French tax law.

## A definition of a trust for the French tax system

### **The fiscal definition of the trust**

The new law inserts a new article, 792-0, into the CGI, defining trusts.

For the purposes of this new article and for the application of the CGI in general (not only taxable events in new law), it defines a trust as:

"All of the legal rights created, by way of the law of a state, other than France, by a person, who has the quality of a settlor, by an act inter vivos or on death, to transfer the

assets or the rights, to the control of an administrator, in the interest of one or of several beneficiaries or for the realisation of a defined objective.”

Please note the administrator in this instance is the trustee.

The definition follows article 2 of The Hague Convention of 1 July 1985 relative to the law applicable to the trust and to its recognition, which was signed, but not ratified by France.

This definition does not allow the creation of trusts under French law, but simply allows for the recognition of foreign trust structures under French tax law.

### Definition of the initial settlor

The law defines, within the framework of title IV of the CGI on registration fees, and identifies, the settlor of the trust as:

- the person who established it,
- when it was established by a person acting professionally or by a legal entity, the person who transferred the assets or rights.

This last definition attempts to allow the administration to judge the basis of the creation of the trust to determine, if necessary, the identity of the real person behind the trust.

### Definition of the fiscal settlor

The law also defines a "fiscal settlor", in addition to the initial settlor, to allow the application of law in the case of future transfers. The beneficiary of a trust from which the original settlor has died is fiscally assigned as a settlor.

The definition of the word settlor is therefore very wide because it can include the ascendants of a current beneficiary.

### Definition of a beneficiary

The beneficiary can be a person with or without a hereditary tie to the settlor or a legal person (entity, body, foundation, etc). The legislator establishes a definition following the nature of the taxation.

#### Inheritance taxes and gifts

The beneficiary of the trust, in practice, will be an individual person, an heir or a dedicated beneficiary, but the text also allows for situations where the beneficiary is not a descendant, but another physical or legal person. In this case, the rate of taxation will be 60% and it does not take into account any relief given to individual persons based on the relationship of the beneficiary.

#### Capital tax and the new forfeit on trusts

This law in relation to capital tax

only applies if the beneficiary is an individual person. The new article 990 J CGI states that “individual persons constituting or profiting by way of a trust defined in the article 792-0 bis are subjected to a specific taxation to be determined”. Only physical persons constituting or profiting from a trust are subject to this taxation and not any other private or public entity or moral persons.

### Trustee obligations

To allow for the application of the new fiscal rules, a new article 1649 AB of the CGI imposes new filing and disclosure obligations relating to trusts.

#### Who has the responsibility to fill the declaration?

According to article 792-0 bis, the administrator of a trust of which either the settlor or at least one of the beneficiaries have their tax residence/domicile in France, or has assets or rights situated there, will be obliged to ensure that the declaration obligations to the French administration are fulfilled.

#### Which trusts should be disclosed?

The following trusts need to be declared:

- if the settlor is resident/domiciled in France.
- if a beneficiary is resident/domiciled in France.
- if assets or rights are situated in France.

The legislation applies where it is defined by law and before any possible administrative amendments, this is extremely wide and includes all trusts, even charitable trusts, which have ties with France, and even where they are not subject to taxation in France.

#### What should be disclosed?

According to the legislation, the administrator of a trust of which the settlor or at least one of the beneficiaries has their tax residence/domicile in France, or which includes assets or rights which are situated in France, will be obliged to disclose the following to the tax authorities.

- The settlor, the modification or the dissolution of the trust.
- The contents of the period (it is advisable to include the rights of the trust and, if necessary, any complementary conditions relating to the functioning of the trust).
- The market value on 1 January of the year of the specific assets and rights. The assets and rights that must be declared are those relating to the application of the forfeit tax on trusts. (Object of the new article 990 J of the CGI).

## A government act will determine the application of the new legislation

### Penalties in cases of non-disclosure

Article 1736 IV bis CGI plans to impose penalties for not respecting the new filing obligations. The fine is EUR10,000 in the case of larger amounts and 5% of the assets of the trust.

This is a very high level, corresponding to ten years of the tax forfeit, and on top of this based on all of the assets of the trust, whether or not they are subject to wealth tax or subject to the new undertaking of the article 990 J.

### Responsibility for the payment of fines

Article 1754 V, a new section of the CGI specifies that the fine will be due jointly and severally by the administrator that is the trustee and by the settlor and the beneficiaries of the trust.

### Taxation of the income of a trust

The new law limits taxation to the distributed income. This allows for exemptions for revenues reinvested in the trust. The income of a trust is therefore only subject to income or corporation tax if it is distributed.

It is, however, advisable to note that the taxation of non-distributed income remains possible, if, for instance, the trust is subject to a privileged tax system. Obviously, this is subject to any existing tax treaties (article 123 bis CGI).

### Taxation of the assets of a trust

For inheritance, gift taxes and wealth tax, the legislation resolves weaknesses in the current system. Except for taking into account any current principles and practices. Professional trust managers, that is the trustees, must reveal to the French treasury the existence of the trust as well as the identity of the settlor and beneficiaries.

How will trustees react? The subject is delicate enough and it is a question of individual ethics and business principals.

In any case the message is clear; a number of trusts should prepare for potential identification by the French banking system of computer files of bank accounts, Fichier Informatisé des Comptes Bancaires (FICоба) and by EVAFISC.

### The tax regime for transfers by donation or inheritance from a trust

The text states that the jurisdiction relating to the transmission of assets and rights constituting the trust, is

interpreted under French tax law, as a gift or a transfer upon death.

**General principles**

The new article 792-0 bis II defines the tax treatment of trusts for gifts and inheritance tax.

**The taxable event is the death of the settlor**

In this case, the inheritance, including the assets initially placed in the trust, will be taxed on their market value at the date of the transmission, (the date of the death) at a rate dependent on the relationship of the family, the settlor and the beneficiary.

**The chargeable rates for inheritance taxes**

Several situations are considered:

**(i) In the case of a direct transfer by gift or inheritance**

If the direct transfer of assets or rights placed in a trust is clear, the net market value of the assets, and/or the rights at the date of the transmission are subjected to transfer taxes which are determined by the family tie existing between the settlor and the beneficiary.

**(ii) If the gift or the transfer by death cannot be established**

The approach is based, so far as possible on the common law. The death of the settlor automatically initiates the transfer.

The assets and the rights placed in a trust, are passed on to the beneficiaries upon the death of the settlor without being integrated into their inheritance, although possibly staying in the trust after the death of the settlor,

Inheritance tax is calculated in the following way:

- If, at the time of death, the part of the assets and rights which are due to a beneficiary is determined, this part is subjected to inheritance taxes according to the family tie between the settlor and the beneficiary.
- If, at the time of death, a specific part of the assets, or the rights are totally due to the descendants of the settlor, this is subject to transfer taxes upon death at the rate applicable to the highest threshold of table I annexed to article 777, which is 45%.
- The third case is, in a way, a "sweep clean theory" of taxation of the net assets of the trust on the day of the settlor's death. This occurs where there is no transmission and the assets stay in the trust upon the death of the settlor, or where there is transmission without a defined individual share for the beneficiaries other than descendants of the

settlor. The taxation rate for inheritance taxes where there are no family links ie 60% is then applied.

**(iii) Where the trustee is subject to the law of a non co-operating state**

The new law stipulates that when the administrator of the trust is subject to the law of a state or non co-operative territory in the sense of article 238-0 A, the rate of gift and inheritance taxes which are owed is the last threshold of table III annexed to article 777, ie 60%.

Article 238-0 A introduced by article 22 of the finance law n°2009-1674 of 30 December 2009 proposes a real innovation, namely the definition, in French law, of states and non co-operative territories (ETNC). This includes those which have not entered into an agreement with France on transparency and the exchange of tax information according to the OECD standard.

**French list of non co-operative states for 2011 Established on 14 April 2011**

Anguilla	Guatemala	Niue
Belize	Cook Islands	Panama
Brunei	Marshall Islands	Philippines
Costa Rica	Liberia	Oman
Dominique	Montserrat	Turks and Caicos Islands
Grenada	Nauru	St Vincent and the Grenadines

*Note: The text is not aimed at the law of the place of residence of the trustee, but at the law to which the trust is subjected to. The marginal rate applicable between non-relatives (that is 60%) applies, in every case, if the trustee is subjected to such a law of a state or a non co-operative territory*

**(iv) If the settlor is established in France (Art. 792-0 bis)**

The text provides that the rate of 60% applies in every case, if the grantor is tax resident in France at the time of the creation of the trust and when the trust was established after 11 May 2011

The rules outlined above are presented in a tabulated format below:

Position of assets at the death of the settlor			Taxation
Assets transferred	Beneficiary's defined share.	Settling a gift or an inheritance.	DMTG* by way of common law
		Not defining a gift or a inheritance.	DMTG* by death by way of common law
	Related share: defined share of several descendants		45%
	Other cases		60%
Assets remaining in the trust			60%

\* DMTG = 'Droits de Mutation à Titre Gratuit', duty due on free transfers.

**The application of the rule of territoriality**

The law applies to trusts the rules of territoriality applicable to the law of inheritance as defined by the article 750 ter of the CGI.

It must be noted that the Droits de Mutation à Titre Gratuit (DMTG), ie duty due on free transfers applies, subject to the fiscal conventions:

- On the French and foreign assets of the donors or when the deceased is domiciled/resident fiscally in France.
- On the French assets of the donors or the deceased being non-resident.
- On the French and foreign assets received by the heirs, the donees or the heirs resident /domiciled fiscally in France on the condition that they were so for at least six out of the ten years preceding the year when they receive the assets.

This measure outlines the application of the new rules of taxation of assets held in trusts or passed on according to modalities which cannot be likened to a gift or to an inheritance.

**The revision of the rules on the presumption of ownership**

The new law completes article 752 CGI, as to widen the presumption of assets or rights placed in a trust.

**Who is responsible for the payment of inheritance or gift taxes?**

In French tax law, the beneficiary of a succession or a gift is legally liable to pay, if necessary, and is joint and severally liable with the heirs.

Concerning the taxation of a transfer by way of a trust, the legislator has modified the traditional principle in the French tax system by engaging the administrative and financial responsibility of the trustee in a large number of situations planned by new article 792-0 bis of the CGI.

The legislation puts the filing obligation and financial responsibility onto the trustee as the visible administrator of the trust and with whom a joint fiscal liability is established with the beneficiary who is established in France in two situations: where the

administrator is established in a non co-operative state or where the administrator is established in a state which hasn't concluded an agreement of mutual assistance in the collection of taxes with France, for example Switzerland.

### The tax regime of the assets in a trust

The ownership of assets through a trust was ambiguous in French law in relation to calculating wealth tax. The legislation therefore proposes on the one hand, to apply general principles to the wealth tax applicable to the assets and rights in a trust, and on the other hand, to create a forfeit taxation in order to tax the assets which would not have been declared to the tax authorities in relation to wealth tax.

In both situations, the taxation is due only if the constituent is an individual person.

### The principle: the implication of the settlor to wealth tax

The new article 885 G ter CGI proposes that the assets placed in a trust are included in the taxable assets of the settlor (if an individual person), for wealth tax purposes, at their net market value on 1 January of each year of taxation.

The text creates an obligation for the trustee to declare the trust, even where the settlor is not liable for wealth tax on the assets considering the taxable net value of the estate, this includes assets as well as rights placed in the trust.

In basic terms, this means that in all situations, the administration will be informed about assets held by a trust in addition to those deemed to be beneficiaries and settlors of the trust.

### An exception for charitable trusts or similar

These provisions do not apply to:

- i) irrevocable trusts;
- ii) of which the exclusive beneficiaries are covered by Article 795 CGI; and
- iii) whose director is subject to the law of a state or territory which has concluded a convention on administrative assistance in cases of fraud and tax evasion with France.

### Fiscal qualification of assets

The fiscal qualification of assets i.e. whether they are taxable or not taxable is maintained.

In view of the rules of territoriality applicable to wealth tax, where the assets are placed in a trust, the settlor of which is a French fiscal resident, the assets would be taxed wherever they are situated. Where assets situated in France are placed in a trust, the settlor

of which is not a fiscal French resident, the assets are taxable in France<sup>1</sup>.

### The exception: withholding tax on trusts

A new obligation is imposed in article 990 J CGI, "to recover" assets or rights not covered by the wealth tax. The legislation does not attempt to create a complex definition of assets placed in a trust, but defines an overall tax for which the trustee, settlor and the beneficiaries of the trust are jointly and severally liable.

#### **The person legally responsible: an individual person**

The new article 990 J CGI outlines:

If the settlor or those benefiting by way of a trust defined in the article 792-0 bis CGI are physical persons, then they are liable at the highest threshold of wealth tax. Other private or public entities or moral persons are not liable to this obligation.

#### **The de facto person responsible for the French trust tax: the trustee**

Article 990 J CGI outlines that liability will be on "physical persons, settlors and beneficiaries of a trust". This exempts charitable trusts whose general objectives are not targeted.

In practice, the liability rests with the trustee, as the text specifies that:

- on one hand, the filing obligations are compulsory for the trustee who will have to declare "the consistency and the value of the assets, or rights placed in the trust".
- on the other hand, the trustee will have to settle and pay the tax to the competent authorities for the trust at the latest by 15 June of every year and for the first time on 15 June 2012.

In cases of non-filing and non-payment, the settlor and the beneficiaries are jointly responsible for payment of the tax, except where the trust was declared to wealth tax by the settlor or by the trustee within the framework of their general obligations.

### The fiscal basis of the French trust tax

Article 990 J CGI creates a specific tax covering assets placed in trusts which have not been declared in accordance with wealth tax obligations.

This tax is based on the market value on 1 January of every year and includes:

- all assets (situated inside and outside France) in a trust which has a French settlor or fiscal resident beneficiaries;
- and all assets placed in the trust (others than the financial investments up to the wealth tax

threshold) which are situated in France, as well as zero coupon bonds or similar capitalisation products for non-resident settlors and beneficiaries.

It is therefore calculated on the same basis as wealth tax, however, exemptions which result from the nature of the assets, for example, works of art and professional assets, will not apply.

This taxes estates not having been declared for taxation to wealth tax.

### Taxation of trusts which have not been declared for wealth tax purposes

All physical persons should declare assets or rights placed in a trust to the tax authorities for the purposes of wealth tax because:

- The exemption for wealth tax is more limited, because it arises from certain assets (professional assets, works of art, etc);
- The rate of wealth tax is never superior than the higher threshold that relates to trusts.

The new tax applies when the assets which were undeclared, are "discovered" by the tax authorities.

#### **The rate of French trust tax**

The tax is equal to the maximum rate of wealth tax: 0.5% on 1 January 2012.

#### **Exceptions relating to French trust tax**

The law provides several exceptions but with a general condition: a treaty with a tax information exchange clause.

The trustee will be subject to the law of a state or territory with which France has concluded an agreement for administrative assistance in the prevention of fraud and tax evasion.

The objective is clear; the trustee must respond to enquiries made by the French tax authorities either under a double tax agreement with exchange of information provision or a tax information exchange agreement.

#### **Pension trust companies**

French trust tax does not apply "to trusts established to manage the rights for pensions acquired, in conformity with a professional activity, by the beneficiaries within the framework of a pension plan set up by a company or a company group".

This exemption is aimed at trusts created by companies to benefit their management and employees and their former management and employees. However, the assets and rights could be subject to wealth tax if circumstances trigger a taxable event.

#### **Charitable trusts or similar**

The law expressly excludes trusts of which the exclusive beneficiaries are related to the provisions of article 795 CGI, ie

- i) an irrevocable trust;
- ii) the exclusive beneficiaries of which are covered by Article 795 CGI; and
- iii) whose director is subject to the law of a state or territory which has concluded a convention on administrative assistance in cases of fraud and tax evasion with France.

This applies to bodies and charitable public institutions, mutual insurance companies and all other state-approved companies, the income of which is allocated, in particular, to benevolent assistance or charity.

### Trusts that declare wealth tax

The new French tax on trusts will not be due where a trust is declared and is not liable to wealth tax.

After all, this new tax on trusts provides an alternative taxation to wealth tax, by applying taxation to assets or rights which have not been declared to the administration.

Where wealth tax arises from a spontaneous, regular declaration of the taxpayer, no extra tax arises. If this is not the case, a tax assessment would be initiated by the administration and a forfeit tax imposed.

In many ways, it makes sense to fix a method of taxation in this way and it is important to realise that taxation on trusts will be more

favourable by regular voluntary disclosure and payment of the wealth tax, which then exempts the trust from the imposition of the new tax.

The aim of the new tax, therefore, is to impose taxation on undeclared assets lodged abroad in trusts.

### The accumulation with a tax of 3%

Article 990 D CGI dictates that legal entities: moral persons, bodies, trusts or comparable institutions which, directly or indirectly, possess one or several buildings situated in France or are holders of rights over these assets, are liable to an annual tax equal to 3% of the market value of these buildings or rights, except where there are legal exemptions.

The question is will this tax continue to be imposed where a declaration of a trust is made?

### Development of assistance in the recovery of tax

For the first time, the legislation makes reference to treaties for mutual assistance in the recovery of tax and to simplify effective measures against fraud and tax evasion.

It is also possible to prepare a safety net against the least common

application, by the European Court of Justice of the freedom of movement of capital, the slightest control of which becomes an obstacle.

To have more effective assistance and to facilitate it in practice, important amendments were necessary, so that the abrogation of directive 2008/55/CE will be realised on 1 January 2012 and replaced by directive 2010/24/EU of the Council of 16 March 2010.

So, article 5§3 raises the exception of bank secrecy between member states.

### The date of implementation: not applicable for past trusts

The law indicates that all new legislation relating to the DMTG will apply to the gifts and bequests from the publication of the law.

#### END NOTES:

1. With the exception of the financial assets, exempted by virtue of the article 885 L from the CGI.



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