Technical Notes: Disposal of A French Property

A BRIEF INTRODUCTION TO THE FRENCH & UK TAX TREATMENT OF ANY GAINS

Gains made from the sale of French property owned directly by an individual or individuals are liable to Capital Gains Tax in France. Equally, if the individual is resident or ordinarily resident in the UK, the disposal of the French property will also be subject to UK Capital Gains Tax.

Although a Double Taxation Treaty exists between France and the UK, the purpose of the agreement is not to allow the individual to "choose" in which country to pay the tax, nor is it designed to allow tax to be paid in only one country and not the other. Instead, the treaty simply allows that for a UK resident, any French tax paid will be credited against the UK tax arising from the same gain.

This introductory report does not cover gains made from the sale of a property by a UK Ltd Company, or gains made from the sale of shares in a Ltd Company.

Please contact our office, if the sale involves a Ltd Company.

Regarding the sale by an *SCI* (*Société Civile Immobilière*) the information below explaining the French tax treatment is also valid. However, the UK tax position is different. The explanation of the UK tax treatment and consequences of sale by an *SCI* is found in our note SCI VOLUNTARY DISSOLUTION.

The report is based on legislation current for the UK tax year 2019/2020 and French Finance Acts of 2019.

Part 1 FRANCE - BASIC RULES FOR RATES OF TAX AND CALCULATION OF THE GAIN (2020). "REGIME DES PLUS VALUES PRIVEES"

The following summary describes the assessment of gains from the sale of private assets realised on or after 01/01/2019, (*Régime des Plus-Values Privées*). This does not apply to property which forms part of the assets of a professional business, such as "*location en meublé professionnelle*". The description also does not apply to the disposal of a property by a UK ltd company or any other commercial company.

Please refer back to our office if you believe your property transaction falls within any of these categories.

In general, apart from both jurisdictions applying tax on the gain and identifying the gain as the difference between the sale price and the purchase price plus enhancement costs, **there is very little similarity between France and the UK as to what constitutes the net taxable gain.**

1. TAX RATE SINCE 01 JANUARY 2019

1.1 IMPOT SUR LE REVENU

This is levied in all cases at a flat rate of 19%

There is no annual allowance – the rate is applied from the first Euro - but instead a taper relief is applied to reduce, (and potentially exempt), the gross gain,

1.2 SUPPLEMENTARY TAX CHARGE ON LARGER GAINS

When the taxable gain exceeds 50.000€ per owner a supplementary tax charge will apply on the whole gain at the following rates shown in the table overleaf.

Click here to see an illustrative table Supplementary Capital Gains Tax : Basic Rates and Transitional Reliefs

1.3 *PRELEVEMENTS SOCIAUX*

As with *Impôt sur le Revenu ("I.R.")* there is no annual allowance – the rate is applied from the first Euro - but again a taper relief is applied to reduce the gross gain, albeit at a slower rate than the taper relief for *I.R.*

The default position is that *PS* will be charged at a flat rate of 17.2%, comprising 3 components:

- *Contribution Sociale Généralisée (CSG)* levied at 9.2%
- *Contribution au Remboursemnent de la Dette Sociale (CRDS)* @ 0.5%
- *Prélèvement de Solidarité* @ 7.5%

➔ Total 17.2%

For technical reasons, the default charge rate can be reduced to 7.5% – with the taxpayer being exempt from the CSG and CRDS components – if they can prove that they are, at the time of disposal, not subject to a French obligatory national insurance scheme and instead subject to the National Insurance legislation of another EU or EEA member State or of Switzerland.

In the event you are charged with CSG and CRDS components, Charles Hamer's full French CGT service includes assessment, preparation and presentation of the claim at the point of sale or for recovering overpayment post sale.

Post Brexit (transition period ends 31/12/2020), unless the UK adopts the EEA route or participates as a special status 3rd State like Switzerland, Regulation 883/2004 and all the protections it offers will no longer apply.

Consequently, in such circumstances, a sale from 01/01/2021 will give rise to the 17.2% default levy applying, without scope for reduction, as France will be freely able to charge PS at full value.

2. EXEMPTIONS & TAPER RELIEF

2.1 EXEMPTIONS

The availability of exemptions and reliefs will depend on several factors:

- How long the property has been owned,
- Whether the owners have at any time been fiscally resident in France and lived at the property as their main residence during that period
- Whether or not the property has been used to generate seasonal holiday lettings and if so, whether the activity qualifies as "*Location en Meublé Professionnelle*".

Other, substantially less frequently occurring exemptions are also available, peculiar to the circumstances of the sale and the taxpayer. When assessing your file, we will consider whether or not your case qualifies for any full or partial exemption.

In practice, however, more often than not, the difficulty lies in being able to justify to the notaire and/or tax office, entitlement to the exemption.

2.2 TAPER RELIEF

Unlike the UK, taper relief is still available in France to offset the impact of inflation in increasing the gain. Relative to the state of play before 01/09/2013 taper relief has been accelerated for the *Impôt sur le Revenu* and Supplementary tax elements of the overall tax charge, but has been back-end loaded for *Prelevements Sociaux*.

Click here to see an illustrative table Summary of Taper Relief Rates

Special rules apply to the disposal of building land and the sale of shares in an SCI (*Société Civile Immobilière*) or other form of civil company. If your disposal concerns either of these scenarios contact our office for more details.

After 22 full years of ownership then, the gain is exempt from *Impot sur le Revenu*, but is still exposed to *Prélèvements Sociaux*. It is not until 30 full years of ownership have been achieved that, 100% taper relief is acquired across the board, effectively rendering the disposal exempt from French Tax.

2.3 ALLOWABLE DEDUCTIONS

In addition to the basic purchase price paid for the property (or its construction) there are a number of limited allowable deductions which may be applied before arriving at the pre tapered gain.

2.3.1 Ancillary Acquisition Costs

As well as the basic purchase price, ("*prix principal*"), ancillary costs of purchase such as notaire's fees and estate agent's commissions can be added to the base purchase cost prior to arriving at the pre- tapered gain.

When these fees cannot be justified, (e.g. absence or loss of notaire's completion account), for French tax purposes, a default value of 7.5% of the *prix principal* will be assumed.

2.3.2 Acquisition Enhancement Costs

Similarly, subject to meeting strict rules on definition and justification, capital works for enlargement, improvement, conversion, construction and reconstruction may also be added – so reducing the pre tapered gain.

When the property has been owned more than 5 years, a default deduction amounting to 15% of the *prix principal* may be applied when actual capital works fall short of this or cannot be justified satisfactorily.

Often the works carried out far exceed this 15% sum, which then leads to the challenge of persuading the notaire responsible for making the CGT declaration to accept the actual costs of improvement.

In practice there is a great deal of variation between notaires as to what they accept as qualifying improvement cost, to the extent that this, in our experience, is the biggest area of dispute between the seller and the notaire when arriving at the taxable gain.

Part of the problem is that there is very little in the way of a statutory definition of what is an improvement (as opposed to major repair or maintenance, which is not allowable). Rather the definition relies heavily on case history, which at best is not clear and downright ambiguous in many instances.

Consequently, the notaire's interpretation tends to err on the side of caution.

2.3.3 Costs of Sale

Meanwhile, the net relevant sale price may be reduced to account for a limited range of sales related costs:

- Estate Agent commission
- Cost of diagnostics
- Discharge of a Mortgage deed
- Fiscal representative charges

2.3.4 Furniture

The price of any furniture forming part of the sale, may be deducted from the sales price, subject to meeting a number of stringent criteria, which – in principle at least – involves the presentation of an inventory, with itemised values, (signed off by a registered auctioneer prior to signature of the Compromis or Promesse de vente). Otherwise it will be included in the sale price used to compute the French gain.

2.4 Declaration & Payment

Since 2005, a non- resident seller has been obliged to appoint a fiscal representative in France to be responsible for the calculation and payment of the tax, whenever the sale price exceeded €150,000.

Following directions from the European Commission, from 01/01/2015, all sales by residents in the EEA (with the exception of Lichtenstein), can now do away with the need for a Fiscal Rep. Instead it will be the notaire who is responsible for submitting the French tax declaration and making payment by deducting the tax due from the sales proceeds.

Only when the seller (or shareholder of an SCI) is non- EEA resident does the requirement for a fiscal representative remain in place.

2.5 The Impact of Brexit – The Return of the Fiscal Representative

Post Brexit, assuming the UK does not remain an EEA member, then the requirement to appoint a fiscal representative will be reintroduced.

Apart from bringing in an extra cost to the sale, our experience of the pre and post 2015 environment suggests that the main issue will be the raising by several notches the burden of proof needed for improvement works to be accepted.

Proof of payment will be a requirement when it is not always demanded by *notaires*.

Compliant invoices will also be needed. In line with the general tax office statement of practice as to the interpretation of legislation, receipts for purchase of materials for work done on a DIY basis will prove unacceptable.

It will become even more important that usual to dig out the correct paperwork on the works completed, chase down contractors to fill gaps in documentation and obtain copies of banking records as far as possible.

Having an adviser / interlocuteur, such as *Charles Hamer*, equally knowledgeable of the legislation and fighting your corner could save 1000's of Euros in tax.

Part 2. THE UK - BRIEF SUMMARY OF RULES (TAX YEAR 2019/2020)

Jointly owned property, unless shown otherwise via the title deeds, is assumed to be owned equally.

A primary consideration that is often initially overlooked is that the computation of the costs and acquisitions must be expressed in £ at the exchange rate experienced at the time of the outlay or the receipt.

The amount of tax due is arrived at by dividing the net gain, (after allowing for purchase and sale costs, improvement costs and taper relief), amongst the owners. Each individual may offset against their share of the net gain their annual personal Capital Gains Tax allowance of £12,000 - assuming that this allowance has not already been used up against other gains made in the same tax year.

The resulting apportioned gain is taxed – prior to any double tax relief - at a rate of between 18% (basic rate tax) and 28% (higher rate tax), depending on:

- Whether or not your taxable income for the year is above or below the basic rate band threshold and
- Whether or not the taxable gain, when added to your taxable income straddles the threshold

For disposals of shares in an SCI the tax rates are reduced to 10% and 20% respectively

The tax rate is potentially reduced to 10% if the property qualifies as a business asset, (e.g. it qualified for Furnished Holiday Lettings tax treatment).

The tax declaration, (and tax payment), is made via self- assessment due no later than 31st January in the year following the UK tax year of disposal.

Other than the application of Double Tax relief, there are no special rules applied to the fact that the gain is made abroad. The various permissible expenses and allowances applied when reducing the gross gain to a net taxable gain for disposals realised within the UK are equally valid for the French property.

Any loss made, (for example as a consequence of exchange rate movement), can be carried forward against any other UK taxable gains made in the same tax year or any future year in the individual's lifetime.

1. DOUBLE TAX RELIEF FOR FRENCH TAX PAID

Double Taxation Treaty provisions allow for some but not all of the French tax already paid or payable following the sale of the French property, to be offset against the UK tax as calculated above.

A tax rebate is not available if the French Tax paid is greater than the UK tax calculated. In such a case, there would simply be no tax to pay in the UK.

1.1. HMRC INTERPRETATION OF PRELEVEMENTS SOCIAUX & CURRENT TREATMENT FOR TAX RELIEF

Prélèvements Sociaux (PS) as they stood prior to the January 2019 changes were excluded from the charges for which credit is allowed against UK Capital Gains Tax.

They were also specifically excluded as an allowable tax in the current double tax treaty, but HMRC have also clarified that they also don't qualify for unilateral tax relief, (which might otherwise be claimed under TIOPA [*Taxation International and Other Provisions*] Act 2010.

In the case of PS levied in 2018, because of funding objective changes made in the 2018 French Finance acts, 2% of the 17.2% charge at source remains applicable even after a successful claim against the main charge has been raised. Our view is that because of this change, the levy can be claimed as a credit against corresponding UK tax, (by reference to *TIOPA 2010*).

1.1.1 Impact of the January 2019 French changes

The legislation behind 2019 changes to PS suggests to us that the *Prélèvement de Solidarité* component of PS – the 7.5% element – now takes on the nature of a tax.

Whilst not expressly catered for in the double tax convention between the UK and France, we therefore believe it reasonable to expect this component, along with the supplementary tax charge – when applicable – to be claimable as a credit against the gross UK tax arrived at on the same transaction.

Meanwhile, for as long as the UK remains a participant in Regulation 883/2004 and the taxpayer is subject to the N.I. legislation of the UK or that of another participant other than France, then the CSG and CRDS components are either not chargeable at the outset or are recoverable.

1.1.2 Impact of Brexit

The hard Brexit scenario – no continued participation by the UK in Regulation 883/2004 – reintroduces the scope to charge the CSG and CRDS components.

In this event, the *Prélèvement de Solidarité* element would remain claimable as a credit against corresponding UK tax but the *CSG* and *CRDS* payments would not normally appear in the UK computations, whether as a tax credit or a cost of disposal.

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