

French Treatment of Foreign Trusts

G. Warren Whitaker
Day Pitney LLP
New York, NY



2017 Delaware Trust Conference
October 24, 2017

 DAY PITNEY LLP

Summary of Recommendations

- Don't create a trust if there will be a French settlor, beneficiary, or assets (except French listed securities)
- Terminate existing trusts with a French settlor
- Exclude French beneficiaries.
- Alternative: Take French advice and prepare for significant and frequent French reporting, possible negative tax consequences, possible disclosure in a public Register.

History

- French law does not include the concept of the Trust, although it does have life estate or usufructs.
- Tax treatment of French residents who were settlor or beneficiary of a foreign trust was unclear and possibly advantageous before 2011.
- Now the treatment is all too clear.

Reporting

- The TRUSTEE must report the creation, modification or termination of a trust with a French settlor, beneficiary or assets must be reported within one month of the event.
- Modification and termination includes every distribution of principal or accumulated income from the trust.
- In addition, an annual report is required by the TRUSTEE for all trusts with a French settlor, beneficiary or assets located in France (except listed securities).
- The report requires identity of the settlor, trustee and beneficiaries and information regarding assets.
- There is a fine of 20,000€ or 12.5% of the trust assets for failure to file.

French Income Taxation

- Income received from a trust by a French resident is taxed with estimated tax of 30% due on the 15th of the following month and total tax rate rising to 45%.
- The original principal is not taxed on distribution to a beneficiary.
- Income that is built up inside a trust without being distributed is normally not subject to French income tax liability but may be subject to French inheritance or gift tax.

French Succession and Gift Taxes

- The trust assets are fully subject to inheritance tax on the death of the settlor if the settlor is a French resident or if any trust assets are situated in France.
- After the settlor’s death the first beneficiary becomes the “deemed settlor” and asset in the trust are subject to succession or gift tax on transfer at their death.
- Whether the trust is revocable or irrevocable, and when it was created, are not relevant. There is no such thing in France as a “completed gift” to a trust.

French Succession and Gift Taxes

Gift and inheritance taxes: Two possibilities:

1. Transfer from the trust is considered as a gift or inheritance under French law on which the French inheritance or gift taxes apply in a normal way.
 - The French Tax Administration considers that a gift or an inheritance is clearly established only when the assets are distributed outright to the beneficiaries at the time of the death of the settlor and these beneficiaries are all legal heirs (closest relatives) of the deceased.

French Succession and Gift Taxes

2. Transfer not considered as a gift or inheritance under French law subject to a specific taxation following 3 different scenarios:
 - If an identified share of the trust assets passes to a trust for a single designated beneficiary, the inheritance tax is levied according to the family link between the beneficiary and the deceased settlor: zero for the spouse or graduated rates up to 45% to the descendants.
 - If, an identified share of the trust assets is payable to a class, such as descendants of the settlor, without it being possible to allocate the assets between such descendants, the inheritance tax will be calculated at the highest rate of tax applicable to direct line beneficiaries, i.e. 45%.
 - In all other cases, for example if the assets pass to a trust whose beneficiaries are unascertainable, the tax will be a flat 60%

French Succession and Gift Taxes

- The taxation is however subject to the treaty provisions
 - The rules above only apply when the settlor is French resident
 - If not, the US-French Death Tax Treaty allows only for taxation in France of French real and tangible properties

French Wealth Tax

- As of today, France imposes a wealth tax on all assets of residents (except real property located outside France under certain double tax treaties) of up to 1.5%.
- All assets (except foreign real estate) in a trust are subject to wealth tax if the settlor is French resident.
- Only French situs assets are subject to wealth tax if the settlor is not a French resident.

(Cont.....)

French Wealth Tax

- If the settlor is deceased, the French resident beneficiary becomes the settlor and is subject to wealth tax on all trust assets.
- Proposed French tax bill for 2018: repeal of the current Wealth Tax and imposition of a new tax on real properties owned directly or indirectly.
- Consequence : only real properties directly owned or shares of companies owning real estate, in a trust, will be subject to wealth tax (up to 1.5%)

Applicability to US Citizens

- A US citizen who becomes resident of France is exempt from French succession, gift and wealth taxation except on a French source income and assets for the **first five years of residence**.
- Special rules also apply for US sources passive income (deductible tax credit in France equal to the French income tax)
- However, a trust of which the U.S. citizen is settlor must still be reported and the exemption claimed for wealth tax purposes.
- After five years, the US citizen residing in France will be fully taxed by France on the trust assets for wealth, gift and succession tax purposes.

Succession Tax: US Citizen Residing in France

- On the death of a US citizen who resides in France, French succession tax on all his/her worldwide assets, including assets in any trust of which he/she is settlor.
- Assets that pass to a trust for a single beneficiary will be taxed at that rate (i.e., spouse, children). Assets passing to discretionary trusts at the settlor's death will be taxed at a 60% rate.
- Under the French US Death Tax Treaty a US citizen residing in France who leaves his assets outright to his French citizen wife will obtain a \$5.49 million marital deduction in addition to the unified credit, for a total of \$10,980,000 he can leave outright to his French wife (so no need for a QDOT up to that amount).

US Citizen trust beneficiary

- A US citizen living in France who is beneficiary of a US trust will be treated as the owner of the trust if the original settlor is not living.
- He/she will be subject to wealth tax, on distributions to French gift tax and on death to French succession tax.
- There will be no credit for US estate tax because no tax will be payable in the US.

Trusts Created by French Citizens/Residents

- Generally there is no tax advantage to a French person creating a Delaware Trust. There will be substantial reporting requirements and the tax effect will be the same as if the property were owned outright, possibly worse.
- However, since trusts are not available under French law, a French person may want to create a trust for long term management and control of assets, recognizing that there will be reporting requirements and no tax advantage but also no disadvantage if done properly.
- She must however not be a French resident at the time of the creation of the trust, otherwise the transfer of the trust assets to the beneficiaries, whoever they are, will be subject to a 60% tax in France.

Acknowledgement

- Thanks to Jean-Philippe Mabru of Bonnard Lawson in Paris for his assistance in preparation of this presentation.