REAL-ESTATE NEWSLETTER

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EDITORIAL

Law no. 2014-626 dated 18 June 2014 relating to trades, retail and very small enterprises, known as the "Pinel" law, was published in the *Journal Officiel* (French legal gazette) on 19 June 2014. It considerably modifies the status of commercial leases. In substance, the Pinel law makes the following major changes: tenants may no longer waive their three-yearly termination option for nine-year leases unless the lease relates to premises constructed for a sole use, premises used exclusively as offices and some storage premises; notification by recorded delivery letter is permitted for tenants' termination notice as well as landlords' notice offering or rejecting renewal; the ICC (French construction costs index) may no longer be used as the reference index to calculate the three-yearly legal revision or the rent cap in a renewed lease; a framework has been created for rent increases due to removal of caps on rent, with the increase resulting from the removal of the rent cap and its fixing at the rental value now being spread over the term of the lease, in increments of 10%; clauses which result in cancelling the effect of the right to renewal of the lease, the term, provisions relating to revision of the rent during the lease, remuneration of the security deposit in excess of two rental terms, the termination clause, despecialisation of the lease and clauses designed to prevent tenants from transferring their lease with their goodwill, are now deemed null and void; this removes and period of limitation on their wrongfulness, while previously they were subject to a two-year time limitation; the establishment of a schedule of condition is now compulsory both on taking of possession of the premises by the tenant and when it is handed back; the lease must include a precise and exhaustive inventory of categories of charges, duties, taxes and fees relating to the lease, including how they are divided between the landlord and the tenant, and set out in an annual statement sent by the landlord to the tenant. Since the breakdown of charges has been established as a public policy regulation, the parties cannot create exceptions. The procedures for application of this rule must be fixed in a decree which should in particular stipulate the charges, duties, taxes and fees which are not attributable to the tenant and procedures for providing information to tenants. Finally, a right of pre-emption is created in favour of the tenant, in the event of sale of leased premises for retail or trade use (although many exclusions are provided for) and the term of exceptional short-term leases is increased from two to three years. This latest real-estate newsletter particularly offers a focus on several key changes introduced by the Pinel law.

Aline Divo, partner

Focus on changes to the term of commercial leases

By **Aline Divo,** partner, specialised in real-estate law. She works in all fields of real-estate law, particularly construction and commercial leases.
aline.divo@cms-bfl.com

For many years, the practice of "fixed-term leases", i.e. a commercial lease preventing the tenant from terminating the lease at the end of one or more three-year periods, became widespread as landlords sought to ensure a long-term rental return. By amending article L. 145-4 of the French Commercial Code, article 2 of the Pinel law of 18 June 2014 puts an end to this practice. Now a nine-year commercial lease can no longer include tenants' waiver of their ability to terminate at three-yearly intervals, with the exception of three categories of lease, which are yet to be fully defined. These are firstly leases for premises constructed for a sole use. We note that the legislature did not use the concept of single-purpose leases.

We believe that it should be assumed that the target is single-purpose premises as referred to in article R. 145-10 of the French Commercial Code (e.g. theatres, cinemas, bakeries with an oven). Although some premises can be considered to be indisputably single-purpose, others are more difficult to define, in the absence of a general definition of the concept.

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The second target is leases for premises used exclusively as offices. According to existing case law, the concept of offices as defined by article R. 145-11 of the French Commercial Code covers premises used for administrative activities as well as all premises allocated to receiving customers, provided they are not used for the warehousing or delivery of goods.

Judges focus on the activity authorised by the lease, rather than the physical characteristics of leases. This implies that both offices in the standard sense (companies' head offices or administrative offices) are affected, as well as "boutique offices" (bank branches, real-estate agencies, travel agencies or advertising agencies).

The third target is leases on storage premises, referred to in section III.3 of article 231 *ter* of the French General Tax Code. This concerns premises or covered areas intended for the warehousing of products, merchandise or goods, not located on the same site as the production establishment. The main target in this case is separate warehouses. Since the definition contained in article 231 *ter* of the General Tax Code is not absolutely clear, numerous questions are bound to arise regarding its scope. Furthermore, it should be noted that the Pinel law did not amend article L. 145-7-1 of the French Commercial Code relating to commercial leases signed between owners and operators of tourism residences mentioned in article L. 321-1 of the French Tourism Code, which states that leases "are for a minimum term of nine years, without the option of termination after three-yearly periods."

We believe that for this category of lease, when it concerns classified tourist residences, the initial nine-year lease is necessarily concluded for a fixed term despite the new wording of article L.145-4 of the French Commercial Code.

Furthermore, the new article L. 145-4 of the French Commercial Code stipulates that if the lease is concluded for a term longer than nine years, the option of concluding a fixed-term lease is re-established for all premises, whatever their type. Given the new wording of article L. 145-4 of the French Commercial Code, many investor-landlords should refuse to offer nine-year leases for premises occupied by shops and mixed use premises (offices and shops),

trades businesses, industrial business and all leases stipulated in article L. 145-2 of the French Commercial Code and leases governed by conventional application of commercial lease status. The practice of a fixed 10-year lease, with tenants' waiver of their ability to terminate at three-yearly intervals, is likely to then become widespread. Tenants who sign this type of lease should attempt to negotiate clauses revised in their interests, for instance several months' rental holiday, a clause concerning compliance works which is relatively balanced between the parties, and expanded ability to sub-let the premises and/or transfer the lease to companies in the tenant's group.

Tenants should also try to negotiate a clause in the lease governing fixing of rent at renewal and including the rent "capping" rule. This clause should be accepted by the landlord unless it relates to premises used exclusively as offices or single-purpose premises. If no clause is included, "capping" of the initial rent will only apply when the lease has been concluded for a term longer than nine years. As a result, the renewal rent shall be set at the rental value. It should also be ensured that the clause governing setting the renewal rent does not use the ICC (French construction costs index) to calculate the maximum rent, but instead the ILC (French index of commercial rents) or the ILAT (French index of tertiary sector rents). By amending article L. 145-34 of the French Code of Commerce, the Pinel law no longer allows this index to be used to determine the maximum rent at renewal of the lease. Furthermore, before the Pinel law of 18 June 2014, it was possible to include stipulations in commercial leases for shorter termination periods than every three years for tenants, for example annually. This practice was based on the fact that notice at the end of a three-year period "unless otherwise agreed". The Paris court of appeal confirmed this position. By removing the wording "unless otherwise stipulated" in the second sentence of article L. 145-4 of the French Commercial Code, the Pinel law now casts doubt over this practice for nine-year leases not falling into one of the above three categories of premises. The question is especially tricky since stipulations contrary to the provisions of article L. 145-4 of the French Commercial Code are now deemed to be null and void by virtue of the new working of article L. 145-15 of the French Commercial Code. In fact the Pinel law effectively amended article L. 145-15 of the French Code of Commerce which stated that some clauses were null and void. As a result, actions seeking a ruling against clauses contrary to article L. 145-4 of the French Commercial Code are no longer subject to a two-year time limitation. Since these actions no longer have any time limitation, they can be brought at any time. Furthermore, in light of the removal of the words "unless otherwise agreed" in the second sentence of article L. 145-4 of the French Commercial Code, we believe that the case law which allowed the inclusion in a commercial lease of a clause stipulating that in the event of exercising of the three-yearly termination option the tenant would pay the landlord compensation for the loss suffered by the landlord as a result of early termination of the lease, is no longer applicable for a nine-year lease which does not fall into one of the three aforementioned categories. As a result of the above, with the exception of certain categories of leases, nine-year commercial leases have lost their appeal for investor-landlords. This situation will undoubtedly lead to consequences in the negotiation of new leases and in particular at the renewal of current leases. Lawyers must therefore come up with new wording for clauses in order to counter the effects of the Pinel law and, hopefully, limit disputes.

"With the exception of certain categories of leases, nine-year commercial leases have lost their appeal for investor-landlords."

Towards a new breakdown in local taxes between landlords and tenants

By **Cathy Goarant-Moraglia,** partner, specialised in tax matters. She works in the field of local taxes on real-estate projects and major restructuring or marketing projects. She also carries out audit, assistance, technical consultancy and corporate defence work in all business sectors.
cathy.goarant@cms-bfl.com

One of the key measures in the Pinel law of 18 June 2014 lies in the establishment of rules for dividing charges and taxes between the landlord and the tenant, having previously been open to contractual agreement. As a matter of public policy, this division is now strictly governed by the law and more precisely by article L. 145-40-2 of the French Commercial Code, from which the parties can no longer create exceptions. However, the law refers to a French Council of State decree for its application procedures, which should stipulate "the charges, duties, taxes and fees which are not attributable to the tenant and procedures for providing information to tenants".

We should also specify that these new provisions are, in principle, applicable to contracts concluded or renewed from the first day of the third month following publication of the law. However, since the law itself refers to an application decree, these new provisions will only apply from the entry into force of that decree.

The future decree (based on our information in September) should therefore particularly target local taxes, i.e. essentially those payable on the actual building, such as land tax, household waste removal tax, road-sweeping tax, some urban development taxes (linked to Greater Paris, tax on certain premises in the Ile-de-France, etc.) and, to a lesser extent, those linked to the landlord's own activity.

In effect, since 2010 when landlords became automatically liable for the CET (regional economic tax), some leases contractually stipulate that the CFE (corporate real-estate contribution) and the CVAE (corporate value added charge) due by the landlord will be reinvoiced to tenants.

Parliamentary debates indicate that the legislature's intention was clearly to transpose into commercial leases the provisions already applicable to residential leases. The new system should therefore reduce re-invoicing of duties and taxes for which landlords are legally liable, such as those mentioned above.

Nevertheless, land tax and tax for removal of household waste, for example, could still be subject to re-invoicing, provided landlords comply with their obligation to send a precise annual statement of re-invoiced charges, including taxes.

The impact of these new measures should be neutral in respect of the CVAE due by tenants, since they were already unable to deduct rent and related charges (particularly including land tax, which was usually reinvoiced to them). In relation to landlords, the limitation on their right to reinvoice certain duties and taxes should at first logically result in a fall in the value-added produced, unless offset by an increase in rent for those tenants.

"The new system should reduce re-invoicing of duties and taxes for which landlords are legally liable."

This new regulation should theoretically lead to an increase in headline commercial rents, since landlords will no longer be able to separate that rent from the taxes for which they are liable. This will make it difficult, however, to pass on variations from one year to the next in non-reinvoicable taxes resulting from changes in calculation bases and tax rates. It will also make it difficult to assess charges linked to long-term leases, unless a specific clause can be introduced during three-yearly revisions.

This reform is likely to indirectly impact land values used as a basis for calculating CVAE (see article p.9).

Exceptional leases after the law

The many reforms to the status of commercial leases contained in the Pinel law include substantial changes to the system governing exceptional short-term leases ("*baux dérogatoires*") concluded from 1 September 2014.

Through a combination of several provisions, the "short-term" period for which the landlord and tenant can contract is at first sight extended, although in reality substantially reduced.

Longer short-term leases...

Until the entry into force of the Pinel law, the parties could conclude one or more leases derogating from the status of commercial leases, provided the total term of the lease or successive leases did not exceed two years. The wording of article L. 1455 of the French Commercial Code resulting from the Pinel law retains this possibility although increases the maximum term to three years.

Very surprisingly, parliamentary debates reveal that the objective was to improve conditions for testing a commercial or trade business's profitability, during this period of commercial uncertainty, despite this objective being sufficiently achieved by exercise of the three-yearly notice period in the commercial lease.

... but not for the long term

The position of the parties on expiry of the maximum three-year term of the short-term leases changes significantly.

If the tenant remains in the premises without the landlord's objection, a new lease governed by the status of commercial leases no longer comes into being from the day after expiry of the lease. The parties now have a period of one month "from expiry of the three-year period" to notify their intention to give up commercial lease status[1]. For tenants, this means vacating the premises and for landlords, it means informing tenants that they wish them to vacate the premises.

The third option, involving the parties recording their renunciation of the status and concluding one or more new exceptional agreements not exceeding three years, no longer appears possible; recognition of this possibility by case law[2], providing strict conditions are met, had contributed to a sharp increase in this practice., providing strict conditions are met, had contributed to a sharp increase in this practice., providing strict conditions are met, had contributed to a sharp increase in this practice.

Now, at the end of the maximum period of three years, the parties may "no longer" conclude a new lease derogating from the status of commercial leases to operate the same business in the same premises[3].

If the parties want the same business to continue to operate in the framework of an exceptional lease, this will require the landlord to have separate premises for this purpose.

Otherwise, if the parties wish to be bound by an exceptional lease in the same premises, it will have to be to carry out a different business[4]. This solution marks a relaxation compared with case law, according to which any new lease concluded between the same parties relating to the same premises was subject to commercial lease status, irrespective of the authorised business, even if it was different[5]. Nevertheless, the effectiveness of this system relies on attentive analysis of whether or not it is indeed a "different business". Abundant case law relating to the transfer of a business disguising the transfer of a lease could assist in this analysis. Furthermore, the obligation to draw up a entry and departure condition schedule is now also extended to this type of lease.

"Now, at the end of the maximum three year period, the parties will no longer be able to conclude a new lease derogating from the status of commercial leases to operate the same business in the same premises."

By **Jean-Luc Tixier,** partner, specialised in real-estate law and public law. He provides both advisory and litigation services to a great many commercial and industrial corporations, as well as property developers in matters of planning, construction, sales and rentals of buildings, long-term leaseholds and building leases. He lectures at Paris University (Paris I).
jean-luc.tixier@cms-bfl.com

1. Ch. Com. Art. L. 145-5, par. 2 as amended.
2. V. particularly Cass. 3rd Civ. 5 May 1999 no. 97-19 163: RJDA 7/99 n° 766 ; Cass. 3rd civ. 2 April 2003 no. 01-14 898: RJDA 7/99 no. 698.
3. Ch. Com. Art. L. 145-5, par. 1.
4. Sen. opinion no. 446.
5. Cass. 3rd Civ. 31 May 2012 no. 11-15 580: RJDA 10/12 no. 831.

Transfer of rights to leases and the TUP – the law brings order

By **Christophe Lefaillet,** partner, specialised in tax law (registration duty and Wealth Tax) and corporate law. He specifically focuses on merger and acquisition transactions in the real estate sector.
christophe.lefaillet@cms-bfl.com

Commercial leases, necessary to any company's economic activity, have been made subject to an exception to common law by the legislature in order to protect the continuation of the business. Protection of the retailer's interests is again confirmed in this case.
Article L. 145-16 paragraph 2 of the French Commercial Code, as it stood prior to the Pinel law[1], explicitly stipulated specific provisions for transferring the right to a lease in the event of a merger of partial contribution of assets subject to demerger regulations. Notwithstanding any contrary stipulation, the acquiring company or company receiving the contribution was substituted for the company which had been granted the lease in all the obligations resulting from the lease (C. Com. L. 145-16 par. 2). However this text contained no provisions relating to relating to the transfer of a commercial lease at the time of dissolution without liquidation of a sole-owner company in favour of its single legal entity shareholder, a transaction commonly referred to as a "TUP".
Since the law was silent in this respect, several voices made themselves heard in appeal courts[2] resulting in a something of a cacophony.
In a ruling dated 9 April 2014[3] the Court of Cassation found that the transfer of the lease right occurring in the context of a TUP is not a transfer of the lease right but should be treated in the same way as the transfer by rights of all the dissolved company's property and rights. This means that the landlord's consent is not required for transfer of the lease. The Court has therefore conflated the transfer of a lease via a merger or partial contribution of assets and a TUP. This ruling is therefore welcome, particularly since it came just ahead of the harmony introduced by the Pinel law. Indeed in the new wording of article L. 145-16, the legislature has confirmed the position adopted by the Court of Cassation, by extending the rules applicable to the transfer of a commercial lease at the time of a merger or partial transfer of assets to lease transfers via a TUP. It should also be noted that the legislature took the opportunity to explicitly stipulate that demergers are covered by the abovementioned article L. 145-16, thereby confirming recent case law[4].
This means that the transfer of a commercial lease via a TUP or demerger is now subject to the same rules as if this transfer occurred as the result of a merger or partial contribution of assets.

"Now, transfer of a commercial lease via application of a TUP or demerger is subject to the same rules as if this transfer resulted from a merger or partial contribution of assets."

This system has two particularly significant and decisive effects.
Firstly, it should be noted that article L. 145-16 nullifies any clauses whose purpose or effect is to limit or restrict the transfer of commercial leases.
This prevents landlords from imposing clauses stipulating specific formalities such as approval or the right of pre-emption or even clauses stipulating a *intuitu personae* relationship between the dissolved tenant company and the landlord. Similarly, since it is no longer considered to be a lease transfer, landlords cannot validly claim any non-compliance of the formalities stipulated in article 1690 of the French Civil Code. This means that none of the notifications to the landlord set out in that article need to be made for the transfer to be enforceable.
Landlords of premises leased to TUP recipient companies have relatively little protection since, pursuant to paragraph 3 of article L. 146-16, the only recourse available to them is to ask the courts for additional guarantees.

1. Law no. 2014-626 dated 18 June 2014 relating to trades, retail and very small enterprises. 2. See in particular: Paris Court of Appeal, 13 Oct. 2004, no. 03/11378; Paris Court of Appeal, 24 June 1997, no. 95/1237. 3. Cass. Civ. 3e, 9 April 2014, no. 13-11 640. 4. Versailles Court of Appeal, 22 Sept. 2011, no. 10/04401.

The existence of a specific clientele to recognise the operation of a business in the public domain

Operation by a company of a business in the public domain has always raised a thorny question: does the absence of "commercial property" exclude the company from having goodwill?

Previously, a number of agreements relating to occupation of public land tended to provide a negative response by precluding any reference or allusion to the fact that authorised activities could constitute goodwill.

Goodwill without right to the lease

If the business's clientele is considered to be personal to the operator, case law generally acknowledges the existence of goodwill[1]. However, acknowledgement of the existence of goodwill does not imply acknowledgement of a right to the lease. Many such funds do not include a right to the lease. This is the case for businesses as the holder of an exceptional short-term lease, an emphyteutic or building lease, or even a tenancy at will agreement[2]. Established case law also emphasises that the existence of a right to the lease is not a prerequisite for the existence of goodwill[3].

The sale, pledging or lease-management of such assets is entirely possible (subject to compliance with the rules governing them), the only unusual aspect being that the goodwill does not include the benefit of a statutory commercial lease (featuring "right to renewal"). This goodwill exists but its duration and value are affected by the absence of a "right to renewal" or the benefit of compensation at the end of the aforementioned occupancy contracts.

Public domain and goodwill – what are the implications?

The administrative courts have long ignored the fact that goodwill can exist without a right to the lease however and, on the contrary, has made a surprising link between these two concepts. The French Council of State considered that occupiers of public land with personal and non-transferable agreements could not be considered to possess goodwill for the simple reason that they could not legally have a statutory commercial lease[4]. It is therefore not legitimate to deny companies operated on public land from having goodwill on the grounds that they do not benefit from the protection associated with the status of commercial leases.

This is the context in which the Pinel law[5] dated 18 June 2014[6] introduced a new article L. 2124-32-1 into the French General Code of Ownership by Public Entities[7] stating that "a business with goodwill may be operated on the public domain provided a specific clientele"[8].

"The fact of whether or not a specific clientele exists will therefore be decisive."

The fact of whether or not a specific clientele exists will therefore be decisive. Abundant case law concerning shops which are isolated or subject to significant restrictions.

The provision is deceptive however. Legal recognition of the possibility of a business with goodwill existing on the public domain does not create corresponding "commercial property", since the occupancy authorisation remains discretionary and revocable. It is not possible to transfer the authorisation to the purchaser of the goodwill, so the case law solution remains unchanged[9].

However, potential purchasers may now ask in advance for temporary authorisation to occupy the public domain[10] without being entitled to such authorisation by right. The scope of this recognition will remain to be assessed in the drafting of clauses relating to compensation for the operator in the event of withdrawal or termination.

By **Jean-Luc Tixier,** partner, specialised in real-estate law and public law.
jean-luc.tixier@cms-bfl.com

1. Cass. Com., 28 May 2013, no. 12-14 049, F + P + B.
2. Now defined in article L. 1455-1 of the French Commercial Code resulting from the Pinel law.
3. Cass. Com., 27 April 1993, no. 9110 819, Bull. Civ. IV, no. 156 ; Cass. Com., 4 Feb. 2014, no. 12-25 528, F-D.
4. V. CE, Ass., 28 April 1965, no. 53714 and 53715, CE 2 and 7 s-s-r., 31 July 2009, no. 316534, the company "Jonathan Loisirs".
5. Art. 72 Law no. 2014-626 dated 18 June 2014 relating to trades, retail and very small enterprises.
6. Applicable from 20 June 2014.
7. French General Code of Ownership by Public Entities.
8. Trades businesses are not concerned (French General Code of Ownership by Public Entities, art. L. 2124-33) nor is the natural public domain (French General Code of Ownership by Public Entities, art. L. 2124-35).

Exemption of non-residents' capital gains from real estate: clarifications from the authorities

By **Julien Saïac,** international tax partner. He deals more specifically with issues related to international restructuring and real-estate investment.
julien.saiac@cms-bfl.com

Natural persons who are non-residents and sell a property in France are subject to income tax in the country under article 244 bis A of the French General Tax Code. However the law has long stipulated an exemption for the first sale by EU or EEA nationals who have been tax residents of France continuously for at least two years at any time prior to the sale. Only a property which is the seller's home and which has been at the seller's disposal since at least 1 January of the year prior to the year of the sale could benefit from the exemption.

The 2014 Finance Act changed this exemption system as follows, for sales occurring from 1 January 2014:

– the exemption may now also be applied to a property which has not been available to the taxpayer, although in this case the sale must occur at the latest by 31 December of the fifth year following transfer of the residence outside France;

– net taxable capital gains are now only exempt up to a limit of 150,000 euros, whereas there was no limit before.

As in the past, the exemption remains applicable without any particular time-limit condition if the property was freely available prior to 1 January of the year preceding that of the sale.

The administrative doctrine was amended on 6 June (particularly BOI-RFPI-PVI-10-40-50) to specify the following points in particular:

– the exemption only applies to sellers who are natural persons, not legal entities, even in the case of a "translucent" partnership. Similarly, the exemption only applies when the taxpayer directly owns the property in France. Therefore it does not apply to sales carried out via an intermediary company, or sales by a non-resident partner of shares in an SPI (predominantly real-estate partnership);

– as previously, the seller must provide evidence of continuous residence in France for at least two years prior to the sale. It is stipulated that sellers can claim years during which they were aged under 18 and a member of the taxable household of their parents who were resident in France;

– the exemption remains limited to the sale of a single home by the taxpayer. However, it is permissible not to include sales which were exempt on other grounds (e.g. sale to social housing organisations), for which no capital gains were realised or for which no capital gains were taxed due to application of the allowance for length of ownership;

– finally, previous exemptions applied to the seller as a French resident, particularly in respect of the sale of their main residence, are not taken into account either.

"Net taxable capital gains are now only exempt up to a limit of 150,000 euros."

It is also stipulated that taxpayers do not have a free choice of which sale the exemption application applies to. It is always the first eligible sale which may be exempt and taxpayers must therefore take this into account when determining the order of sales, if several properties are likely to be sold. In respect of the exempt fraction of capital gains, the tax authorities have stipulated that the cap of 150,000 euros is assessed individually in relation to each seller, in the case of cohabiting partners, civil partners or joint owners. In the case of sale of a property by a married couple, despite spouses normally being considered to be co-sellers, it has been agreed that the cap will assessed in respect of the portion of capital gains realised by each spouse individually rather than in respect of the total amount of capital gains realised by the couple.

Reform of land rental values for 2016

On 1 July 2014 an information meeting was held in Bercy for trade bodies regarding progress of the revision of land values which began in 2010.

Since the electoral calendar made it impossible to maintain the pace initially planned, the scale of the work remaining to be carried out led the tax authorities to impose a very tight schedule.

Everything is now being done to ensure that land tax and CVAE charged in 2016 are based on the new calculation bases according to the rental market on 1 January 2013.

Following a campaign of owner declarations (form 6660 REV) in the spring of 2013, the next complex phase is examination of the assessment criteria by departmental commissions.

We should recall that the majority of the commissions will be made up of representatives from local authorities (10 commissioners) and a minority will be representatives of companies using the buildings to be valued (nine commissioners, only four of whom will be appointed by trade bodies and liberal professions, the other five by the chambers of commerce and industry and chambers of trades). They are due to be appointed by 31 October 2014.

"Following a campaign of owner declarations the next complex phase is examination of the assessment criteria by departmental commissions."

Companies should not neglect this phase and must take measures to ensure that their voices are heard. These commissions will have just two months to examine the documents prepared by tax departments (valuation areas, tariff schedules and location coefficients), to be used as a basis for future valuations. We should add that in the event of persistent disagreement within commissions preventing adoption of corrections to documents, the criteria will be approved by the Prefect. In any case, the valuation criteria will be finalised during May 2015. At this stage only the macro results will be available to ensure that overall levels of revenue received by the various local authorities will not be affected by increases or decreases.

During the second half of 2015, advanced simulations will be carried out by local authorities to prepare for tax to be charged in 2016, providing local authorities with information on the calculation bases for voting on the 2016 tax rate in February.

The law stipulated an obligation to publish the assessment criteria, which should be available by the end of 2015. Although slightly late in terms of preparing for budgets, a simulator of the effects of the reform should be made available during the first half of 2016.

Furthermore, in respect of the ongoing updating system introduced by the law, the obligation on tenants to remotely declare their rent is due to be tested in the autumn. Although this new remote declaration will be compulsory, no penalties will be imposed during this test phase. However, this obligation shall apply each May from 2015 and the amounts of rent declared will be used to update the assessment criteria. Responsibility for updating the tax calculation bases will therefore be passed on to taxpayers.

It will therefore be crucial for all tenant companies to be aware of the importance of this new declaration obligation or else run the risk of consequences which will be difficult to correct.

The Pinel law (see article p.4) is also expected to impact land values. The 6660 REV declaration used as a basis for launching land-registry changes currently does not ask for rental charges to be declared with the rent. If these charges, which can no longer be invoiced as a result of the Pinel law, are included in rent, this will naturally increase amounts declared and therefore land values.

By **Cathy Goarant-Moraglia,** partner, specialised in tax matters.
cathy.goarant@cms-bfl.com

Long-term leasing of real-estate stock: a fiscal oxymoron?

By **François Lacroix,** partner, specialised in tax matters. He specifically focuses on the sectors of real-estate tax, public services, companies and not-for-profit public or private legal entities.
francois.lacroix@cms-bfl.com

Can a company subject to wealth tax consider a building let long-term to be a fixed asset (and amortise it) if it was bought to be re-sold? If a change of intended use for tax purposes is subsequently possible, does that necessarily imply that a decision by competent bodies should be taken for that purpose? Conversely, does posting it in the accounts as a fixed asset constitute sufficient evidence that the building has been defined as such for tax purposes and therefore allow it to be amortised?

These are the three questions which the French Council of State had to address on 9 April 2014 (SCI du Forum, no. 358 278) in respect of a listed real-estate company with a dual purpose listed in its articles of association: "purchase and re-sale with the possibility of opting for the "estate agent" tax regime, administration and operation of the acquired buildings by lease, rental or otherwise". The building which was the subject of the dispute, in use as a hotel and purchased with exemption from stamp duty (under the estate agent regime), and let under a commercial lease to a new group company which was still operating the hotel.

The authorities initially challenged the exemption from transfer duties, due to posting of the building as a fixed asset because of its use as a rented property. A final appeal ruling confirmed this exemption, however, due to its acquisition "with the intention of trading", which the Council of State acknowledges: rejecting the normal simplistic approach (long-term lease = fixed asset), its public rapporteur stated that the establishment of the commercial lease supported the initial intention to re-sell the building, through the increase in its value due to the enhancement of the business it housed, made possible by operating it. Based on this case law definition and drawing on previous decisions defining fiscal stocks of buildings leased pending their re-sale, the Council of State therefore did not take into account in this case the rental activity, considering that this could not take precedence over the intention to re-sell previously identified by the registration judge.

Posting as a fixed asset was not the main issue for the appeal court either, which found that (despite its recent decision dated 25 March 2013 which left little ambiguity on this point) that the operation's tax status depended exclusively on the underlying intention, rather than the accounting method used.

On a subsidiary level, however, the listed real-estate company argued that the building had changed use in 2000, due to not having been resold within the time period required for the exemption and that its status as a fixed asset should be recognised at least from that date. The Council of State refused to make a change of fiscal use subordinate to an explicit decision by the competent statutory bodies, ruling that reference should be made to the taxpayer's intention. Since this contradicted the administrative appeal court, the Council of State referred the case back to that court to determine, 15 years after the event, whether the intention to re-sell the building had actually been abandoned in 2000.

"The French Council of State [has ruled] that reference should be made to the taxpayer's intention."

Setting aside the legal and accounting "preservatives" represented by the decisions taken by corporate bodies and the accounting approach adopted, this ruling is therefore decidedly organic, focusing on the basic ingredients (in this case, the taxpayer's intention and the actual intended use of the building) in the "stew" of the taxpayer's tax calculation basis. We will soon find out whether, without these preservatives, the meal has retained sufficient freshness to be palatable to the court.

Extension of the 25% allowance on individuals' real-estate capital gains – what are the restrictions?

The 2014 Finance Act legalised the 25% allowance on real-estate capital gains other than those from building land from 31 August 2014. Since then, a second measure has been introduced to take over until the end of 2016 but in a restrictive framework, the outlines of which still have room for improvement, despite the intervention of the amended Finance Act for 2014.

A private individual who sells a building destined to be demolished and replaced with residential housing can therefore still benefit from this capital gains allowance. The property must be located in a continuous built-up area with more than 50,000 inhabitants (as defined for application of the vacant housing tax) and, for sales carried out in 2015 and 2016, the undertaking to sell must have a definite date of 31 December 2014 at the latest.

However the law also stated that the purchaser must undertake, in the deed of sale, to reconstruct residential buildings with a floor area equal to at least 90% of that authorised by the COS (ground occupancy coefficient), within four years of the date of that deed. In the event of failure to comply with this undertaking, the purchaser must pay a fine equal to 10% of the purchase price.

Implementation of this rule raised practical difficulties:

– in its wording resulting from the ALUR law, article L. 123-1-5 of the French Urban Development Code stipulates that the regulations of a PLU (local development plan) can no longer include a COS[1];

– the land acquired may well be in a POS (ground occupancy plan) zone without any COS rules;

Purchasers were not always able to establish the exact extent of their obligations in terms of constructability, a prejudicial situation to say the least, given the penalty at stake.

The amended Finance Act for 2014 attempted to provide a solution by replacing the term COS with "floor surface area". The houses constructed must now have a surface area equal to at least 90% of the maximum floor surface area authorised under PLU and POS rules. Nevertheless, the adoption of the concept of "maximum authorised" floor surface area raises fresh uncertainty and does not appear to be sufficiently precise to reliably implement the aforementioned system.

Removal of the COS does not mean that constructions are free of all rules. In fact, the PLU or POS may indirectly determine the density of constructions through a combination of rules regarding volume layout, setback, site coverage, siting of constructions, height, overlooking neighbours, etc.

The maximum authorised floor area "in application of the PLU or POS rules" is therefore harder to calculate than before. It is no longer sufficient to carry out a relatively rapid mathematical calculation. It is now necessary to determine the optimum combination of the various rules in question. The exercise also involves employing a design professional (architect, engineering office, project manager, etc.).

At present, since the authorities have not yet commented on this system, it would be advisable to carry out a preliminary study combining all the urban development rules in collaboration with the abovementioned professionals; assessment of the situation in respect of the maximum floor area appears very unpredictable since the content and nature of architectural projects can vary significantly. It will always be difficult, in any way including for the purposes of tax rules, for a given project to be able to come up with a single theoretical calculation of maximum floor area.

"The houses constructed must now have a surface area equal to at least 90% of the maximum floor surface area authorised under PLU and POS rules."

By **Christophe Frionnet,** partner, specialised in tax matters. He particularly advises companies on their whole range of operations. He lectures in real-estate taxation at Paris University (Paris I).
christophe.frionnet@cms-bfl.com

And **Jean-Luc Tixier,** partner, specialised in real-estate law and public law.
jean-luc.tixier@cms-bfl.com

1. This removal of the COS does not apply in municipalities covered by a POS requiring a COS; we should recall that POS which have not been incorporated into a PLU pursuant to articles L. 123-1 s. C. urb. by 31 December 2015 at the latest will become null and void on that date. We should note that the law also applies if the POS has been revised.

Tax inspection: the authorities' sources are impenetrable

By **Stéphanie Némarq,** associate, specialised in tax matters. She focuses on all areas of corporate taxation, particularly in relation to real estate
stephanie.nemarq@cms-bfl.com

In the context of a tax inspector, the question of the "right price" for a property may be the subject of discussion between the taxpayer and the tax department.

In practice, if the tax authorities challenge the declared value of a property, they will base their assessment on use of the comparison method, based on similar properties sold in the same geographical area.

It is then up to the individual to submit a different estimation to defend their position. To do this, individuals need access to reliable and accurate information, which is often not easy for non-professionals, particularly when there are few transactions for similar properties and the real-estate market is volatile.

Help is now available in the form of the DGFiP's Patrim service, which went live in early 2014. This tool aims to list comparable property transactions based on the search criteria entered (location, size, floors, etc.). This information, obtained from the land registry departments and land registry documentation, is considered incomplete by its users.

We could therefore wonder which sources the tax authorities are using for their estimations and, by extension, whether a taxpayer is entitled to ask to be sent the information used to assess a property? This is the question which was recently discussed by the Court of Cassation.

A company had sold an apartment for 10 times more than it bought it. The tax authorities, suspecting a hidden advantage, notified the purchaser of a tax adjustment. The taxpayer, criticising the valuation used by the authorities, asked to be sent the sources used and, when they refused, complained of a procedural flaw. This was rejected by the French Council of State (CE 26-5-2014 no. 348574) which exempted the tax authorities from providing the information contained in its real-estate files. The confidentiality of the authorities' sources remains intact.

The taxpayer, meanwhile, will have difficulty justifying a 90% fall in the value of its property in the space of a day.

C/M/S/ Bureau Francis Lefebvre

1-3 Villa Emile-Bergerat
92522 Neuilly-sur-Seine Cedex
Tel 01 37 38 55 00

You can find further information about our Real-Estate activity at:

If you would like to contact the authors of this newsletter, please write to the editorial team will pass on your comments to the persons concerned. You can also write to:

Me Aline Divo, aline.divo@cms-bfl.com
Me Christophe Frionnet, christophe.frionnet@cms-bfl.com
Me Cathy Goarant-Moraglia, cathy.goarant@cms-bfl.com
Me François Lacroix, francois.lacroix@cms-bfl.com
Me Christophe Lefaillet, christophe.lefaillet@cms-bfl.com
Me Julien Saïac, julien.saiac@cms-bfl.com
Me Jean-Luc Tixier, jean-luc.tixier@cms-bfl.com