REAL-ESTATE NEWSLETTER

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EDITORIAL

This issue of the Real-Estate Newsletter is devoted to valuation and revaluation of office buildings.

We will firstly look at the conditions under which the tax authorities can challenge the price of a real-estate transaction for the purposes of inspecting transfer duties and corporation tax, noting that while the Council of State now seems to require a significant discrepancy in value to challenge a transaction, this principle remains uncertain in relation to properties. In the context of an examination of rules applicable to transfer duties, we will examine the question of joint and several liability between seller and purchaser and draw a distinction between the concept of taxpayer and that of joint and several co-debtor of duties.

Applying the old adage "Prevention is better than cure", for our guest column we have invited a specialist in property valuation who warns very convincingly of the need to carry out real-estate valuations as a prior and preventive measure. This is a conviction shared by the tax authorities, which have established the Patrim valuation tool, designed to allow taxpayers to estimate the value of some of their real-estate assets and to which we devote an article.

Knowledge of property values also raises two distinct topics, namely the policy for allocating provisions for properties' depreciation and the free revaluation of the assets in question.

In terms of provisions, we highlight the particularity specified in article 39-1-5-39th paragraph of the French General Tax Code which limits provisions for depreciation to the unrealised net capital losses for all buildings owned by the company.

Developments relating to the consequences of the revaluation of properties concern three specific situations: that of partnerships owned by physical partners, considering the Council of State decision on 12 July 2013, which creates a new event triggering taxation of real-estate capital gains, that of foreign real-estate companies relocating their head office to France, for which the question of the revaluation of French buildings prior to relocation of the head office remains a highly controversial issue, and finally that of premises defined as "industrial" in terms of local taxation, for which revaluations have no impact.

Finally, as dictated by the nature of case-law news, we will discuss at length the project owner's liability in relation to subcontracting and the fight against undeclared employment and note that the argued ruling by the Chambéry Court of Appeal on 7 November 2013 fits into the broader scope of the fight against undeclared employment and posting fraud in Europe.

Richard Foissac, partner

Preventive expertise: prevention is better than cure when it comes to taxation

By Claude Galpin, MRICS REV, chairman of VIF Expertise

The difficulty during a tax inspection for a property valuer is to undertake his assignment in retrospect, often three or four years later. This delay reduces the probative force of the property valuation intended to challenge the grounds of a reassessment by the tax authorities even if the burden of proof lies with them.

Furthermore, on a practical level, our experience in this area has taught us that launching a retrospective valuation under these circumstances is often undermined by the taxpayer's unclear memories of the situation when making the declaration. In terms of allocating provisions for depreciation of the property, for example, it is not always easy to obtain access to all the documents from the time forming the basis of this accounting entry. Indeed, the people who decided on this accounting entry are sometimes no longer with the company. It then becomes extremely difficult to understand the context and motivations of the players at the time and therefore to explain in detail the reasons for this provisioning. That is why we now advise our clients, as in medicine, that prevention is better than cure.

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Carrying out a property valuation at the time of the tax declaration has the advantage of constituting evidence of the justification for the terms, context and conditions of the declaration at the time of the facts rather than with hindsight. During a tax inspection, the existence of a report provides a framework for the reassessment, which is always an advantage for the taxpayer, giving them evidence from an independent third-party and the upper hand when it comes to the economic approach as well as the negotiations.

Before the conciliation commission, or the judge if the tax authorities have not sufficiently justified their reassessment, the taxpayer will often obtain a favourable verdict particularly as a result of the prior work undertaken at its request, which also demonstrates good faith.

In accordance with the Property Valuation Charter, the only reference system for property valuation common to all valuers in France, the property valuation assignment must be subject to a valuation contract in which the assignment and its purpose are explicitly defined. The purpose of the assignment will not be to prevent a tax inspection, but rather the framework for the assignment: provision for property depreciation, inheritance declaration, wealth tax, disposal of shares or units, etc. The upper and lower admissible limits will be better contextualised if the valuation is carried out at the time of the facts. The use of at least two methods offers various angles for a real-estate analysis able to support dynamic management of the value prior to any tax inspection, unlike the often reductive comparison approach which always favours the tax authorities, despite the recommendations by the Court of Auditors in its 2010 annual report, to make more use of the income capitalisation approach for example. Contextual information regarding the time the facts occurred remains decisive.

It is for all these reasons that we recommend carrying out a preventive property valuation whenever justified by the context.

Revaluation of buildings in an SCI: beware

In principle, revaluation of the properties of a real-estate investment company owned by natural persons has no impact on real-estate income. In effect, this includes only gross revenue received plus expenditure normally payable by the owner but contractually assigned to the tenant. This reassessment also has no impact on capital gains, provided they are not determined by sale of the ownership right relating to the aforementioned properties. The solution is different when the share capital of a partnership is owned by legal entities subject to corporate tax, since in that case the combination of corporate tax rules and article 238 Bis K I of the French General Tax Code (CGI) means that the revaluation profit is included in the civil company's taxable profit for a portion relating to the aforementioned partners.

In a recent ruling dated 12 July 2013 (no. 338278, 8th and 3rd s.-s., Cofathim), the Council of State has changed this situation in the context of a case which could be described as "unusual" but nonetheless establishes a taxation principle which should now be taken into account.

The case was as follows: an SCI (real-estate investment company) covered by article 8 of the CGI with partially paid-up share capital, and owned by natural persons, carried out a free revaluation of buildings it owned and had credited to the "free revaluation surplus" liabilities account by debiting the "constructions" asset account.

The partners, who were natural persons, had then withdrawn a sum from the revaluation surplus account to credit their partners' current accounts. They then paid up the unpaid-up portion of the share capital by offsetting against their partners' current accounts and finally, in the same tax year, sold their shareholdings to a company subject to corporate tax.

The tax authorities included in the SCI's profits the share of the revaluation surplus which had been allocated to the current accounts of the natural person partners on the grounds that it did not correspond to any economic flows and could not represent a consideration in return for actual contributions by the partners. However, it had subjected the sums in question to corporate tax in relation to the natural person partner when he held securities at the end of the operating year.

The Council of State confirmed the principle that capital gains realised by a company covered by article 8 of the CGI (owned by natural persons) at the time of revaluation of buildings, are not included in profits provided the revalued fixed asset has not been sold. On the other hand, it ruled that the transfer of sums from the revaluation surplus account to the partners' current account, when the corresponding fixed assets had not been sold, represented a distribution to partners of the sums concerned, contrary to the provisions of article L. 232-11 of the French Commercial Code. This transfer removed the unrealised aspect of the capital gains corresponding to the revaluation surplus, making it immediately taxable for the partners present on that date, i.e. the natural person partners and not the legal entity partner present at the end of the financial year. This solution raises difficulties since up until now, it was considered that the distribution of revaluation surpluses within an SCI not subject to corporate tax and owned by natural persons did not contravene the provisions of article L. 232-11 of the French Commercial Code and did not constitute an event triggering taxation of capital gains. It should be hoped that the solution reached was justified by the complexity of the transactions carried out, combining revaluation, distribution of revaluation surpluses and disposal of securities. Watch this space....

"The Council of State confirmed the principle that capital gains realised by a company covered by article 8 of the CGI (...) are not included in profits provided the revalued fixed asset has not been sold."

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Deductibility of property depreciation: rejection, option or obligation?

Over the course of a company's lifetime, the question will regularly arise of whether or not to depreciate its properties if their market value is falling. Having analysed the nature and usage of its properties to decide their accounting treatment, the question remains of whether to align the tax treatment.

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A building intended for long-term use by the company (its head office, premises leased to a third party, etc.), is considered to be a fixed asset. Loss of value over the course of time is recorded via allocations to depreciation which, when spread over a normal period of use, are tax deductible. In addition to these allocations to depreciation, depreciation can be recorded if the probable value of the property at the end of the financial year is less than its net book value. Subject to demonstrating this loss (specific events, market value, independent valuation, etc.) and its amount, this depreciation is tax deductible.

Buildings built or acquired to be resold are meanwhile classed as inventory. If, on closing of the accounts, their valuation is less than their cost, the company is not able to record this write-down for accounting purposes as a reduction of entry cost (no-netting principle). On the other hand, the possibility of directly depreciating inventory is permitted from a tax perspective (BOI-BIC-PDSTK-20-20-10-20 no 60) and if such a provision is justified, it will be deductible.

As for securities in SPIs (predominantly real-estate companies), like all shareholdings, they must be assessed on their actual value at the end of the financial year. When this valuation shows a depreciation, this should be recorded as a provision. This provision is then tax deductible in the absence of other securities of a similar kind (listed or unlisted) presenting unrealised capital gains (cap system).

Having recalled these general principles, a recent case caused waves in the tax/accounting world. Case law from the Council of State set out the principle that, unless otherwise stipulated in law, a provision allocated for accounting purposes is tax deductible.

While this position may appear favourable to the taxpayer, make no mistake: the move was designed not with the initial provision in mind, but rather potential taxation on the future transfer.

To understand this decision, let us look at the facts at the origin of the dispute submitted to the administrative court. In 1996 (at the time of the property crisis, a real-estate investment company allocated a provision for depreciation of a building it owned but did not deduct this provision from its taxable profit. When the building was sold in lots in 1998 and 1999, this provision, now redundant, was reincorporated from an accounting perspective but not a tax perspective.

"Case law from the Council of State set out the principle that, unless otherwise stipulated in law, a provision allocated for accounting purposes is tax deductible."

Finding in favour of the tax authorities, the Council of State ruled that when a provision was allocated in the accounts, the taxable profit should in principle be reduced by the amount of this provision, since the subsequent transfer is deemed to be taxable.

Consequently, in relation to depreciation of buildings classed as fixed assets or inventory, if the general conditions for deduction are met and the company demonstrates a loss "clearly specified and which current events make probable" (art. 39, 1 5° of the CGI), the company will have no other choice but to declare this depreciation as tax deductible.

Impact of valuations and revaluations of properties in relation to local taxation

Given the significant and increasing share of local taxes in companies' budgets, the question of property valuation generates significant challenges for taxpayers, especially since local authorities are seeking to preserve their resources in anticipation of the dreaded withdrawal of State support.

We should recall that these concepts (valuation and revaluation) have no impact on industrial premises.

Real-estate valuations for commercial premises, which mainly use the comparison approach, are based on a per-square-metre price which is then applied to the weighted surface area of the building. This method is therefore totally unconcerned by the concepts of valuation and revaluation, since it does not make reference at any time to the concept of cost price. We should also recall that the obsolescence of the pricing structure used, the reference for which is 1970 (largely irrelevant to the current rental market), has led legislators to undertake a large-scale review of real-estate rental values in this category of premises, due to come into force in 2015 or 2016. There remains the case of commercial premises covered by the direct valuation approach which involves the concept of market value, which is a major question in itself, requiring an in-depth and specific analysis depending on the buildings concerned. In relation to industrial premises, or those classed as such by the tax authorities, they are covered by the accounting valuation approach, determined based on the cost price of fixed real-estate assets as recorded in their owner's accounts. For this method, attention needs to be paid to the bases used by the tax authorities to identify fixed assets subject to real-estate tax on built property and the corporate real-estate charge (CFE). This is the case, for example, with land which may be covered by real-estate tax on unbuilt property, when it does not constitute an immediately adjoining building necessary to the main building being operated, or certain assets not considered real-estate property.

"Concepts of valuation and revaluation have no impact on industrial premises."

In relation to free revaluation of these assets, carried out in order to provide a faithful image of the company's portfolio and to moderate the historic cost accounting principle, this should not be used for the purpose of determining the taxable base in respect of real-estate tax and CFE. In this case only the original cost price, understood to be that first recorded in the balance sheet, is used.

On the other hand, recording of the original cost price in the balance sheet has a very different impact in the event of transfer of the property's ownership, since the resulting revaluations are then taken into account to determine the tax bases (the original cost price recorded in the balance sheet is then used by the new owner). This principle was moderated, however, by article 1518 B of the CGI, which specified a minimum rental value of between 50% and 90% of that used in relation to the year preceding the transaction, depending on the type of transaction carried out (takeover of a company in difficulty, merger, contribution, absorption of assets, or transfer) and depending on whether they were carried out between linked companies or with third parties. These provisions now set the rental value at that recorded in the year of the transfer.

This system, described as combatting corrupt practices, was introduced at the request of local officials in order to preserve local authorities' resources in light of restructuring and transfers of businesses by companies in their region.

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Disputing of a property value by the tax authorities: limited powers

The price of a real-estate transaction, or generally the value of a building used as a taxation base, is always open to a challenge from the tax authorities. Nevertheless, their power is subject to very specific conditions and carefully examined by the court which, in order to uphold the tax authorities' claims, requires the difference between the value determined by the taxpayer and that proposed by the tax authorities to be significant.

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Determining a property's value, either as an asset or as the subject of a transaction, is often an exercise with significant tax implications for both individuals and companies. In terms of registration and wealth tax, except in cases where tax law sets the valuation bases, the value used for the payment of duties is generally the actual market value of the properties assessed on the date of the event triggering taxation (transfer date or, in the case or wealth tax, 1 January of the tax year).

Sometimes the market value is the sole base used to determine duties. This is particularly the case in relation to transfer duties on donations and in relation to wealth tax.

Sometimes this value is used as the base for payment of duties only when it is higher than the price agreed between the parties plus charges. This is the case in relation to duties on transfers for valuable consideration.

Pursuant to article L. 17 of the French Book of Tax Procedures, the tax authorities may seek to amend the price or valuation of property used as a base for payment of a tax when this price or valuation is below the actual market value of the property being transferred or stated in the deeds or declarations.

Although the law does not define "market value", case law and administrative doctrine consider that it corresponds to the price which could be obtained by the play of supply and demand on a real market, after deduction of any suitability value. This definition concerns an objective concept of market value (exchange value) rather than a subjective concept (suitability or usage value). If the tax authorities challenge the value declared by the taxpayer, the burden of proof of the under-valuation lies with them, and it is up to them to establish this under-valuation by reference to prices recorded for sales of similar properties to that of the taxpayer, completed prior to the event triggering the taxation. The tax authorities may only use other valuation approaches in the absence of comparison values or in the case of leased buildings.

To determine the price using the comparison approach, it is necessary to take account of the physical, geographical, legal and economic factors specific to each building and to compare them to intrinsically similar properties.

For instance, case law particularly establishes that the property must be considered according to its legal characteristics – existence of easements, a usufruct or a lease, classification as being of public utility, joint and several nature of the rights owned – in order to apply the corresponding reductions to the market value.

Finally, according to well-established case law, the elements of comparison – which are crucial in establishing the actual market value of a property –must be mentioned in the amendment proposal with sufficient detail to allow a practical assessment of whether they relate to sales of intrinsically similar properties. The Court of Cassation (18 December 2007, no. 06-18879) considers that the tax authorities must provide at least three valid elements of comparison in their amendment proposal.

The taxpayer may challenge the market value used by the tax authorities by providing other elements of comparison and demonstrating the unusual nature of the property.
Since January 2014, the Creation of the PATRIM-users service allows taxpayers, identified by their tax identification number, to estimate the value of a building. This service may pose a danger due to the non-anonymous nature of the procedure. However, the market value determined by the platform cannot be used by the tax authorities in the event of a rectification. The fair value of a property also has an impact in terms of tax on profits and income. When there is a discrepancy between a building's value and the transaction price, the tax authorities may reclassify the difference as a donation constituting an unusual management act which is not deductible for the penalised party and a concealed advantage, taxable for the advantaged party.
The Council of State nonetheless requires the tax authorities to provide proof of the existence of a significant discrepancy between the market value of the property and the transaction price before reclassifying this difference as a donation constituting a concealed advantage. In the Hérail ruling dated 3 July 2009, the Court of Cassation ruled that a discrepancy of 9% to 20% was not significant, the reporting judge in the case explained that it "would appear unwarranted to consider a price differing by less than 20% from the estimated market value as significant." Olivier Fouquet, president of the finance section of the Council of State, declared that this requirement of a difference greater than 20% could well become an "unwritten judge-made law of Council of State case law" (see Et. Fisc. Intern., Dec. 2009).
However, this ruling was given in relation to valuation of unlisted securities and it is not certain that this requirement for a discrepancy of at least 20% would be transposable to building valuations.
In fact, recent case law indicates the contrary. In fact, in the Feray ruling of 21 April 2011, the Administrative Court of Appeal in Nantes found that a difference of 12% between the market value used by the tax authorities and the sale price of an apartment was sufficiently significant. It is true that in this case the method used by the tax authorities to calculate the market value was particularly accurate since its elements of comparison included properties located in the same building at comparable levels which had been sold at a similar time to the disputed sale. Furthermore, in a ruling dated 13 June 2012, the Council of State refused to uphold an appeal against this decision, the reporting judge stating that the Court of Cassation Judge should not exercise judicial control over the definition of the significant nature of the difference, but leave this assessment up to the sovereign power of the lower court judges.
So in the current state of case law, the concept of significant difference is an argument to be used with some caution when it comes to real-estate valuations. Prudent taxpayers will seek to avoid any dispute by the tax authorities by taking care over the conditions of valuation of the property and employing a valuer where relevant.

"The Council of State requires the tax authorities to provide proof of the existence of a significant discrepancy between the market value of the property and the transaction price before reclassifying this difference as a donation constituting a concealed advantage."

Patrim: a new product in the field of online valuations

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The question of the "fair value" of a property often arises when it comes to selling, declaring or depreciating it. This task is not made any easier by the fact that the various methods which exist to assess the market value give disparate results.

The value which will be binding on the tax authorities in the event of an inspection remains to be seen. Doctrine favours the comparison approach, using sales of similar properties in the same geographical area. This still requires, firstly, taxpayers to have access to reliable and precise information and, secondly, that the characteristics of the property and its location make it comparable, especially when transactions are rare and the market is subject to permanent variations.

In this context, the DGFiP recently launched an online service designed to help taxpayers estimate the value of their residential property.

Introduced by the amended 2011 Finance Law, the Patrim "Find real-estate transactions" service has been available to all taxpayers since January 2014 via their tax account page at impots.gouv.fr.

How should this new tool be used?

Firstly, Patrim is not intended to help sell an apartment or research a future acquisition. Codified in article L. 107 B of the Book of Tax Procedures, its use is in principle strictly reserved for tax purposes. It aims to provide access to comparable real-estate data for the fulfilment of declaration obligations in relation to wealth tax, inheritance, donations, as well as in the event of a tax inspection or expropriation. The stated objective is to rebalance the level of access to information between individuals and the tax authorities.

This transparency cuts two ways. Firstly, users identify themselves via their personal space. Their visit (identification number, IP address, date, time and reason for visit) is memorised for one year.

They then enter their search criteria: type of property (e.g. apartment, house), surface area, location, area and period for the search and, to refine the search, year of construction, number of rooms, floor, presence of a lift, outbuildings (garage, car park, cellar, attic, swimming pool, terrace, etc.), the rental situation, surface area of land, etc.

Transactions for similar properties, probably few in number, and their characteristics – recorded by the land registry and cadastral documentation – are presented in the form of a table and displayed on a map.

To anticipate anomalies and criticisms of the system, the DGFiP has stipulated two points: – in discussions with the local tax office, this tool is simply a guide and further refinement is required in terms of noise, the site's aspect, whether it is overlooked, the layout of rooms, easements, works, etc.

"The stated objective is to rebalance the level of access to information between individuals and the tax authorities."

Use of Patrim should therefore not prevent the tax authorities from adjusting the estimate for a declared property in the context of adversarial proceedings. Logically and conversely, taxpayers should consider themselves to be safe from tax inspectors using the existence of this simplified tool, in respect of deliberate intention, against a taxpayer who has assessed a property without taking into account the theoretical value proposed by Patrim.

– in respect of data protection and according to the CNIL (data protection commission), the tax authorities cannot – in principle – view or use data recorded by the system in the context of a tax inspection process or ahead of an inspection (decree no. 2013-718 of 2 August 2013 adopted based on an opinion by the CNIL).

Should buildings be revalued in the event of relocation of a foreign company's head office to France?

It may be supposed that this type of relocation would not involve termination of the legal personality.

Let's take the example of a company located in a European Union Member State which owns a building in France and which relocates its head office. We shall assume that the company has no permanent establishment in France. The response differs depending on whether or not this company was subject to corporate tax in France prior to this relocation.

The company was not subject to corporate tax prior to relocation

This scenario is of largely historical interest, since only the Franco-Luxembourg tax convention, in its version applicable before 1 January 2008, and the Franco-Danish tax convention, before it was abandoned by Denmark, enabled a local company to avoid being subject to corporate tax on capital gains from real-estate in France. This analysis would only appear possible at the present time under the Franco-Lebanese tax convention.

In this scenario, we believe it was possible to revalue the buildings owned by the foreign company at their market value on the date of the relocation to France. This position is based on Council of State case law which has confirmed on several occasions that in the event of a change to a company's tax status, fixed assets must be included in the opening balance sheet for the first financial year following this change of tax status at their market value (rulings of 6 December 1961, 10 July 2007 and 31 July 2009).

Indeed, there is no notable difference between a French company changing tax status due to a change in French law and a foreign company becoming taxable in France due to a change to a tax convention. This position is clearly contrary, however, to that adopted by the tax authorities in its doctrine, which indicates that capital gains from the transfer of buildings located in France owned by Luxemburgish companies are determined under common law according to the difference between buildings' sale price and their net tax value, corresponding to their original value minus depreciation which should have been recorded, in application of the provisions of article 39 of the CGI, since their acquisition date

The company was subject to corporate tax prior to relocation

In the absence of a change in tax status, no revaluation should normally be required. We should not, however, that the tax authorities' doctrine on relocation of head offices states that when the relocation occurs from an EU Member State to France, in order to avoid taxation on a capital gain which would have been taxable in the other Member State, the relocated elements of the fixed asset should be recorded in the balance sheet of a French company at their actual value on the transfer date. This actual value shall be used to calculate subsequent capital gains or losses taxable in France as well as to calculate depreciation, if the property is depreciable. What conclusions should be drawn regarding an EU company owning real-estate property in France? Applied to the letter, the aforementioned doctrine could be invoked in the non-theoretical scenario that relocation of the head office to France justified the company's taxation, in its original Member State, on the unrealised capital gains relating to a building located in France. The rules stipulated by conventions do not appear to prohibit this taxation in the original Member State, although this state should generally grant a tax credit corresponding to the French tax on the capital gains (tax credit of zero if France does not impose any taxation in respect of the relocation year). It is likely, however, that real-estate property was not the intended object of the tolerance outlined above, since, in the converse situation of a head office relocating abroad, the tax authorities agree to defer tax on capital gains at the time of the building's sale.

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Registration fees: joint and several liability between seller and purchaser?

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Registration fees are of special interest in the field of real-estate taxation given the sums they can represent, whether in the case of the direct sale of a property or the sale of securities in an SPI (predominantly real-estate company).

Two questions crop up frequently in this area: who pays the registration fees? Does joint and several liability exist between seller and purchaser?

In response, the CGI makes a distinction between the payment contribution rule and the payment obligation rule. The first results from article 1712 of the CGI which stipulates that in principle the purchaser is responsible for paying the registration fees in the event of a sale. The purchaser is therefore personally and definitively the debtor of the fees to be paid. That being the case, the parties are free to agree a different rule in the contract (e.g. "all inclusive" sale).

Clauses in deeds making fees payable by a specific party are not enforceable on the tax authorities, however. That is in application of the payment obligation rule, the purpose of which is to determine who is liable for paying the tax and against whom the Treasury can bring recovery proceedings.

"Registration fees are of special interest in the field of real-estate taxation given the sums they can represent, whether in the case of the direct sale of a property or the sale of securities in an SPI."

In relation to notarised deeds of sale, the first paragraph of article 1705 of the CGI obliges notaries to pay the fees at the time the deeds are submitted. In relation to deeds agreed privately, paragraph 5 of the aforementioned article obliges all parties to the deed to pay fees. Under this principle, parties are therefore jointly and severally liable to the Treasury. This joint and several liability applies not only to the payment of any simple fees and any penalties due to a failure to register or a delay in registering, but also to extra fees omitted or whose payment is determined subsequently. This has been established by consistent case law in the Commercial Court of the Court of Cassation1, whether the deed was finalised by a notary or privately.

The consequence of the payment obligation principle is that all parties to the deed are jointly and severally liable, meaning that in the context of a sale the tax authorities may send notification of an adjustment to the seller, the purchaser or both.

Therefore, through the combination of these two rules and in the event that the parties have agreed that the purchaser will pay the fees, the purchaser will be solely liable in respect of the seller, but not in respect of the tax authorities since they may pursue either party under the joint and several liability resulting from article 1705 of the CGI. In this case, the tax authorities' proceedings may be marred by irregularities if they do not respect the principle of an adversarial process and the fairness of debates in respect of all parties, by not informing them and not involving them in the proceedings2. In order to improve the seller's protection and in the case they have agree that the fees will be payable by the purchaser, the seller may attempt to obtain a compensation commitment from the purchaser to cover fees, interest, penalties and supplements which may be claimed from the seller, as well as any loss suffered by it, particularly in respect of defence costs it incurs, since in this case it will be a party to the proceedings. .

1. Cass. Com. 23 May 1973, Maillet-Baslez: BODGI 7 A-3-73 ; Cass. Com. 15 March 1988, Ingebat: Bull. Civ. IV no. 109; BOI–ENR–DG–50–10–20, no. 20.
2. Cass.com. 12 June 2012, no. 11-30396 and no. 11-30397; Cass. com. 26 February 2013, no. 12-13877; and BOI-CFIOR-10-30 and BOI-ENR-DG-50-10-20.

Greater liability for the project owner in the event of undeclared work

In order to tackle undeclared work, the French Labour Code stipulates the obligation on the principal to verify, when concluding a contract for services, then every six months until its termination, that the co-contractor fulfils its declaration obligations, pays its social charges and does not employ foreign workers without a work permit. The aim is to ensure that the service provider's employees all have the correct paperwork. This verification obligation is applicable to co-contractors based in France or abroad. If the principal does not carry out this verification, it becomes liable for civil and criminal penalties. The principal has an obligation of vigilance but also of diligence. A simple request for documents is not enough to exempt its liability. In the case of sub-contracting, the principal must also verify that the subcontractor is able to fulfil the contract

In a ruling dated 7 November 2013, the Chambéry Court of Appeal invoked these rules against a project owner. In the case in question, the project owner had entrusted the main structural work in a construction project to a company called Pala, which had then subcontracted this work to a Polish company, Manualis, which it had provided with all the equipment required for carrying out the work. Manualis then posted Polish workers to France to carry out the work. Following a workplace accident on the construction site involving a Polish worker, an inquiry revealed numerous breaches of safety rules resulting in the labour inspectorate ordering the immediate shutdown of the site. Following an examination of the contractual chain, the labour inspectorate determined the subcontracting to be false and designed exclusively to provide undeclared labour. In reality, the Polish workers, although officially employed by the Polish company, actually worked under the direct authority of Pala. The sole purpose of the subcontracting contract was to provide low-cost labour.

The Chambéry Court of Appeal not only found Pala and Manualis guilty of supplying illegal labour and illegal subcontracting but also the project owner. It ruled that the project owner had approved the subcontracting contract signed between Pala and Manualis; had never claimed not to be informed about every aspect of the construction project; was the recipient of correspondence from the labour inspectorate drawing its attention to the legality of the subcontracting carried out. The Court therefore found that the project owner had, with full knowledge of the facts, contributed to the illegal practices of its co-contractor by failing to meet the inspection obligations imposed on it by law. It ruled that the project involved undeclared work and illegal subcontracting. The posted Polish employees did not benefit from public policy provisions under French law, particularly in relation to health and safety, applicable to postings within the European Community. This ruling is part of the clampdown on undeclared work in the construction and civil engineering sector, both at a European and French level. This is in line with the decision by European ministers on 9 December 2013, to completely review the 1996 directive on posting of workers in the context of a contract to provide services. The aim is to reinforce controls to combat "social dumping". This will involve the mandatory implementation, specifically in the construction and civil engineering sector, of joint and several liability between the principal and throughout all European Union Member States.

"The principal has an obligation of vigilance but also of diligence."

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In all European Union countries, principals will now have to verify the practices of their subcontractors. They will therefore be liable for prosecution in the event of fraud committed by those subcontractors. This will allow a chain of responsibility to be established in order to combat organised fraud. Cooperation will also be established between European countries.
In France, the Minister of Labour recently announced the establishment of a plan to tackle undeclared work and posting fraud in Europe, particularly including the stepping up of inspections by the labour inspectorate, targeting of dubious practices and reinforcement of inspectors' powers. Inspectors may now directly impose fines on companies which breach the rules and their powers to shut down construction sites may be expanded. Project owners must now pay more attention than ever to their responsibilities Particular caution is advised in the case of subcontracting. Compliance with obligations of vigilance and diligence should make project owners particularly wary of contractors offering services at prices well below market norms.

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