OPTION
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REAL ESTATE NEWSLETTER

Dossier on
Real estate professionals rising to the challenges of the economic crisis

Focus - International

News

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Editorial

Whether this period of unrest which we are currently going through is perceived or considered as a just a slow-down or as a profound crisis, relevant legal and tax matters never leave any respite for those protagonists involved. However, despite the fact that in this context law will constitute above all an instrument to be used for ensuring a line of defence and providing a certain amount of security, the abundance and diversity of our system reveals a great many tools which, in a virtually contradictory manner in this post financial crisis period, will sometimes also afford real opportunities. We have devoted this special issue mainly to those real estate professionals which, property developers or real estate dealers, are confronted first hand with the weakening of the sector, but which are nevertheless in a position to take advantage of this period to apply optimising techniques and to deal as best possible with the situation. Indeed, this could concern upfront taking those steps required to counter the pitfalls which lie in the lack of flexibility of certain regulatory frameworks. This is for instance the question at hand when one is unable to release oneself from deadlines that apply even though current market conditions are ill-adapted: in matters of local taxes or VAT one might attempt to obtain a temporary exemption or to avoid any overspending and from a legal standpoint one might solicit an extension of validity of administrative authorisations. Likewise, the recent years of prosperity must not have lead us to forget those methods which previously were part of any optimised management of assets and of cash flow, which will need to be updated. It would thus seem to be the appropriate moment to take a closer look at the costs involved with planning taxes or to consider implementing, if the results over the last few years were profitable, a mechanism for the carry-back of any possible deficits realized. Let us recall indeed that among the various tax measures voted recently through Parliament was the possibility for undertakings to obtain a refund of carry-back receivables, without having to wait for the expiry of the 5 year period (failing chargeable corporate income tax). However, this accelerated refund will no longer apply – save a new statute – for the financial years closed as from 30 September next. Therefore, it is now or never the time to address this issue.

Moreover, those operators contemplating a diversification or a reorientation of their business activities will also have to ascertain under which terms of tax neutrality the reclassification of their assets, or even the possible outsourcing thereof, will be to occur. Finally, as one should not lose sight of the fact that the current crisis knows no borders, international groups will have to see to it that the same applies to the administration of their losses, in particular having regard to the flexibility of certain legislations, or even in the light of recent decisions rendered by European courts.

In a nutshell, there are a great many areas of investigation that we would invite you to discover – or to rediscover – in the search for a few keys enabling you to keep a positive outlook in dealing with the crisis and therefore… to anticipate as best possible the recovery of the economy. ■

Christophe Frionnet, Lawyer

The tax regime applicable to real estate dealers: what solutions in a bear real estate market?

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Real estate dealers benefit, under certain conditions, from a preferential tax regime for acquisition of property. The benefit of this preferential tax regime is subordinated in particular to the condition that the property acquired is resold within a maximum time period of four years at the risk of entailing the enforceability of transfer duties and taxes, the collection of which was deferred, and of default interest. Let us first of all set aside those solutions which are no longer or which are not viable, that is to say (aa) contributions to a company, (bb) gifts, (cc) the alteration of the corporate form of the real estate dealer corporation, (dd) resales to a real estate dealer, (ee) *force majeure*, save demonstration that the "event invoked [is], besides being outside the control of the parties and unforeseeable, insurmountable due to the absolute impossibility to perform the obligation entered into" and (ff) assignments which constitute unreasonable exercise of rights which are unenforceable against the tax authorities: such as the case of a real estate dealer having resold a building, just a few days before the expiry of the allotted period, to a company with which there was a "pooling of interests".

In this context, only two options remain viable. First of all, the entry of the building (a component of the stock) as a fixed asset : such entry is an act of management which leads to the immediate lapsing of the preferential regime that the real estate dealer invoked the benefit of at the time of the acquisition of the property: the transfer duties, the collection of which was deferred, are then immediately due and default interest is enforceable in respect of the period running from the acquisition up until entry as a fixed asset; the interest of such entry is twofold: interrupting the computation of default interest and creating an amortizable basis. Second, assignments or reclassifications of assets – which by definition do not constitute unreasonable exercise of a right: it results from case law that the main elements taken into consideration to qualify the unreasonable exercise and to demonstrate the fictional character and/or the exclusively tax motivated purpose of the resale are (i) "the absence of any effective financial consideration representing a price", (ii) "the similitude of corporate purpose, the identity of the shareholders and of their interests in the share capital, the identity of the managers", (iii) the "pointlessness of the sales of the buildings (…) due to the fact that the company could have ensured, itself, the renovation and rental process", or yet still (iv) the fact that the resale occurs in favour of a "company created less than two months before the expiry of the allotted period". The alternative, or even the dilemma, which operators are faced with, is painfully simple: to duly record the non resale and to correlatively settle the duties, the collection of which was deferred, marked up by default interest, or to accept to assign the asset on current market terms. In a similar bear real estate market, in the 1990's, the legislator had amended on several occasions the legal tool, in particular by extending the deadlines for resale. One can only hope for such a reform to be introduced within the next few months. At this stage, no draft bill or bill proposal has been presented to Parliament or is even, to our knowledge, currently under examination. ■

"A reform to be planned"

Improving cash flow via VAT credit refunds and the option for taxation on a cash basis

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The principle of neutrality of VAT requires that initial capital expenditure outlaid for the purposes of an activity be immediately considered as an economic activity. There is therefore no need to wait for the taxable income to arise to exempt expenditure. This situation will generate a VAT credit, that the beneficiary can decide either to defer until its appropriation against any VAT which will be collected at a later stage, or obtain a refund from the administrative authorities. Real estate transactions often implying significant amounts of VAT and lengthy periods of time between initial expenditure and first receipts, operators will generally prefer to opt for the refund. In order to face up to the currently prevailing crisis situation, the government announced at the beginning of the year the possibility to present monthly applications for refunds of VAT credits (the latter being until then quarterly or annual). Those enterprises subject to the normal tax regime based on effective bookkeeping can thus, as from the tax return filed in February 2009, claim a refund of the tax credit realized in respect of a month, subject to the exclusive condition that the refund application applies to an amount at least equal to 760 euros. Once the application is presented, the relevant department will have to examine it, which will inevitably take time. Nevertheless, the administrative authorities have recalled that refunds of VAT credits have to take place within the shortest time frame and at the latest within two months from the presentation of the application. In practice, the efforts deployed along these lines appear genuine. For a long time these rules did not apply to real estate operators having formulated an option making VAT chargeable on their sales off plans progressively as monies are cashed. The advantage afforded by this option was indeed counterbalanced by the impossibility to obtain VAT credit refunds, for as long as the price had not been fully cashed. On 17 June 2008, the administrative authorities published a tax ruling acknowledging in favour of vendors of buildings off plans (VEFA) having opted for taxation under VAT according to the cash basis rule, the right to obtain a refund of their tax credit without having to wait for the complete payment of the price by the purchaser. This solution thus put an end to the dilemma which existed until then between the effort in terms of cash flow on VAT collected (without an option, the VAT becomes fully chargeable at the time of the deed, without taking into account the schedule of payments) and that on deductible VAT (with the option, refunds were frozen). From now on, VAT can be collected upon option at the time of and proportionally to the cashing of the price (avoiding the financial carry of VAT collected), without this forming an obstacle to the obtaining of VAT credit refunds (thus reducing noticeably the financial carry of deductible VAT). Ultimately, the option for the cash basis seems to only present advantages, all the more so that the administrative authorities have taken the habit of exempting their beneficiary from having to present a guarantee (which anyway appears more in line with community law). All these measures are extremely well suited to the situation and are to be used unreservedly. ■

"Good command of the rules of VAT recovery will enable significant optimisation of the cash flow of real estate operators. "

Changes of business activity and reclassification of assets

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Enterprises exercising a real estate dealer or real estate development activity can elect, in times of crisis, to definitively change business activity and to thus exercise a purely property income based business activity. We will invoke hereinafter, merely the consequences in terms of direct taxes indicating that these consequences are not the same depending on whether the enterprise is incorporated in the form of a company subject to corporate income tax or to standard income tax. When the enterprise is not subject to corporate income tax and comes under the normal or simplified tax regime of profits based on effective bookkeeping, the change of business activity will entail the consequences of a discontinuance of business activity, and thus in application of the provisions of article 201 of the Tax Code, the immediate taxation of the business profits realized since the end of the last financial year taxed, determined according to standard rule of law, of the profits under deferred taxation and, in particular, of the provisions previously booked which have become irrelevant on account of the assignment or of the discontinuance of business activity, and finally of the capital gains (or capital losses) on fixed assets recorded on the occasion of the discontinuance of business activity. All unrealized capital gains on stocks are thus subject to taxation immediately. In return for this taxation, the buildings will then be deemed to have a tax cost price equal to fair market value at the date of the change of business activity. Other consequences must be indicated at the level of the shareholders, and a distinction must be made here between legal persons subject to corporate income tax and natural persons, and concerning the latter, according to whether or not the shares of the company form a professional asset within the meaning of article 151 nonies of the Tax Code. When such is the case, the change of business activity of the company will deprive the shares of their status as professional assets and the consequence is then in principle the taxation of the shareholders concerned accordingly to the unrealized capital gains on the shares. However, the taxation of the capital gains will be postponed until the date of assignment, redemption or cancellation of these shares; these capital gains will be computed according to the principles set out in the "Quemener" ruling of the *Conseil d'Etat.* When such is not the case, the change of business activity will not alter the situation of the shareholders whose shares will continue to be construed as shares of predominantly real estate holding companies. On the other hand, when the enterprise is subject to corporate income tax, the consequences remain in principle the same, that is to say that of a discontinuance of business activity. In the absence of creation of a new legal person, on account of the provisions of article 221 bis of the Tax Code, the effects of the change of business activity are limited to the immediate taxation of the business profits of the financial year in effect at the date of the operation, to the loss of the right to carry-over previous losses and to the add-back of regulated provisions, as the case may be. On the other hand, as concerns profits under deferred taxation (which include essentially provisions which have not yet been added-back to the results and profits which come under certain special averaging tax regimes), unrealized capital gains vested at such date and deferred profits comprised in the value of inventories, their immediate taxation is excluded when no alteration is made to the book values of the assets and that the taxation thereof remains possible within the framework of the new tax regime applying to the enterprise. It is in application of these principles that a company subject to corporate income tax, which discontinues its real estate dealer or real estate developer business activity, can reclassify its stocks under the fixed assets heading without sustaining on this occasion the taxation of the unrealized capital gains, to the extent where the value of these assets remains unaltered in the balance sheet, the condition of maintaining of the principle of taxation being vested on account of the corporate income tax regime. ■

"A company subject to corporate income tax, which discontinues its real estate dealer or real estate developer business activity, can reclassify its stocks under the fixed assets heading without sustaining on this occasion any taxation of unrealized capital gains"

Optimising balance sheets and planning taxes

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Planning taxes and contributions form a non insignificant part of the budget of a real estate project. These will therefore need to be managed in the best possible way in order to mitigate their impact, and such management will sometimes imply applying to the relevant courts. Depending on the taxes and contributions, the modalities and subject matter of disputes will differ. We would recall briefly the rules applicable to a few of them. Thus, as concerns local facilities tax (*taxe locale d'équipement*), the amount of which is the result of multiplying the net area (*surface hors œuvre nette*) by the value of the construction category1, the classification of the authorised construction may be challenged, both via recourse on the grounds of *ultra vires* action (at the stage of the classification of the building by the administrative authorities) or an application for stoppage of payment (at the stage of the issuance of the enforceable title). Article L. 1617-5 of the General Code governing Local Authority Bodies provides indeed grounds for challenging both the formal validity as well as the relevance of an order to pay, whilst suspending the enforcement of this order throughout the duration of the contentious proceedings. A contribution which is chargeable in respect of a planning permission delivered within the ambit of a general development program (PAE) can also be challenged before an administrative court. The most frequent discussion will concern the legitimacy of the facilities placed on the burden of the builders in respect of the PAE. Indeed, the provisions of article L.332-9 of the planning Code specify that only the fraction of the cost of the public facilities to be carried out in order to satisfy the needs of the future inhabitants or users of the constructions can be placed on the burden of builders. In particular, the beneficiary of the planning permission will be able to challenge, by way of a demurrer, the deliberation of the municipal council instituting the PAE and determining the proportion of the cost of each facility placed on the burden of the builders. Other contentious proceedings can be brought before the civil courts, such as the contestation of the value of a piece of land within the framework of the determination of the amount of the payment for Exceeding the Statutory Density Cap2 in the event of disagreement between the applicant and the director of the tax department. In this case scenario, it is the judge in charge of expropriation affairs who will be solicited, at the initiative of the first party to act, and who will rule according to the proceedings contemplated by the Code of expropriation on grounds of the general interest3. Great care will therefore have to be applied to the terms presiding over the determination of the amount of the taxes and contributions in order to optimize the budget for a project, as the case may be, soliciting the relevant judge. To bring this matter to a conclusion, we would add that the management of a project over a period of time must also be thought through in terms of planning taxes and contributions. Indeed, the operative event being the planning permission, their chargeability does not depend on the implementation of said planning permission or not, but merely on the lapsing of a certain period of time as from the delivery thereof. In the event where a project is abandoned, it is essential to apply for the cancellation of the operative event triggering the tax or the contribution by soliciting the withdrawal of the planning authorisation without waiting for the latter to expire. The presentation to the tax authorities of the withdrawal bylaw will, under these circumstances, enable the obtaining of a rebate in respect of such tax or contribution. ■

"The management of a project over a period of time must also be thought through in terms of planning taxes and contributions"

1 - Article 1585D of the Tax Code.
2 – In those sectors where this is still in effect.
3 – Article R. 333-4 subparagraph7 of the Planning Code.

Wealth Tax: assets disappearing, the exemption remains

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The real estate crisis has inevitably altered the behaviour of real estate developers and real estate dealers. A great many of them are going to have to temporarily rent out all or part of their real estate stock, while waiting for economic recovery to occur. Others will hold onto the funds generated through the sale of stocks with the perspective of seizing new opportunities. This situation deserves more specific attention for those of them who, in matters of Wealth Tax, benefit from the exemption in respect of professional property. From the standpoint of Wealth Tax, we would recall that real estate development and real estate dealer business activities are eligible under the professional property exemption. They have indeed a commercial character within the meaning of article 885 N of the Tax Code and can be exercised in a professional capacity within the meaning of this same article. The exemption applying to professional property often leads to an exemption of the entire value of the enterprises concerned, to the extent where the buildings held as stocks constitute components which are necessary to the real estate developer and dealer's business activity and where the cash position corresponds to the requirement in terms of working capital. In the contrary case and besides specific exceptions, the building rental business activity is not susceptible to benefit from the exemption in respect of professional property. The tax authorities refuse to consider this business activity as the exercise of a genuine profession and considers that such comes under the ambit of private estate management. However, in application of the rules of Wealth Tax, property which is not strictly necessary to the exercise of a professional activity, that is to say, in practise, property which belongs to private estate, is not eligible under the professional property exemption. In the context of the above mentioned crisis, the following queries arise: can the temporary rental of part of the stocks affect, in all or in part only, the professional character of a real estate developer or dealer's business activities? Could the accrual of cash exceeding the normal level be criticised as not being strictly necessary to the exercise of the professional activity? For the following reasons, it would seem to us that neither the very principle of the exemption itself, nor its extent could be criticised. To the extent where such is temporary and dictated by the real estate crisis, that is to say by an event which is outside the control of the tax payer, the leasing out of stocks does not appear likely to adversely affect the speculative intent which drives these professionals. However, it is this very speculative intent which confers upon the business activities concerned their commercial and professional character and ensures their eligibility under the Wealth Tax exemption. Thus and to the extent where the tax payer concerned is able to provide evidence that the temporary rental is but a consequence of the real estate crisis, it will not lose the benefit of its "in principle" Wealth Tax exemption and the property concerned will continue to be analysed as necessary to the professional activity. The same will apply as concerns the possible excess cash realized due to the wait-and-see attitude of the professional which may not be assimilated to assets with a purely private character. Indeed the accrual of such surplus cash will enable those parties interested to hold out for better days and to take advantage of any opportunities that should arise out of the crisis, which in any case will contribute to enhancing the value of what remains a professional tool and which goes considerably beyond the framework of the mere management of a private estate. ■

"Neither the very principle of the exemption itself, nor its extent could be criticised"

Management of local taxes within the framework of real estate projects

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During periods of crisis, the emphasis is placed on the necessity of optimizing management of real estate programs, in particular through a particularly careful audit of the various real estate related taxes.

In this context, the various real estate programs which exist are likely to justify the implementation of mechanisms for reduction or exemption of local taxes. However, the benefit of these various mechanisms is totally dependent on return requirements, the non compliance with which will put offenders to a disadvantageous. Thus, within the framework of major refurbishment operations on premises, for which the scale of works is such that they can be analysed as a demolition and reconstruction operation, it is possible to solicit the taxation of the site under real estate tax on undeveloped property (which is significantly lower than real estate tax on developed property) throughout the duration of the works. It is important then to inform the relevant real estate tax office by filing an "IL" tax return form indicating the demolition.

"In the event of a demolition and reconstruction project, always consider real estate tax on undeveloped property."

Upon completion of the works, new constructions, reconstructions and additions to the construction will be exempted from real estate tax on developed property for a period of two years following that of their completion. For buildings which are not assigned to a residential use, this exemption is restricted to the local (*départementale*) and regional share. Such exemption is total for residential buildings, save a decision to the contrary of the *communes* or of their consortiums accordingly to the share of taxation which falls to them. The benefit of this exemption is subordinated to the condition that the new constructions as well as the changes of consistency or of assigned use are brought to the attention of the administrative authorities within a period of 90 days from their definitive realisation. In the event of a filing outside the deadline, the exemption will apply for the period remaining after the 31 December of the following year. It should be noted, within this framework, that in the event of negligence of the builder, and in order to avoid the lapse of the right to the exemption, purchasers of apartments or of individual houses which should become owners subsequently to the completion of the construction will benefit from a special 90 day period as from the date of the acquisition of the property to file the return. As concerns partial completion, the *Conseil d'Etat* has considered that the various parts of a same building can be considered as completed at successive dates, when they can be used separately. It results that in the event of completion at successive dates, the return requirement set forth in article 1406 of the Tax Code applies as per fraction of property completed. Moreover, as concerns the annual tax on office space within the Ile-de-France region, and to the extent where a property complex can be considered as no longer being usable in accordance with its purpose, on account of the scale of the renovation works underway, it is possible to draw the consequence in this matter and to not include these surface areas in the return for such tax. Indeed, falling liability under real estate tax on developed property, these surface areas will no longer come under the ambit of the annual tax on office space.

The management of real estate related taxes implies, thus, meticulous attention to the various return requirements, as well as treatment on a "case-by-case" basis having regard to the factual and legal specificities of each real estate project. ■

The decree of 19 December 2008 has not extended the term of validity of all planning authorisations

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The reform of planning authorisations having entered into effect on 1st October 2007 purported to standardize the periods of validity of all planning authorisations.
Article R. 424-17 of the planning Code thus provides that "planning permissions, development or demolition permits expire if the works are not undertaken within a period of two years" as from their notification or from the advent of a tacit decision.
Having regard to the difficulties encountered by economic operators in the current economic situation, the government purported to extend them a "helping hand" by increasing this period of validity to three years, this extension applying to any authorisations which are currently valid at the date of 19 December 2008 (decree of 19 December 2008). However all authorisations which are currently valid at such date will not benefit from this extension. Indeed, we would note that the decree of 19 December 2008 refers expressly to the provisions of articles R. 424-17 and R. 424-18 of the planning Code, and thus to the statutes stemming from the reform on planning authorisations, which entered into effect on 1st October 2007. There is absolutely no doubt as regards an authorisation issued subsequently to such date: they are governed by the provisions of articles R. 424-17 and R. 424-18 of the planning Code in their wording stemming from the reform, and as such benefit from this extension. The date of filing of the application (prior or subsequently to 1st October 2007) remains irrelevant. On the other hand, an authorisation obtained prior to 1st October 2007 remains, according to us, and subject to a different interpretation by administrative courts, governed by the regime in effect at the date of its delivery. Thus the former provisions of article R. 421-32 of the planning Code, which provide for a two year period of validity as from the notification or the tacit delivery of the planning permission, will apply to this authorisation. Thus, the extension of the period of validity for planning authorisations, increased to three years, being limited to those authorisations governed by the regime of the new wording of articles R. 424-17 and R. 424-18 of the planning Code, an authorisation which is not governed by these provisions would appear to be excluded from the benefit thereof. Under these circumstances, the decree of 19 December 2008 would not seem to provide the expected "helping hand" for all authorisations, those delivered prior to 1st October 2007 not benefiting from such. It is therefore important, for each beneficiary of a planning authorisation, to check the regime which the latter is governed by and to not be misled by an apparent extension of all planning authorisations currently valid at the date of 19 December 2008. In any event, in the case of recourse on grounds of *ultra vires* action before the administrative courts or of recourse for demolition before the civil courts (article L. 480-13 of the planning Code), all planning authorisations will benefit from a suspension of their period of validity until an irrevocable court ruling is passed, either under the ambit of the former statutes for authorisations delivered prior to 1st October 2007 (article R. 424-32 amended by decree of 31 July 2006) or of the statutes stemming from the reform for authorisations delivered after its entry into effect (article R. 424-19). ■

"The decree of 19 December 2008 does not extend the period of validity of those authorisations delivered prior to 1st October 2007."

Fixing rent under commercial leases

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The main item of news regarding commercial leases undeniably concerns the fixing of rent, whether in the context of mere revisions or of renewals of leases. Articles L. and R. 145-1 et seq. of the commercial Code, which govern most commercial leases, define the boundaries of rent variation during the course of performance of the lease, then at the time of its renewal. The initial objective was to protect tenants against the consequences of excessive increases, whilst preserving a balance between the interests at stake. However, quite recently, two contradictory factors have combined to justify changes in rent and their being fixed at rental value. These are: the reduction of the rental value of many sites on account of the direct effect of the economic crisis; of the average annual variation of the INSEE index measuring the cost of construction (ICC) of about 3 to 5 % per annum on account of the significant rise in raw materials. Market operators are faced with the rule – paradoxical -, according to which when the rental value is inferior to the current rent, such is binding without any conditions or limitations, both for exclusive office use premises and for stores. If article L. 145-34 of the commercial Code institutes, essentially for retail premises, a rent cap, measured with respect to the variation of the ICC over the term of the lease, no minimum limit on rent, on the other hand, exists. The current economic circumstances will be particularly decisive on the rent of premises leased out for an exclusive office use, for which the rule is that the price of the lease is fixed with reference to those practised for equivalent premises, save adjustment in consideration of the differences established between the premises and rented and those premises taken in reference (article R. 145-11 of the commercial Code). However, setting aside the case of renewal of the lease, the variation of the ICC, and more particularly its variation in a proportion of more than 25 % over recent years, opens the way during the lifetime of a lease to an application for the revised rent to be fixed at rental value when, by operation of the escalator clause stipulated in the lease, the rent is found to be increased or reduced in a proportion of more than one quarter in comparison to the previously fixed price; this action is based on article L. 145-39 of the commercial Code. Thus, virtually all rents in respect of leases concluded in 2001 or prior to such date having been increased by more than 25 %, these will be able to give rise to a claim, with respect to the rent to be revised, for such to be fixed at rental value. Over the last few years, this mechanism has not had the chance to be applied as the variation of the ICC (which is the index which is chosen the most) did not lead to variations of rent upwards of 25 % in comparison to the initial rent within a period of less than nine years. Today, the adjustment of rent as per rental value will translate, more particularly for offices, as a reduction all the more significant as the progression of the ICC was intense and as the market has gone into a downward spin. The revision process set out in article L. 145-39 contains a paradoxical effect: it can be invoked by both parties whatever the variation of the index, so that an increase of rent by more than 25 % on account of the variation of the ICC can be claimed by the landlord in order to obtain an adjustment of the rent as per the rental value which may, as applicable, be superior to the result of the indexation. These rules being mandatory rules of public policy, no clause of a lease can impede any such application, which is possible at all times via process server's instrument or registered letter with acknowledgement of receipt. The variation of the ICC over the last five years has thus sown the seed for a de facto "uncapping" of the rents of a great many leases applying to shops which are at a historical low. ■

All three are co-authors of the Mémento entitled "Expert Baux Commerciaux 2009/2010, EFL" which is devoted to the analysis of all of the specific features of commercial leases.

International management of losses abroad

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On account of the current crisis, French property developers with establishments abroad may have to face up to the more or less brutal reversal of local real estate markets, entailing in particular significant depreciations or losses on programs which have already been started. The financial situation, sometimes extremely fraught, of foreign subsidiaries will in general require the French parent to take wide scale measures for the reinstatement of the equity capital of the subsidiaries concerned in order to avoid the latter from having to file for bankruptcy. Generally speaking, the local subsidiaries will have been financed both by means of capital and of indebtedness, most often via loans granted by the parent company. The nature of the aforementioned measures, to be enacted by the French parent, will depend on numerous parameters. A share capital increase could be inappropriate, on account for instance of the contribution duties which may be enforceable locally (this is the case for instance in Poland, where a 0.5 % duty applies), or yet still of the formalism contemplated by local laws (reverting to a notary). In this case, other options will have to be considered. Certain countries enable the reinstatement of equity capital of a company via a contribution of capital reserves, without affecting the share capital (in the case of Germany, contributions referred to as "Kapitalrücklage"). This type of contribution may of course, due to its flexibility, be an appropriate solution, but raises however from a pragmatic point of view a great many legal, accounting and tax issues at the level of the French parent company. First of all, is the issue of the accounting treatment to be retained in France for such a contribution which is unheard of under French law.

"Certain countries enable the reinstatement of equity capital of a company via a contribution of capital reserves, without affecting the share capital"

Two options seem conceivable: (a) booking the contribution as a receivable attached to the share holdings, or (b) incorporating such into the cost price of the securities held in the foreign subsidiary. In case (a), the French company risks, in the event of an audit, having the tax authorities uphold against it the absence of invoicing of interests (and thus even where under foreign law, it is out of the question for the subsidiary to pay interests in respect of monies incorporated into its equity capital). In situation (b), the French company will not be able to deduct tax wise a subsequent provision recorded on the foreign securities, the cost price of which has been increased. The French parent company may also consider granting a cancellation of debt in favour of its foreign subsidiary: generally, such a cancellation of debt may be deducted tax wise in France, accordingly to the negative net equity of the subsidiary. At the level of the beneficiary subsidiary, this cancellation of debt will in general be treated as extraordinary income, and as such fully taxable. If the foreign subsidiary has sufficient fiscal loss carry-overs, the cancellation of debt will not entail *a priori* an effective payment of tax at its level. However, the rules which are applicable to such matters in certain countries will have to lead to a meticulous prior examination of the local tax consequences. Thus, in Belgium for instance, financial aid contributed by a shareholder can, in certain situations, be treated as an "unreasonable or gratuitous benefit", the profit resulting from the aid received then not being able to be set off against the existing loss carry-overs. We would underline, to conclude, that the reclassification within a group of a foreign subsidiary is liable to entail the immediate cancellation of its loss carry-overs (this is the case in particular in Germany).■

The real estate dealer regime in the Islamic financing sector

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Compliance with Sharia law has entailed the creation of several financing techniques, including what is known as Murabaha financing. this is a purchase and resale transaction by virtue of which a broker (the "Financier") goes into debt, purchases a property and resells such to an Islamic investor in consideration for a price, payable on a deferred basis for the amount corresponding to the Financier's debt and including a predetermined profit ("ribh") corresponding to the remuneration of the Financier. The Murabaha technique is used in particular in transactions concerning the acquisition of buildings or of securities of predominantly real estate holding companies ("SPI"). This explains why the Financier will adopt real estate dealer status, in order to benefit from the regime of article 1115 of the French Tax Code in matters of transfer taxes. Under this regime, subject to certain conditions, only the resale is subject to transfer tax, the acquisition being exempted (purchases of buildings remain however subject to land registration tax at the rate of 0.715 %). France has recently taken a view regarding the tax treatment of certain Islamic financing techniques in various notes published on 18 December 2008 and restated in the form of administrative guidelines published on 25 February 20091. The authorities validated the use of the real estate dealer regime in Murabaha financing applying to buildings or securities of SPI specifying that the conditions of habitualness and of speculative intent were deemed to be fulfilled. As concerns buildings, if it is recalled that, as in the real estate dealer regime, the Financier's margin is subject to VAT, the remuneration of the deferment of payment will not be subject to VAT and will be excluded from the assessment basis of transfer tax due on the occasion of the resale. We would recall that, in order to benefit from the regime of article 1115, the Financier will have to comply with the specific obligations contemplated by this regime (covenant to resell, keeping of a directory…). ■

1 – Guidelines with the reference 4 FE/09.

Local Zoning Plan (PLU) of Paris : protection of trade and crafts

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The administrative court of appeals of Paris, in a ruling dated 2 April 2009, confirmed the validity of articles UG.2.2.b and UG.2.2.e related to the protection of trade and crafts and to sites for the protection of trade and crafts under the local zoning plan ratified in June 2006.
The court considered that these two articles were aimed at safeguarding the commercial diversity of certain districts and that they could not be regarded as affecting the right of property in a disproportionate manner in relation to the objective they are pursuing. We would recall that these provisions are aimed essentially at limiting and defining the assigned use of constructions or reconstructions of premises located on ground floors fronting the street. ■

The "Boutin" law of 25 March 2009 and alteration of the scope of application of the urban pre-emption right

One might recall that the law of 13 July 2006 carrying a national undertaking for housing introduced the possibility for urban pre-emption right holders to exercise their right, in a reinforced urban pre-emption right zone, at the time of the assignment of the totality of the partnership shares of a real estate partnership, when the assets of this partnership were made up of a land unit, whether developed or not. In practise, this possibility was afforded very few chances to be applied due to its extremely confined scope of application: assignment of the totality of the shares of the real estate partnership holding a single land unit. Thus, the assignment of 99 % of the shares of a real estate partnership did not fall within the ambit of this mechanism. The "Boutin" law, duly noting the proposals of the *Conseil d'Etat* in its report on pre-emption rights dated 6 December 2007, purported to extend the scope of application of the pre-emption right applicable to assignments of shares of real estate partnerships. Article L. 211-4 d) of the planning Code now provides that, in a zone in which a reinforced urban pre-emption right applies, the urban pre-emption right is applicable in the event of assignment of the majority of the shares of a real estate partnership, when the assets of this partnership are made up of a land unit, whether developed or not, the assignment of which would be subject to the pre-emption right. However, the new statute carries a restriction to this scope of application specifying that the pre-emption right does not apply to real estate partnerships exclusively incorporated between relatives and in-laws down to the fourth degree included.

Finally one will observe that the condition as to holding of one single asset remains. ■

Outsourcing of real estate assets: a source of finance which is attractive tax wise in times of crisis

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In the current context of limited access to credit, outsourcing real estate assets in favour of financial leasing companies can represent for many enterprises a serious alternative for the purpose of procuring financial resources without reverting to traditional capital markets. This possibility is all the more worthwhile that two amended finance bills have successively relaxed the tax regime applying to real estate capital gains realized on this occasion by the assignor, provided that the assigned building is immediately placed under a financial lease, either in favour of a specialised land corporation, or to the assignor itself (lease-back). When the enjoyment of the building transferred to a financial leasing company is licensed to a SIIC (REIT), an SCPI (Unlisted partnership for real estate investment), a Sppicav (predominantly real estate investment company with a variable share capital) or to one of their subsidiaries, the real estate capital gains realized on this occasion may now benefit from the application of the reduced rate of 19 % which until now only concerned direct assignments to specialized land corporations (law no.2009-122 of 4 February 2009, article 10). In order to benefit from this measure, limited to capital gains realized up until 31 December 2009, the financial lessee company must be a party to the deed of assignment in order to enter into the covenant to hold the rights pertaining to this contract during a minimum period of five years. When it is the assignor itself which will be resuming enjoyment of the building by operation of a financial lease agreement, the amount of the assignment capital gains realized prior to the 1st January 2011 may be apportioned in equal shares over the term of the contract without exceeding fifteen years (law no.2009-431 of 20 April 2009, article 3). For enterprises which come within the ambit of income tax, this mechanism will only have an impact, as concerns long term capital gains, if the building assigned has been held for less than fifteen years, to the extent that the capital gains benefiting from the averaging is that remaining taxable after the application of the exemption mechanism of article 151 septies B of the Tax Code which provides for a 10 % relief as per year of holding of a commercial building beyond the fifth. ■

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