

# REAL ESTATE NEWSLETTER

## Dossier on

### New tax and legal constraints

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## Editorial

**G**enerally devoted to the adoption of the national budget of the upcoming year,

this time of the year is traditionally extremely busy in terms of tax reforms. When, as this is the case this year, the economic outlook is also somewhat dull and that there has been a change in government, the general trend is one of greater constraints rather than increased freedom.

You will note, when reading this new issue of the Real Estate Newsletter that the real estate sector has not been overlooked by this movement and that it has been hit both by targeted measures (announced cancellation of the regime of capital gains on the sales of building land realized by individuals, increase and broadening of the territorial scope of registration duty on sales of shares of real estate companies, umpteenth reform of the regime on rental investments) and through more general measures of application but with effects that are nonetheless quite devastating (limitation on the deduction of the financial expenses of enterprises).

Besides the fact that this tends to deprive the French tax system of any logic, this legislative inflation has caused a feeling of legal uncertainty among economic operators which is likely to lead to situations which are quite the opposite of the expected result.

One example is particularly striking: the reform of tax liabilities related to the capital gains on building land. Announced as being an incentive for owners to sell their land in order to release land for the construction of new housing accommodation, it risks, in actual reality, having the reverse effect. The cancellation of taper relief combined with the failure to take into account the effects of monetary depreciation and with the announced cancellation of the proportional tax rate come 2015 will lead to such a high tax burden (liable to reach near to 65%) that it is likely that a great many land owners will put their proposed sales on hold until a change of government brings tax back down to a more acceptable level. When moreover you consider that the new limitations on the deductibility of financial expenses borne by enterprises will lead mechanically to a rise in the financial costs of the construction of new buildings and thus of new accommodation, one has trouble trying to find any sort of logic behind these current tax reforms.

In addition to a review of the return requirements that will be incumbent upon building owners within the framework of the reform on cadastral rental values, our panorama of the new restrictions binding on operators in the real estate market will also be completed by the presentation of certain novelties in commercial lease related matters concerning more precisely the liability for the works required in order to comply with accessibility standards in premises open to the public and in matters of environmental exposure, as well as the financial consequences of the determination of renewed rent by a court. ■

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# Taxation of the real estate capital gains realized by individuals: a promise which has yet to be kept

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**T**he draft finance bill for 2013 provided its fair share of novelties, including in the sector of real estate capital gains. However, the organisation of their regime does not quite go in the direction one might have hoped for. Let us recall that the regime applicable to the taxation of real estate capital gains was already intensified just a little over a year ago by the second amended finance bill for 2011 which lengthened quite considerably the holding period necessary for taper relief (30 years instead of 15, the first 15 years moreover only benefitting from reduced relief).

This reform, which had been met with a very hostile reception, led the Presidential candidate, François Hollande, to promise to return to the initial regime characterized by a tax exemption after a twenty-two year holding period. Alas! Far from relaxing the rules applicable under this regime, it would seem that tax payers will moreover be faced with an increase.

The regime applicable to real estate capital gains has not been the subject of an overhaul, but provision has been made for two targeted measures:

- creation of an exceptional 20 % relief for the calculation of capital gains on immovable property other than building land, measure which is however restricted merely to sales carried out in 2013 ;
- permanent cancellation of the taper relief and the reintroduction of the progressive tax rate schedule for the taxation of capital gains on building land.

The main stated purpose of these two provisions is a single objective: the idea is to create a “supply shock” designed to stimulate the development of the offer in terms of housing. As concerns immovable property other than building land, the exemption will still not be vested after a holding period of thirty years. However, for those capital gains realized during

***“Exempted up until 2012, capital gains on sales of building land held for more than thirty years will be taxed at 34.5 % in 2013 and 2014 then at a rate of up to 64.5 % as from 2015.”***

the first thirty years, the application of an exceptional 20 % relief is contemplated, calculated on the basis of net capital gains determined after application of the taper relief. The scope of this measure is however doubly limited: it only concerns income tax and not social security deductions (whose constantly increasing rate has reached to date 15.5%) and its application is confined only to sales carried out in 2013.

As concerns building land, the approach is reversed. Whereas the objective is the same, that is to say to encourage land resources being put on the market, the means used are radically the opposite. Rather than reducing the taxation of capital gains, the principle of taper relief is, on the contrary, purely and simply cancelled for sales carried out as from 1<sup>st</sup> January 2013. A transitional measure is however contemplated and will enable to continue benefitting from the taper relief if a sale carried out in 2013 or 2014 was preceded by a promise agreement signed at the latest by 31 December 2012.

This is not the first time that a less favourable differentiated regime is contemplated for building land, but never before has taper relief been cancelled since it was created nearly fifty years ago. The regime is all the more harsh that inflation has not been taken into account to escalate the purchase price, and that the capital gains taxed are thus often much higher than the real capital gain.

The underlying idea is that by disconnecting tax liabilities from any notion of holding period, owners of building land will no longer have any incentive to hold on to their property at a time where there is a shortage in terms of offer. However, such disconnection will lead to a rise in taxation. Under these circumstances, the reaction of sellers can not be easily anticipated.

In order to ensure the efficiency of the measure, it is moreover contemplated to submit capital gains realized on sales of building land to the progressive income tax rate schedule as from 1<sup>st</sup> January 2015. The outlook of even higher taxes within the next two years should provide incentive to building land owners to sell now in order to benefit from a tax liability which will remain, temporarily at least, less disadvantageous.

There is a small consolation prize in that in order to mitigate the progressive character of income tax, the quarter ratio system may be applied when the land sold has been held for more than four years.

You will therefore have to do the math if you own a piece of building land, which carries significant unrealized capital gains and that an opportunity arises in 2013 or 2014. Exempted up until 2012 (even up until 31 December 2014 in the case of signature of a promise agreement prior to 1<sup>st</sup> January 2013), the capital gains realized on the sale of building land held for more than thirty years will be taxed at 34.5 % in 2013 and 2014, then at a rate which is liable to reach 64.5 % as from 2015. However, to do the math is to assume that these new rules will not be changed again in the future, which nobody can guarantee. One has but to wait until the final vote of the finance bill in late December to confirm whether these measures are adopted. Until then, it may be in the interests of tax payers about to sell building land to accelerate completion of the transaction in order to benefit from the transitional measure. ■

	Building land	Other immovable property
1964-1975	<ul style="list-style-type: none"> <li>• submission to the progressive income tax rate</li> <li>• no exemption in consideration of the holding period</li> </ul>	<ul style="list-style-type: none"> <li>• no taxation</li> </ul>
1976-1982	<ul style="list-style-type: none"> <li>• submission to the progressive income tax rate</li> <li>• no relief for the first 10 years</li> <li>• exemption after 30 years</li> </ul>	<ul style="list-style-type: none"> <li>• submission to the progressive income tax rate</li> <li>• no relief for the first 10 years</li> <li>• exemption after 20 years</li> </ul>
1983-1986	<ul style="list-style-type: none"> <li>• submission to the progressive income tax rate</li> <li>• no relief for the first 2 years</li> <li>• exemption after 32 years</li> </ul>	<ul style="list-style-type: none"> <li>• submission to the progressive income tax rate</li> <li>• no relief for the first 2 years</li> <li>• exemption after 22 years</li> </ul>
1987-1990		<ul style="list-style-type: none"> <li>• submission to the progressive income tax rate</li> <li>• no relief for the first 2 years</li> <li>• exemption after 22 years</li> </ul>
1991-1992		<ul style="list-style-type: none"> <li>• submission to the progressive income tax rate</li> <li>• no relief for the first 2 years</li> <li>• exemption after 32 years</li> </ul>
1993-2003		<ul style="list-style-type: none"> <li>• submission to the progressive income tax rate</li> <li>• no relief for the first 2 years</li> <li>• exemption after 22 years</li> </ul>
2004-2011		<ul style="list-style-type: none"> <li>• income tax at the rate of 16% (increased to 19% I 2011)</li> <li>• no relief for the first 5 years</li> <li>• exemption after 15 years</li> </ul>
2012		<ul style="list-style-type: none"> <li>• income tax at the rate of 19%</li> <li>• no relief for the first 5 years</li> <li>• exemption after 30 years</li> </ul>
2013-2014 (draft)	<ul style="list-style-type: none"> <li>• income tax at the rate of 19%</li> <li>• no exemption in consideration of the holding period (transitional regime for sales with a promise agreement in 2012: submission to the regime applicable in 2012)</li> </ul>	<ul style="list-style-type: none"> <li>• income tax at the rate of 19%</li> <li>• no relief for the first 5 years</li> <li>• exemption after 30 years + additional relief of 20 % exclusively on capital gains realized in 2013</li> </ul>
2015... (draft)	<ul style="list-style-type: none"> <li>• submission to the progressive income tax rate</li> <li>• no exemption in consideration of the holding period</li> </ul>	<ul style="list-style-type: none"> <li>• income tax at the rate of 19%</li> <li>• no relief for the first 5 years</li> <li>• exemption after 30 years</li> </ul>

# Commercial leases and accessibility standards: who is to pay for works?

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## Situation as regards existing Category 5 Establishments Receiving the Public

**P**rior to 1<sup>st</sup> January 2015 existing Establishments Receiving

the Public (ERP) of the 5<sup>th</sup> category will have to include an area of the premises enabling disabled persons to gain access to all of the commodities for which the establishment was designed. A great many of these premises are operated within the framework of a statutory commercial lease. The objective is to afford persons with disabilities the same possibilities as non-disabled persons, whether their disability is physical, sensory, cognitive, mental or psychic (article L. 111-7 of the Housing and Construction Code).

There are three exceptions:

- where it is necessary to protect architectural heritage;
- where there is a technical impossibility to implement accessibility: environment of the building; characteristics of the land; presence of existing constructions or of constraints in connection with the classification of the construction zone; planning rules preventing an extension necessary for the implementation of the accessibility rules

- where there is an obvious disproportion between the improvements and their consequences : such as a significant reduction of the space for the activity of the Establishment Receiving the Public, on account of the volume of the fittings required and of the impossibility to extend the occupied floor area, or such as the economic impact of the cost of the works.

In practice, local accessibility committees (*commissions départementales d'accessibilité*) grant a great many exceptions in particular for high street retail stores.

The penalties incurred in the event of failure to carry out mandatory works prescribed (article L. 152-4 of the Housing and Construction Code) are significant:

- a 45,000 Euro fine (x5 for a legal person)
- 1 month prison sentence and a 75,000 Euro fine in the event of repeat offence
- temporary or definitive administrative close down order
- publicity of the decision in two local newspapers

<sup>1</sup> – The requirements imposed on ERP of the first four categories are not dealt with here.

## Ensuring compliance of Category 5 Establishments Receiving the Public: a liability of landlord or tenant?

The statutory regime organised by the Commercial Code does not govern the “rental” aspect. It is the standard rule of law governing rentals (civil Code) that applies.

Works to ensure standard compliance, which are required by a statute, do not come under either the notion of major repairs or that of major upkeep. It is not the nature of the elements physically affected by the compliance works which determines liability for such.

Compliance works in accordance with their contractually intended use are incumbent on the landlord (*Cour de cassation*, 3<sup>rd</sup> Civil chamber, 13 July 1994, no. 91-22260). However, the latter can refuse to carry these out where undertaking these would be equivalent to the “total loss of the rented item” (article 1722 of the Civil Code). This is the case in particular if the expenditures required should prove to be excessive having regard to the value of the building.

It is nevertheless possible to transfer this landlord's obligation onto the tenant and this is often the case; however such clauses must be clear and precise, and mention expressly the transfer to

the tenant of the works induced by new regulatory frameworks. Thus, the clause by virtue of which the tenant covenants to take the premises on an *as is where is* basis at the time of entry into enjoyment will exempt the landlord from his obligation to deliver the rented property in a good state of repair, but shall not exonerate him from maintaining the property in such condition enabling the latter to serve the purpose for which it is intended and thus from bearing the burden of compliance works. A careful examination of the lease will therefore be necessary on a case by case basis to identify the existence of such a clause and its effective scope. ■

## Will the “Duflot” act help forget the early retirement of the “Scellier” act?

The “Scellier” system shall no longer apply to acquisitions to take place from 1<sup>st</sup> April 2013 (for reservation contracts and/or promises signed before 31 December of this year). The Government has redefined in the draft finance bill for 2013 the outlines of a replacement, but its success is not yet guaranteed, all the more so that not all of its terms have been unveiled yet.

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Investors will inevitably be induced to compare the choices they should be faced with in eligible zones in order to determine whether it is worth taking advantage of the opportunity to benefit from the former tax credit without waiting for next year. Although focusing more specifically on certain geographical zones and on accommodation for low-income households, the new system (codified under article 199 novocies of the Tax Code) seems to have definite similarities with the previous system: the owner's covenant to rent the accommodation empty as a main place of residence for at least nine years, a minimum level of energy efficient performance and the base of the relief capped at 300,000 Euros. Prima facie, the rate of the new tax reduction would be set at 18 %, where the “Scellier” act provided, for investments carried out in 2012, rates of 6 % or 13 % depending on the case (excluding reservation contracts signed in 2011). But this increase in rate will just be consideration for more stringent terms of application, and investors do not necessarily stand to gain in this regard... Let us consider a couple with two children and a budget of 400,000 Euros wanting to invest in rental accommodation. Capped at a 300,000 Euro base, the reduction spread out over a nine year period would theoretically be around 54,000 Euros (i.e. 6,000 Euros a year) under the “Duflot” system, where it would have been 39,000 Euros (i.e. 4,333 Euros a year) with the “Scellier BBC” system. However, when choosing the location for the project, in order to benefit from the new system, this couple would have to purchase according to the rezoning scheme. Indeed, the location of buildings would be limited to those geographical areas which are characterized, according to the bylaw, “*by a significant unbalance between offer and demand for rental accommodation*”, which restricts even further the territories concerned under the previous system. The choice in terms of tenant will also be subject to a restriction as the financial resources of the latter must not exceed certain limits (undetermined to date). Likewise, the cap on rent should be lower than the current one, the Government suggesting prices inferior by 20 % to benchmark market rents. This requirement will of course need a precise cartography of the rental market value to be established depending on the location of the accommodation, the type of property and its floor area.

Beyond the tax savings targeted, this formula should lead more than ever these tax payers to check the level of the resulting rental return depending on the zone of the property. Finally, having regard to the global cap on tax loopholes, this couple had in 2012 a tax reduction capacity equal to 18,000 Euros + 4 % of their taxable income. Right from 2013, this cap would drop to 10,000 Euros according to the draft bill as concerns investments made from 2013, such as the “Duflot” investment. On account of the project for the extension of the “Scellier” system beyond 31 December 2012 as concerns reservation contracts and/or promises signed at this date (subject to the final adoption of the draft finance bill for 2013 such as amended by the MPs), and provided that the notarised deed is entered into prior to 1<sup>st</sup> April 2013, there will therefore also be grounds to ensure that these latter investments can remain under the ambit of the former more tax efficient cap. It should be noted indeed that the tax reductions that should result from investments carried out prior to 2013 will remain subject to the tax loophole cap corresponding to their “vintage”, which could lead our “test” tax household to not totally exclude the idea of accumulation ... ■

# Deductibility of financial expenses in light of the draft finance bill for 2013

The new government has introduced into the draft finance bill for 2013 a new limit on the right to deduct the financial expenses (or assimilated expenses) of enterprises. Below is our – provisional - review of the situation related to the conditions applicable to deductions as set forth by the new statute in its wording approved after its first reading by the *Assemblée Nationale*.

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In pursuit of its desire to thwart the tax efficient structuring of enterprises, the legislator, considering French legislation still too favourable, is continuing to implement limits on the deductibility of financial expenses with the announced objective of stamping out the abusive behaviour of large businesses in terms of their debt strategy but also of foreign groups which tend to abusively localize their debts in France. Up until now, limitations on the deduction of financial expenses concerned, excessive returns in the field of shareholder loans (article 39 1 3° of the Tax Code), enterprises with insufficient equity capital within the framework of their relations with affiliated companies (anti-thin capitalisation rules, article 212 of the Tax Code) or yet still acquisitions of equity interests whose capital gains benefit from the regime of exemption of capital gains at the instigation of a non resident shareholder (article 209 IX of the Tax Code). The new system purports to simply outlaw and on a fixed basis the deduction of a fraction of the net financial expenses of enterprises (see hereinafter) without any distinction as to the relative burden of said expenses in the results of the enterprises considered or yet still as to the allocation of the monies made available to them. In other words, this system will sanction on identical terms moderately leveraged enterprises financing the acquisition of their productive assets through a loan and highly leveraged financial enterprises financing the acquisition of equity interests. Article 15 of the draft finance bill for 2013 thus provides – subject to corrective measures addressing companies which are members of a group placed under a tax consolidation regime – that enterprises determining their results according to the rules of corporate income tax and whose net financial expenses are equal or superior to 3 million Euros will have to add-back, for the determination of their tax result, a 15 % fraction on the amount of these expenses for financial years closed up to 31 December 2013, then a 25 % fraction of these same expenses. As concerns financial expenses borne by companies which are members of a tax relief group, the capping measure only concerns, for the determination of the overall result, those net financial expenses related to monies left or made available to persons which are not members of the group. Finally, it is contemplated that the amount of net financial expenses taken into consideration shall be determined through the difference between, on the one hand, the sum of financial expenses borne due to the monies left or made available to the enterprise considered and, on the other hand, the sum of financial revenues remunerating monies left or made available to

third parties by the same enterprise. To the two components of this difference must be added, as applicable, the total amount of rents collected or paid, after deducting the depreciation amount corresponding to the assets rented and the ancillary expenses and services invoiced by the landlord in the context of financial leasing transactions, rentals with an option to purchase or rentals entered into between affiliated enterprises. This system, which is meant to apply in respect of financial years closed as at 31 December 2012, calls as of now – as concerns the real estate sector – for a few observations related to the situation of enterprises subscribing a debt in order to purchase a building (1) or renting a building (2).

## 1 - Enterprises purchasing a building financed via a loan

If the mechanism set up by the legislator has the advantage of being relatively simple in its implementation, its application leads to a few surprising conclusions.

The situation of a company, even a business based unit, taking out a loan to finance the acquisition of one or more buildings that it will apply to its own use, would appear on a *prima facie* basis to be quite simple.

To the extent that the sum of financial expenses borne, in particular in this respect reaches (subject to financial revenue being recorded which reduces the amount of net financial expenses) 3 million Euros, the company will have to add back, for the determination of its tax result 15 % (and tomorrow 25 %) of its net financial expenses.

The same will apply if the company has entered into, for the same assets, a financial lease agreement, commensurate with the fraction of rental charges paid corresponding to the financial lessor's financial compensation.

On the other hand, if the company is a management company and that the assets are rented out to an affiliated company, the company will be entitled to take into consideration, as financial revenue, the fraction of rents collected exceeding the depreciation of the building. It will thus be able to correlatively limit in all or part the amount of its add-backs. Let us recall that the rental of these same assets to a non-affiliated enterprise would not enable this adjustment.

*“For affiliated enterprises, the base for add-backs can exceed notably the amount of financial expenses that the company would have borne if it had*

*taken out a loan to purchase the asset rented.”*

## **2 - Enterprises which are tenants of a building**

Contrarily to what was initially contemplated by the draft bill, enterprises which are tenants of an asset, in particular of real estate assets, fall within the scope of the system but avoid the increase related to rental expenses where the asset rented out belongs to a non-affiliated enterprise.

For affiliated enterprises, the base for add-backs can exceed notably the amount of financial expenses that the company would have borne if it had taken out a loan to purchase the asset rented.

Indeed, this base is equal to the amount of the rent paid, after deduction of the depreciation for the asset practiced by the landlord, which leads in actual fact to retaining in this situation the entirety of the landlord's margin, or even, once the asset is fully depreciated, the entirety of the amount of the rent (in spite of already being retained for the determination of the tax result of the landlord company).

This could thus lead, within the framework of affiliated companies to a partial dual taxation of the rent.

It is readily conceivable, in light of these consequences, that the objective of the legislator can make sense in financial leasing transactions or rentals combined with an option to purchase (in which the landlord's margin corresponds by design to the remuneration of a purely financial transaction) but leads to various unreasonable situations, which are highly illegitimate or even excessive, in the context of mere rentals.

This incongruity, that the government has sought to justify in particular for cases in which an enterprise pays rent to an affiliated company established abroad, calls for two specific criticisms:

- first of all, as a general rule, the position expressed leads us to assume that no tax will be levied abroad or that such tax would be insufficient. However, in such a case, anti-abuse or anti-evasion schemes already enable the deduction of expenses borne by French enterprises to be prohibited or restricted.
- second of all, as concerns specifically real estate, most agreements lead to the taxation in France of the rental results realized by the landlord company on account of the possession of a building located in France, even if this company is established abroad (including for that matter in Luxembourg), which neutralizes the criticism related to the absence of taxation of the rent. ■

*1 - Jérôme Cahuzac, minister delegate: “Imagine what a scandal it would be if a governmental amendment was to exclude from this system the rent that an enterprise pays to an affiliated enterprise, set up for instance in Luxembourg.”*

## Recent developments in case law – Environmental law

In two recent rulings, the civil courts have qualified in further detail the respective liability of owners, operators and the Authorities in environmental related matters.

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In a first decision, rendered on 11 July 2012<sup>1</sup>, the *Cour de cassation* asserted the principle according to which “in the absence of any other liable party, the owner of a piece of land on which waste materials have been stored is, in this sole capacity, the holder thereof”. The owner of land on which waste materials are stored is therefore liable for such. However, this decision allows for this liability to be set aside if such owner “proves that he was not a party to such abandonment and that he did not permit or facilitate such through neglect or complacency”. This ruling considers thus that there is a presumption of liability that the owner can only exclude if he proves that he was not a party to the abandonment of the waste materials or that he did not permit or facilitate such through neglect. It is thus up to the owner to provide proof to support one of the grounds for exemption. In the case at hand, the former tenant of the land, operating a classified facility, had abandoned various chemical substances when ceasing his activity. The prefect referred the matter to the *Agence de l’environnement et de la maîtrise de l’énergie (Ademe)* for the latter to dispose of the waste materials thus abandoned. Subsequently, *Ademe* turned to the owners and solicited the reimbursement of the monies thus committed.

Underlining that the owners “had not, on the occasion of the production of these waste materials, any controlling or managerial powers over the activity having generated these”, nor had they “themselves, through their own activity, contributed to a risk of pollution”, the Court deduced, on the basis of the legal reasoning of the lower courts, that the “abandonment of waste materials on their land was not attributable to them” and that they could not, as a consequence, “be criticized for any wrongful conduct”.

In a ruling dated 6 September 2012<sup>2</sup>, the *cour d’appel* of Versailles for its part, acknowledged the liability in tort incurred by the assign of the last operator responsible for the pollution for not having reinstated the land, and thus, even where the Authorities had not ordered him to do so at the time of the declaration of cessation of activity. As a consequence, the latter is answerable for such misconduct to the person having become in the meantime the owner of the land. In the case at hand, the storage tank belonging to the operator of hydrocarbon depot had overflowed and polluted the site. The operator, at the time of the cessation of the activity, did not reinstate the site via its decontamination. The *Cour* considered that the assign of the last operator could not exclude his tortious liability based on the absence of any misconduct on his part or on compliance with the various “successive and conflicting administrative prescriptions”, to the extent that “the vicissitudes of the administrative prescriptions and the delay in their implementation are ineffective” against the company having subsequently purchased the land.

The former operator’s assign will not be entitled either to reasonably invoke that clause of the contract entered into with the current owner of the land and his vendor, by virtue of which the purchaser represents to be personally responsible for the situation of the building having regard to the issue of pollution, without the right to exercise any remedy against the vendor. This clause is irrelevant to the tortious action exercised against the assign of the last operator. ■

1 – *Cour de cassation*, 3<sup>e</sup> civil chamber, *Ademe v. Mrs Viviane Y, née X.; Mrs Léonie Z.*, no.11-10.478.

2 – *CA Versailles*, 6 September 2012, *SARL Pauli Immeuble Sofi v. Société Shell*, no.11.08231.

# The reform on the rental values applicable as from 2015

The amended finance bill for 2012 reactivated this summer the reform of cadastral rental values of professional premises, postponing by a year its application and correcting certain undesirable effects contained in the initial statute.

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Based on the latest amendments adopted, the review of rental values should use as a reference the date of 1<sup>st</sup> January 2013 and its results should be taken into account for 2015 taxations. Each property will have to be assessed taking into account its nature, its intended use, its utilisation, its physical characteristics, its location and its consistency. The classification of premises provides for 10 sub-groups of premises divided into 39 categories.

The weighted surface area will be obtained on the basis of the effective floor area and applying to the noble areas (category P1) a coefficient of 1, to covered and annex areas (category P2) 0.5 and to those which are not covered (category P3) 0.2.

The time has therefore come to have an accurate and detailed survey drawn up for the buildings for which you will have to fill in per lot, probably in the spring of 2013, a 6660 REV return form. This concerns the floor area, calculated between outer and inner walls for each floor level.

The prices will be determined per square metre on the basis of the rents recorded in each evaluation sector (*communes* or portions of *commune* which have a consistent rental market). Their delimitation will be decided on by specifically instituted local commissions. The price scale should correspond to the weighted average of effective rents, subject to adjustments intended to take into account the situation of the property within the evaluation sector.

Failing which, the professional premises will then be valued according to the method of direct appraisal, which consists of multiplying the fair market value of the building recorded as at 1<sup>st</sup> January 2013 applying a uniform and national interest rate of 8 %. Further to the governmental report having established its conclusions regarding the test in five *départements*, various corrections were required to pursue the reform.

*“The time has come to have an accurate and detailed survey drawn up*

*for the buildings for which you will have to fill in per lot probably in the spring of 2013, a 6660 REV return form.”*

The existence and importance of the transfer of charges generated by the reform has been taken into account justifying a smoothing out of the effects over a period of several years. Let us underline that the significant revaluation of the rental value of shop premises will be in part finally compensated by a relative decrease of that of office use buildings.

Thus, in the case of Paris, the rental value of “high street stores” would rise by 31 % whereas that of “recently fitted out office buildings” would benefit from a 20 % drop.

However, the reform must be neutral for beneficiary local authorities (neither drop nor rise in their revenue on account of the application of the 2013 values). The implementation of the new bases, necessarily higher, will require the application of a “neutralisation coefficient” specific to each local authority. The latter is designed to have the effect of maintaining tax revenues at their current level despite the mechanical increase of the tax base.

In its initial wording, this neutralisation coefficient was supposed to apply to industrial buildings, despite the fact that these were not concerned by a change in rental value. From now on, they will be excluded from the mechanism so that this should reduce slightly the impact of the neutralisation coefficient for non-industrial buildings, which alone are concerned by the reform. If the current trend of legislative reform does not enable us to assert that there shall not be any more modifications of the law to attain the values taxable in 2015, what does seem inevitable is the requirement to comply with the return requirement by springtime next year, which needs to be anticipated as of now. ■

## Reversal of case law on the starting point of default interest applicable to arrears on renewed rent

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In the event of litigation regarding the determination of renewed rent under a commercial lease, the judge in charge of rental matters will generally determine this rent after a court-appointed expert appraisal process that will generally last for at least six months.

In certain cases, the tenant will have to make the additional payment of rent which is due and outstanding, plus default interest at the statutory interest rate. The tenant is required to pay these monies even where the judge does not order him to pay the new rent but merely confines himself to the determination thereof. In this case, when is the starting point for these interests? Given that the duration of proceedings for the determination of rent on renewal, often exceeds an eighteen month period, the financial implications at stake are not unimportant. This issue, seemingly trivial has caused over a great many years, judicial turmoil and extensive debate among legal authors. In the 1960's, the *Cour de cassation* considered that default interest was due as from the date of the writ of summons. Thereafter, it changed its position, on the legal grounding of article 1155 of the civil Code, considering that the starting point of interest on rent under the renewed lease was to be set at the effective date of the renewal of the lease and as and when rent instalments become due. This case law has been consistently confirmed by *Cour de cassation*. However, this has not been unanimously accepted by first instance and appellate judges.

Thus, the *cour d'appel* of Paris, after having applied this solution in an initial phase, subsequently reversed its position by considering that default interest on commercial rent, in the event of the renewal of the lease, runs from the date of the court ruling determining the renewed rent.

*“The 3<sup>rd</sup> civil chamber of the Cour de cassation considered in a ruling of 3 October 2012 that default interest attaching to rent runs, in the absence of*

*an agreement to the contrary relating to interests, from the date of the application to court for the determination of the new rent merely by operation of law.”*

For instance, in a ruling of 5 September 2012 the *cour d'appel* of Paris substantiated its decision as follows: *“Considering that as concerns default interests, they assume, even for matured income such as rent instalments addressed under the provisions of article 1155 of the civil Code, that such income be determined with respect to its amount, the delay not being in the contrary case qualified; that the interests at the statutory interest rate will thus run on the additional rent payments as from the confirmed judgement.”*

The legal argumentation of the *cour d'appel* of Paris was perfectly clear: interest can only be due as from that time at which the judgement is pronounced, to the extent that it is only at such date that the amount of rent is known and that it can reasonably be the subject of an application for the payment of interest.

However, this is not the legal argumentation that was retained by the 3<sup>rd</sup> Civil chamber of the *Cour de cassation* in a ruling of 3 October 2012. Indeed, in this decision, it was considered that *“default interest attaching to rent runs, in the absence of an agreement to the contrary relating to interests, from the date of the application to court for the determination of the new rent merely by operation of law”*. This is a genuine reversal of case law that should put an end to the resistance led by the *cour d'appel* of Paris.

The idea according to which the renewed lease is to be assimilated to the agreement addressed by article 1155 of the civil Code is now set aside. This decision is excellent news for landlords. Having regard to tenants, on the other hand, it is now necessary to draft leases appropriately, in order to neutralize the effects of this new case law. ■

# Predominantly real estate holding companies: an unfinished tax regime?

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**T**he finance bill for 2012 substantially altered the terms of calculation of registration duties applicable to the sales of corporate ownership interests of predominantly real estate holding companies (SPI). Indeed, since 1<sup>st</sup> January 2012, “the taxable base for registration duty includes, accordingly to the fraction of securities sold, the effective value of the real estate assets and rights held, directly or indirectly, via other predominantly real estate holding corporations, after deducting only the liabilities pertaining to the acquisition of said real estate assets and rights, as well as the effective value of other gross assets<sup>1</sup>.”

The analysis of Parliament’s preparatory works proves that this measure corresponded to a dual objective:

- on the one hand, for a budgetary compensation logic, for the purpose of financing the arrangements made concomitantly to the regime applicable to real estate capital gains realized by individuals;
  - on the other hand, for the purpose of putting an end to tax efficient structuring operations consisting of putting into place in the SPI, prior to the sale, shareholder loans for the sole purpose of reducing the taxable base of registration duty.
- The new system consisting of retaining as the taxable base for duty the effective value of the immovable and movable assets of the SPI reduced only by “the liabilities pertaining to the acquisition of said real estate assets and rights” thus poses essentially the question as to the definition of this notion of liabilities (1) and leads surprisingly to penalising for no apparent reason the holding of movable assets by SPIs (2).

## 1 – What is meant by “liabilities pertaining to the acquisition of said real estate assets and rights” ?

It is clear that debts for the acquisition of an immovable, contrarily to debts for the acquisition of movable assets, can be taken into account, as addressed expressly by the statute. However, in practice SPIs can be induced to enter into debts related to their immovable property but which are not strictly

speaking acquisition debts. For instance: upkeep or repair related debt.

To date, this statute has not been commented on by the tax authorities and the preparatory works are silent as regards this issue<sup>2</sup>. Moreover, certain authors consider that liabilities pertaining to mere upkeep should not be taken into account. Others consider that construction or reconstruction works should be taken into account event if they are not strictly speaking the result of an acquisition transaction. Others, including ourselves, are of the opinion that the acquisition debt entered into by a “parent SPI” to finance the acquisition of a holding interest in another “subsidiary SPI” should be taken into account. Indeed, the spirit of the law consists of disregarding the legal personhood of the interposed entities, and of reasoning exclusively on the basis of the immovables held directly or indirectly by the SPI and, in this case, the liabilities entered into to purchase the securities of the subsidiary is duly entered into to purchase the assets of the latter.

On the other hand, refinancing debt (understood within the meaning of a loan taken out with a mortgage security but whose assigned use is not the acquisition or the refinancing of the acquisition of the immovable or construction or extension works) should not be deductible from the taxable base of registration duty.

## 2 - Contradictions of this new system

This new system leads, in total contradiction with its spirit, to raising, without any logical explanation, the tax on the transfer of an SPI where the latter also holds movable assets. Indeed, the statute excludes from the calculation of the taxable base the liabilities pertaining to movable assets held by the SPI. The objective and the spirit of the statute not being to penalize the inclusion in a same company of immovable and movable property, this statute should be amended, failing which the SPIs concerned will be forced to consider converting their business concerns into subsidiaries! ■

1- Article 726 II of the Tax Code

2 – See for instance an article published by Richard Foissac in the magazine Option Finance issue no. 1149 on 21 November 2011, and by Catherine Charpentier and Margot Wilhelm on 23 January 2012 in Capital Finance.

# Sales of securities of a French or foreign SPI is subject to registration duty in France

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**O**n account of the changes that have occurred over recent years, it is worthwhile taking stock of the situation as regards the territoriality of registration duties in the event of sales of real estate or of the shares of predominantly real estate holding companies. Sales of real estate located in France are taxable, whether the deed is executed in France or abroad. In this latter case, the sale has to be reported to the tax office of the place where the property is located within a month from entry into possession. The rate applicable is the standard rate of 5,09 %.

Sales of real estate located abroad recorded by a notarised deed executed in France are subject to a specific duty of 5 % (article 714 of the Tax Code). Such duty is only due subject to the provisions of international treaties. Since the amended finance bill for 2009, sales of the securities of a company whose assets are essentially made up of real estate located in France, whether it is French or

foreign, and whether the deed has been executed in France or abroad, are subject to registration duty in France. Are considered as being predominantly real estate holding entities, those legal persons whose corporate ownership interests are not listed and whose assets are, or have been during the course of the year preceding the sale, essentially made up of real estate, of real estate rights located in France or of securities of companies themselves being a predominantly real estate holding entity (article 726 of the Tax Code). The real estate assigned by the company to its own business is taken into account. The rate applicable is 5 %, bearing in mind that to define the taxable base of the duties, the finance bill for 2012 limited the possibility to deduct the debts of the company merely to liabilities pertaining to the acquisition of these assets. Where the sales are completed abroad, they must be recorded within a period of one month by a deed executed in the notarised form by a notary practising in France. Subject to certain conditions, the amount of registration duties effectively paid abroad may constitute a tax credit in France. ■

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