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REAL ESTATE NEWSLETTER

Dossier on
The SIIC: a tax payer which has not been overlooked

Special supplement
Operating photovoltaic panels

C'M'S Bureau Francis Lefebvre
Supplement to number 1054 of November 30th, 2009

Real estate: the rules change, the tax remains

Legislative activity in matters of real estate taxation was particularly rich in 2009. A great many measures substantiated by the economic context intermittently alleviated the taxation of real estate, both for individuals and for enterprises. Despite these accommodations, for the most part limited in time, real estate remains a heavily taxed sector. It is in this state of mind that we conceived this special issue in the form of a panorama of the taxes and levies which today burden real estate in France including changes that are to come about in 2010. Without intruding on the topics that will be addressed in this issue, several flagship-vehicles designed to boost the real estate market reflect particularly well the current trend of real estate taxation as a whole.

Let us recall first of all the momentary lull generated by the "*Scellier*" law which replaced from 1st January 2009 the "*Robien*" and "*Borloo*" vehicles, by instituting a rebate on income tax in favour of tax payers investing in brand new housing.

Then there are the numerous tax incentives accompanying the "green revolution": driven by the Grenelle Environment Round Table process (*Grenelle de l'environnement*), real estate is tending to become sustainable and the tax legislator has come to realize that this tendency is an important factor for the creation of wealth, that will need to be supported.

Finally, the relaxing of the rules of taxation of real estate capital gains realized in the event of outsourcing real estate assets in favour of a financial leasing company: among the traditional tools for the financing of real estate investments, financial leasing has indeed proven to be extremely relevant in the current context in that it provides a remedy to companies' lack of resources.

This good news from 2009 should not however lead us to eclipse the overall tax burden that already encumbers the real estate sector and the contemplated intensification thereof to the detriment of certain major operators of the real estate market, that is to say lessors of professional use premises. Currently exempted from business tax due to the non professional nature of their activity, the latter should, from 1st January 2010, come within the scope of application of the new territorial economic contribution which is designed to replace business tax. One can only hope that this noteworthy change will not call into the question the significant role played by an essential investment vehicle: the SIIC. Indeed, in a context of limited access to debt financing, these listed real estate entities provide the liquidities that the real estate market needs, by using the trading platforms of stock markets, and enabling thus to counter, at least in part, the current impossibility to invest directly in real estate, due to the shortfall in equity.

Even if there are indicators showing that the rebound may be imminent, the market remains still too fragile to bear serenely any increase of the tax liabilities which apply to the real estate sector.

Didier Gingembre, General Manager, Partner

Editorial

DOSSIER ON: Real estate: the rules change, the tax remains

Panorama of taxation affecting real estate from purchase to sale (*)

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(see below)

Panorama of taxation affecting real estate from purchase to sale (*)

		Real estate professionals (subdivision developers, real estate dealers, property developers)
Purchase (land, buildings)	**VAT**	● Real estate VAT on purchases of building land and "new" buildings (1st transfer within a five year period following completion). ● Margin VAT in the event of acquisition of an "old" building from a real estate dealer or a subdivision developer.
	Registration Duty	● Exemption for acquisitions of building land taxed under VAT. ● Reduced rate (0.715%) for purchases of new buildings taxed under VAT. ● Standard rate (5.09%) in all other cases, save covenant to resell entered into by a real estate dealer (0.715%).
Holding	**Corporate Income Tax/Income Tax**	● Buildings booked in inventory account: no depreciation. ● Interest expense on acquisition is, according to the option exercised by the tax payer: - either included in the expenses which are immediately deductible; - or attached to acquisition costs of the building (annex III to the Tax Code, Art. 38 undecies). The choice between the two methods applies globally and irrevocably
	VAT	● N/A
	Local Taxes	● Business tax (or the future territorial economic contribution) has as its basis the rental value of tangible fixed assets that the tax payer holds for the purpose of its professional activity during the benchmark period (Art. 1467 of the Tax Code). Fixed assets are to be distinguished from assets acquired or manufactured in order to be resold, which are booked from an accounting standpoint in the inventory accounts and which are not taxable. This is the case of buildings acquired by real estate dealers in view of resale thereof. ● Liability for real estate tax on property for the whole year in the name of the owner as at 1st January of the year of taxation (Art.1415 of the Tax Code).
	Wealth Tax	● Exemption in respect of professional property assets of the value of the buildings necessary to professional activities (Art. 885 N and 885 O of the Tax Code)
Sale	**Corporate Income Tax/Income Tax**	● Professional legal person subject to CIT: real estate profits are subject to CIT at the standard rate (33.33%) ● Professional natural person or legal person not subject to CIT: Income tax according to standard rules.
	VAT	● Taxation under VAT of sales of building land and of first transfers of buildings completed for less than five years. ● Taxation under margin VAT in the event of sale by a real estate dealer or a subdivision developer.
	Registration Duty	● Exemption for sales of building land taxed under VAT. ● Reduced rate (0.715%) for sales of new buildings taxed under VAT. ● Standard rate (5.09%) in all other cases or reduced rate if taxation under margin VAT.
	Local Taxes	● Real estate tax on developed and non developed property, business tax (or the future territorial economic contribution) due for the year of the sale for the entire year (Art. 1415 and 1478 of the Tax Code). In the event of turnover exceeding 7.6 million euros (or 500,000 euros for the future territorial economic contribution), the sale may entail liability to the minimum contribution on added value or to the future additional contribution (1.5% of the added value produced), according to the terms of booking of the real estate transaction.

Panorama of taxation affecting real estate from purchase to sale (*)

User companies	Lessors
● Real estate VAT on purchases of building land and "new" buildings (1st transfer within a five year period following completion). ● Margin VAT in the event of acquisition of an "old" building from a real estate dealer or a subdivision developer.	● Real estate VAT on purchases of building land and "new" buildings (1st transfer within a five year period following completion). ● Margin VAT in the event of acquisition of an "old" building from a real estate dealer or a subdivision developer.
● Exemption for acquisitions of building land taxed under VAT. ● Reduced rate (0.715%) for purchases of new buildings taxed under VAT. ● Standard rate (5.09%) in all other cases.	● Exemption for acquisitions of building land taxed under VAT. ● Reduced rate (0.715%) for purchases of new buildings taxed under VAT. ● Standard rate (5.09%) in all other cases.
● Fixed immovable assets: depreciation. - Structure: according to the term of use. - Components: according to the effective term of utilisation. ● Interest expense on acquisition is, according to the option exercised by the tax payer: - either included in the expenses which are immediately deductible; - or attached to acquisition costs of the building (annex III to the Tax Code, Art. 38 undecies). The choice between the two methods applies globally and irrevocably	● Taxation of rent according to standard rules, save exemption in application of specific regimes (examples, SIIC, SII, etc.) ● Depreciation of fixed immovable assets (immovable investment products): the structure and components are depreciated according to the effective period of utilisation, not over the term of rental. (Art.39 of the Tax Code). ● Interest expense on acquisition is, according to the option exercised by the tax payer: - either included in the expenses which are immediately deductible; - or attached to acquisition costs of the building (annex III to the Tax Code, Art. 38 undecies). The choice between the two methods applies globally and irrevocably
● N/A	● VAT on the rent of professional premises rented out furnished or unfurnished, if option exercised
● Business tax (or the future territorial economic contribution) has as its basis the rental value of tangible fixed asset, with the exception of intangible fixed assets and fixed financial assets (Art. 1467 of the Tax Code). Are thus liable land, fittings and equipment of land as well as constructions and constructions on other's land (Art. 1469-1° of the Tax Code). ● Liability for real estate tax on property for the whole year in the name of the owner as at 1st January of the year of taxation (Art.1415 of the Tax Code), and as the case may be, for annual tax on office space within the Ile de France Region (Art. 231 ter of the Tax Code).	● Having regard to the current regime, the activity consisting of rentals of unfurnished buildings is assimilated to a patrimonial activity outside the scope of business tax. However, the draft finance bill for 2010, as adopted by the *Assemblée Nationale* after its first reading, provides that the activity consisting of the rental of buildings, with the exception of those which are for a residential use, is deemed to be conducted in a professional capacity and falls within the scope of application of the future territorial economic contribution, to the extent where it generates revenue in excess of 100,000 euros. ● Liability for real estate tax on property for the whole year in the name of the owner as at 1st January of the year of taxation (Art.1415 of the Tax Code), and as the case may be, for annual tax on office space within the Ile de France Region (Art. 231 ter of the Tax Code).
● Exemption in respect of professional property assets of the value of the buildings necessary to professional activities (Art. 885 N and 885 O of the Tax Code)	● In the event of rental of unfurnished buildings, the buildings come within the assessment basis of Wealth Tax (Art.885E of the Tax Code). ● On the other hand, professional renters of furnished property are in principle exempted from Wealth Tax in respect of professional property assets.
● Professional legal person subject to CIT: the capital gains on assignments of buildings are subject to CIT at the standard rate (33.33%) save application of the reduced rate of 19% (Art. 219, IV of the Tax Code) for assignments to a specialized land corporation, financial leasing body or a low-rent housing body (Art. 210 E of the Tax Code) ● Sole proprietorships or companies subject to income tax: professional capital gains regime (Art. 39 duodecies of the Tax Code). - Short term capital gains: Income tax at the standard rate - Long term capital gains: 27% (16% + social deductions 12.1%) ● Lease-back: spread of the capital gains over the term of the lease agreement within a limit of 15 years (Art. 39 novodecies of the Tax Code)	● Non professional renters (Art.150 U and 150 VC of the Tax Code): real estate capital gains regime (taper relief of 10% per holding year beyond the fifth, hence the full exemption of long term capital gains after a holding period of 15 years). ● Professional renters (Art.151 septies): - revenue < 250,000 euros excl. tax: full exemption provided the activity has been conducted for at least five years; - revenue comprised between 250,000 and 350,000 euros excl. tax: partial exemption; - in all other cases: professional capital gains regime (Art. 39 duodecies of the Tax Code). ● SIIC: exemption provided that 50% of the capital gains are distributed to the shareholders (Art. 208 C of the Tax Code). ● Low-rent housing bodies or corporations: depending on whether their operations are in the general interest, they are exempted or taxed at the reduced rate of 19% on condition of reinvestment (Art. 210 E, IV of the Tax Code).
● Taxation under VAT of sales of building land and of first transfers of buildings completed for less than five years.	● Taxation under VAT of sales of building land and of first transfers of buildings completed for less than five years.
● Exemption for sales of building land taxed under VAT. ● Reduced rate (0.715%) for sales of new buildings taxed under VAT. ● Standard rate (5.09%) in all other cases.	● Exemption for sales of building land taxed under VAT. ● Reduced rate (0.715%) for sales of new buildings taxed under VAT. ● Standard rate (5.09%) in all other cases.
● Real estate tax on developed and non developed property, business tax (or the future territorial economic contribution) due for the year of the sale for the entire year (Art. 1415 and 1478 of the Tax Code).	● Real estate tax on developed and non developed property, business tax (or the future territorial economic contribution) due for the year of the sale for the entire year (Art. 1415 and 1478 of the Tax Code).

The SIIC: a tax payer which has not been overlooked

SIICS are sometimes presented as being totally exempt from taxation, and some would easily say that they benefit from tax favouritism which is not necessarily justified. Without addressing the obvious impact that the creation of the statutory regime of SIICS has had on the Paris listed real estate sector or in terms of market dynamic, we will show that in actual fact this is not technically true.

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The tax regime applicable to SIICS (Article 208 C II of the Tax Code), on the one hand, is based on the principle of a transfer of taxation onto the shareholders, and on the other hand, has been substantially amended since it was created in 2003, in order to censor various situations perceived, often rightly so, as undue.

In terms of direct tax first of all, the initial deal was quite clear. In consideration for the taxation over a four year period at the rate, admittedly reduced, of 16.5% (since increased to 19%) of unrealized capital gains which exist in respect of real estate assets or assimilated assets (such as for instance the securities of translucent land corporations), SIICS will be exempted from corporate income tax (CIT) over the portion of their income which stems from the rental of their eligible real estate assets (such as these are defined by Article 208 C II), from capital gains realized on the sale of these assets, from dividends received from subsidiaries subject to the same regime or collected from another SIIC (on condition of holding at least 5% of the capital and of the voting rights of the distributing company during a period of two years).

"It was contrary to the fundamental principles of the regime for non resident shareholders, subscribing substantial holding interests, to be able to benefit from a total or almost total exemption."

The second pillar of the regime is the taxation of the SIIC'S exempted profits at the level of its shareholders, which is guaranteed by the distribution obligations which are binding on it.

1. As shown, the exemption of the SIIC from CIT is not, first of all, a general exemption, as only the portion of income corresponding to certain sources of revenue (real estate and assimilated) is exempted, SIICS thus being able to have two separate sectors of taxation.

2. As concerns capital gains, all are not exempted, as Article 208 C II only refers to capital gains on sales to unrelated parties within the meaning of Article 39-12 of the Tax Code, bonds of dependency being deemed to exist between two undertakings when one holds directly, or via an interposed party, the majority of the share capital of the other or factually exercises decision-making power, or when they are both placed under the control of a same third party undertaking.

Admittedly, various adjustments have been made to this regime. Thus the capital gains on the assignment of buildings, property rights or rights pertaining to a financial leasing contract applying to a building, between a SIIC and its subsidiaries having opted, or between such subsidiaries, are no longer subject to CIT in respect of the financial year of consummation thereof, provided that the assigning company covenants to comply, in respect of the capital gains concerned, with the obligations contemplated within the framework of the special merger regime.

All possible case scenarios have not however been covered, in particular those related to assignments between two SIICS or their subsidiaries under joint control within the meaning of article 39-12 of the Tax Code.

3. As concerns the terms of determination of the exempted income and of the taxable income when a SIIC has two sectors, the authorities have retained certain rules which in practice will increase a SIIC'S tax liabilities.

Thus, and essentially in terms of financial revenue and expenses, the tax authorities, arguing that Article 208 C II of the Tax Code does not provide for the exemption of income which is ancillary to real estate income and assimilated income, contend that net financial revenue comes under the taxable sector, whereas in the case of net financial expense, failing an exclusive allocation, the offset against the exempted sector will be prorated on the basis of the ratio between the gross book value of the assets conducive to the consummation of the exempted transactions and the gross book value of all assets (guidelines 4 H-5-03 no.38).

4. The consideration for the exemption of real estate income and assimilated income, which it can be seen is not a total exemption, is thus the taxation of this same income at the level of the shareholders.

"SIICS are the only listed corporations whose shareholders are not able to benefit from the exemption regime for long term business capital gains."

The exemption is thus subordinated to the compliance with distribution obligations, the proportion of which will differ depending on the nature of revenue: 85% of rental income (before the end of the financial year following that of their realization), 50% of capital gains (before the end of the second financial year following that of their realization) and 100% of the exempted dividends received (during the course of the financial year following that of their collection).

For shareholders which are French residents, as far as legal persons are concerned, the taxation is ensured by the exclusion of the dividends in question from the benefit of the parent company regime. As concerns, on the other hand, shareholders which are natural persons, the law makes no difference between dividends stemming from the exempted sector of SIICS and all other dividends, which means in particular that both benefit as of right from the 40% relief, this measure aiming to encourage individual shareholding.

As concerns shareholders which are not residents, the initial regime has been significantly amended. If initially, it was clear that dividends stemming from exempted income would not be able to benefit from the exemption from withholding tax contemplated by Community Law (Article 119 ter of the Tax Code), it has appeared that the effective character of the collection of tax could not be guaranteed in certain cases. In this regard, we would underline that it mattered little initially whether the tax was levied at the French level or at the level of the State of residence of the shareholder (in particular when concerning a Member of the European Union). On the other hand, it was contrary to the fundamental principles of the regime for non resident shareholders, subscribing substantial holding interests, to be able to benefit from a total or almost total exemption, in particular as due to a tax treaty the dividends of the SIIC were the subject of a reduced withholding tax of 5% (or even 0%, in the case of the tax treaty between France and Spain) and due to the application of the domestic law of the State of residence of the shareholder (this is the case for Spain) or of the tax treaty between this State and France (this is the case for Luxembourg with regard to holding interests at least equal to 25%), the non resident shareholder was not taxable in his or its State…

Thus the legislator provided for a specific levy of 20% on dividends distributed by SIICS from 1st July 2007 in favour of legal person shareholders, which hold at least 10% thereof directly or indirectly, when these dividends are not subject to effective taxation in an amount equal to at least one third of the French tax (in order to avoid the mutualisation of this possible cost between all the shareholders of SIICS, the latter extensively adopted amendments to their bylaws in order to enable the passing of the cost of the withholding tax onto the shareholder responsible).

More generally, in accordance with the works conducted within the OECD at the end of 2007, from now on France provides, within the context

of its treaties, that dividends from SIICS will not benefit from the reduced rate (or the nil rate) of withholding contemplated by the tax treaty in the event of a substantial holding interest. There are two case scenarios: shareholders holding less than 10% will continue to benefit from the provisions of the treaty (withholding at the rate of 15%), whereas dividends paid out to more significant shareholders will be subject to the domestic withholding tax, that being 25%. This evolution, which ensures that the tax is collected in France, has already been adopted within the framework of the treaties executed with the United States and the United Kingdom, and it is highly likely that it will, over years to come, be inserted into all tax treaties.

5. Moreover, SIICS as major operators in the real estate sector, will pay all of the taxes which are specific to this sector, which is probably one of the most comprehensive in this regard.

We will mention real estate tax on developed property, the annual tax on office, commercial or storage premises, these being however often invoiced back to tenants, specific transfer taxes (5.09% or 5% in the event of assignment of the company), land registration tax of 0.715% applicable in certain mortgage financing facilities or within the framework of certain leases or financial leasing agreements, the land registrar's fees (0.10%) without forgetting for the great many SIICS active in the property development field, all of the planning taxes (tax on the creation of office space in the Ile de France region, special facilities tax, local tax on sensitive natural zones, levy for exceeding the legal density cap, etc).

In addition, if they are taxable at 19%, rate which is admittedly inferior to that applicable to assignments of the securities of unlisted land corporations, SIICS are nevertheless the only listed corporations whose shareholders are not able to benefit from the exemption regime for long term business capital gains.

Finally, the reform currently underway on business tax will put an end to the exemption in favour of the unfurnished rental activity, via the creation of the additional contribution based on added value. According to the text which is available at the date at which this goes to press, SIICS, similarly to unlisted land corporations, will thus be included among those that stand to lose in the face of the reform. One is forced to acknowledge that, from an economic standpoint, the grounds underlying the exemption that the unfurnished rental activity has enjoyed up until now, and which is civil by nature, but which is conducted on an industrial scale, were questionable. However, if one is to consider that the real estate industry should be treated in the same way as any other sector, one can but state from the above that that there are a great many taxes specific to the real estate sector, which to our knowledge it is out of the question to cancel. And, concerning specifically SIICS (and SPPICAVS), the taxation of a basis which the SIIC is not really the beneficiary of, on account of the distribution obligations that are binding on it, can appear debatable. For that matter, on the international level, the only country to have a tax which is really comparable to business tax applicable to property rental activities (Italy, with the IRAP) provides for an exemption in favour of Italian SIICS…

The reform of VAT and registration duty applicable to real estate transactions

The reform of the VAT regime applicable to real estate transactions had become unavoidable, due to the great many incompatibilities of current rules with the Community Directive (EC/2006/112). This is the objective assigned to article 55 of the bill proposal for the "simplification and improvement of the quality of law", which was lodged last August.

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For the time being, this is only a draft, which will undoubtedly be amended during the course of parliamentary debate, which means that one would be well advised to keep this text in perspective. This being said, it is possible to outline the basic principles of the reform to a certain degree of certainty.

1. The special regimes related to "Real Estate VAT" and to "Real Estate Dealers" have come to an end

A structuring modification throughout this draft bill concerns the connecting of real estate transactions to general VAT mechanisms. The directive indeed establishes, as a matter of principle, a system of taxation in common to movable and immovable property, that the reform naturally fits into.

The special regimes related to "Real Estate VAT" and to "Real Estate Dealers" have come to an end

There would therefore be a traditional dividing line between, on the one hand, transactions carried out within the framework of an economic activity, subject to VAT, and on the other hand transactions which stand outside any economic activity.

1.1 The supply of immovable property realized within the framework of an economic activity

These transactions, which all fall within the scope of application of VAT, would be partly exempted. Thus, would be taxed as of right under VAT, exclusively the following transactions:

- the supply of building land, being specified that the draft contemplates redefining this concept in an objective manner, removing any reference to the purchaser's intention to build. In addition, the exemption limited to natural persons contemplating the construction of residential buildings would be cancelled;
- the supply of buildings completed for less than five years (from now on without restricting taxation to the first transfer taking place within this period).

For transactions regarding other property assets (land other than building land and buildings which have been completed for more than five years), the principle would be a VAT exemption, but with an option remaining open for taxation on a transaction-by-transaction basis.

For taxable supplies, the basis for taxation under VAT would be governed by specific rules:

- whereas sales of buildings completed for less than five years would still be taxable over the full purchase price (ordinary rule in the field of VAT);
- transfers of building land and sales taxable upon option would see their taxable basis depend on whether or not the property asset had given rise or not to a deduction right at acquisition thereof. In the affirmative (the property asset was not detaxable) the basis would correspond to the full price, whereas in the contrary case (the property asset was not detaxable) the basis would be equal to the difference between the sale price and the purchase price (taxation on the margin).

As for the current regime applicable to "real estate dealers", this would disappear purely and simply, being nevertheless observed that:
the new mechanism of taxation on the margin would potentially concern any liable party (and not just real estate dealers);

likewise for the exemption from transfer tax (save land registration tax at the reduced rate of 0.715%) on acquisitions of buildings including a covenant to resell within a period of five years. In the event of successive acquisitions carried out under this regime, the deadline allocated to the first purchaser would be imposed on all those that follow.

More generally, exemptions from transfer tax would be altered, so that:

- acquisitions of land or buildings, including a covenant to carry out within a period of four years the works conducive to the production of a brand new building or necessary in order to complete an unfinished building, would be taxed exclusively under the fixed duty of 125 euros (this covenant would become independent from taxation under VAT);
- transfers for valuable consideration of building land and of brand new buildings (other than those referred to in the foregoing subparagraph) liable to VAT over the full price, would be subject to land registration tax at the reduced rate (0.60%).

In all other cases (including taxation under VAT on the margin), sales duty on immovable property would apply in an ordinary manner (5.09%).

1.2 The supply of immovable property realized outside the framework of any economic activity

Among these transactions, in principle excluded from the scope of application of VAT, would only be taxed: supplies of immovable property completed for less than five years, previously acquired off plans. Sales duty on immovable property should, as far as they are concerned, apply to all transfers in an ordinary manner (5.09%), with the exception of sales of brand new buildings subject to VAT, which should only bear the burden of land registration tax at the rate of 0.715%.

2. Bringing certain measures up to standard with Community Law

Besides the basic principles set out above, the draft bill provides for certain rules to be brought up to standard with Directive EC/2006/112. The reversal of the VAT liable party at the time of acquisition of building land would thus be cancelled, so that the vendor would still be in charge of collecting such tax.

The chargeability of VAT encumbering transfers of buildings off plans would occur upon cashing of the price, at the contractually scheduled due dates, according to work progress. The taxable base of building leases would include, besides the rent instalments, the value of the landlord's right of repossession at term-end of the contract, to the exclusion of any possible indemnity stipulated in favour of the tenant.

3. The creation of new cases of self supply

The draft bill provides for a broad extension of the scope of application of self-supplies, as these would in particular become taxable when a brand new building is not sold within a period of two years following its completion. This obligation would thus concern, in particular, immovable assets held as an inventory item during a period of more than two years by developer-builders.

"The variations that the draft bill may undergo during the forthcoming parliamentary debates will therefore need to be monitored closely"

"The variations that the draft bill may undergo during the forthcoming parliamentary debates will therefore need to be monitored closely."

This measure fits into the framework of a general redefinition of self-supplies, of all services and goods self-produced or self-consumed. With regard to this issue, the draft bill goes extensively beyond what is contemplated by the directive and therefore makes it necessary, *a priori*, to obtain derogation from the Council of the European Union. The latter however only being able to be based on cases of tax fraud or evasion, or justified by a simplification of the tax collection process, it is uncertain whether the proposed measures will actually come into existence. The variations that the draft bill may undergo during the forthcoming parliamentary debates will therefore need to be monitored closely.

SPECIAL SUPPLEMENT
Operating photovoltaic panels
Photovoltaic panels: their status under private law

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Photovoltaic projects will be directly put into place by the owner of the land or of a built structure, when the operator acquires the site. However, more frequently, the installation of a photovoltaic plant is not contemplated by the operator acting as a proprietor, in this case the latter will then have to chose the appropriate legal title in order to carry out this type of installation, being provided that:

- the term of the contract must enable to cover the equipment depreciation period (> 15 years) and carry a title of occupancy sufficiently long in order to ensure the enjoyment of the site throughout the whole term of the electricity purchase agreement (20 years);
- the financing of operations requires to be able to offer the financial institution a surety and more particularly a real estate right which is liable of being mortgaged;
- the contract must cover the question as to the ownership of the constructions during its term and as to the transfer of the constructions and fittings upon expiry.

The constraints related to the implementation of a bank financing, a loan or financial leasing solution, will indeed exert an influence on the structure of the transaction. If the main source of repayment comes from the revenue related to the sale of electricity to EDF, generally the lender will require other sureties: pledge of the shares or partnership shares of the company or partnership carrying the construction and operation, mortgage over the *in rem* property rights stemming from a building lease or from an emphyteutic lease or even non-possessory pledges over all of the plant materials.

The question regarding the legal classification of this type of facility

On the basis of case law, which for the time being has been rendered in construction matters (removable greenhouses, construction based on a framework of metallic girders)[1], it appears that classification as an "immovable by nature" is independent from whether the construction is temporary or not, from whether or not it is removable or transportable. Only the degree of incorporation into the ground thereof is decisive: the facility must not merely be placed on the ground and be maintained there simply due to its own weight, an effective anchoring or foundation system is required. To this extent, one will need to ensure that their anchorage to the ground is sufficiently elaborate in order to confer status as an immovable by nature.

Panels integrated into the roof are undoubtedly immovable by nature, on account of their integration into the roof. In this regard we would recall that components which are not indissociably connected to immovable property and the removal of which would not adversely affect the structural integrity of the latter are not immovable by nature[2]. As concerns panels which are merely stacked upon each other, one will need to check whether such facilities can or can not be subsequently withdrawn without adversely affecting the structural integrity of the building or without damaging them according to the physical means of anchorage.

Failing classification as an immovable by nature, the assets assigned to the service and operation of an estate can be considered as "immobilised" as a result of their intended use[3]. But such will not be the case if the owner of the panels is the owner of the estate and not a mere emphyteutic tenant, a usufuctuary or a lessee[4].

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[1] Cour de cassation, Commercial chamber, 10 June 1974, Bull. IV. No. 183, Commercial Chamber, 1st February 1984; Bull. civ. IV no.53, Court of Appeals of Aix-en-Provence, 3 May 2005, N. v. SA Financo-Sofemo.
[2] *Cour de cassation*, 3rd civil chamber, 23 January 2002, Bull Civ.III no.12 (in the case at hand electrical convectors).
[3] Article 524 of the Civil Code
[4] *Cour de cassation*, 1st civil chamber, 18 February 1957, Dalloz, 1957, p.249.

[([5]) This footnote does not appear on the original document]

Contracts contemplated

Generally, two types of contract are contemplated, the emphyteutic lease or the building lease[6]. Emphyteutic leases, besides the conditions related to term, which will necessarily be comprised between more than 18 and 99 years, vest their holders with extremely broad prerogatives: construction and demolition works without landlord's consent, effective possibility to build, free choice of intended use, right to freely assign and to mortgage.

Building leases can, on the other hand, restrict the lessee's freedom to build, by imposing certain constructions or restricting its possibilities in this regard, but can also restrict intended use. Article L. 251-1 of the Housing and Construction Code imposes however that "the building lessee covenants, in a principal respect, to develop constructions on the lessor's land". If the concept of development was not defined, it would seem doubtful that the installation of photovoltaic panels on the lessor's land be classified as the "development of a construction" and thus be able to be carried out within the framework of a building lease.

Finally, if the installing party does not revert to mortgage financing or to financial leasing, or if the lessor intends to control the intended use of the site and/or of the transfer of the lease, a standard long term lease, which does not vest *in rem* rights, is also conceivable. Such may provide for the accession of a property right over the facilities at the end of the lease, or impose reinstatement of the site on the lessee, being specified that that leases with a term which exceeds 12 years will have to be executed by notarised deed in order to be published at the land registry office, thus to be enforceable against any subsequent owner of the site. We would note that in such a case, the lessor will be able to impose a precise intended use, to prohibit (or control) assignments or sub-rentals[7].

The ambit of the lease

If the ambit of a lease applying to a bare piece of land poses no difficulty, in the case scenario of a lease applying to a roof facility, it is the upper side of the roof which will be the subject matter of the lease. In the case of panels which are not integrated into built structures, the ambit of the real estate right of the operator will be comprised between the roof and the panels on a parallel footing with the roof. For integrated panels, the operator is the owner of the roof. The ambit of his right will be the outer confines of the framework of the built structure onto which the roof is installed. It should be noted that the incorporation into a roof of integrated photovoltaic panels will not preclude them from being non-proprietary to the owner of the other parts of the building. In this case scenario a division into flying freehold units will be almost inevitable. In practice, such will necessarily include the stipulation of an easement encumbering the flying freehold unit comprising the integrated photovoltaic components in favour of the flying freehold units below, securing the "watertight status" of the latter.

[5] Art. L. 451-1 et seq. of the Rural Code.
[6] Art. L.251-1 of the Construction and Housing Code.
[7] Indeed such a lease will not come under the statutory regime governing commercial leases failing compliance with the conditions of application decreed by articles L145-1 et seq. of the Commercial Code.

SPECIAL SUPPLEMENT
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What requirements for the installation of photovoltaic panels having regard to planning law and environmental law?

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Two case scenarios need to be distinguished.

Photovoltaic panels installed on buildings

Installation on buildings under construction ("integrated into the built structure")

The formalities from a planning law standpoint are the same as those required for the main construction. A planning permission will thus, most often, be necessary for the development of the building, in accordance with article R.421-1 of the Planning Code. Within this framework, the possibility of installing photovoltaic panels will be appraised at the time of examining the whole project, and having regard to compliance with applicable planning rules[1].

Installation on an existing building

A prior declaration of works will be necessary[2]. Indeed, works on existing constructions are subject to a prior declaration of works to the extent where they have the effect of "altering the outside aspect of an existing building"[3]. However this situation will be different if the building is protected[4] or is located in a conservation area[5].

Case scenarios in which the *Architecte des Bâtiments de France* (Listed Building Architectural Department) are required to provide an opinion will also have to be taken into account. Besides the fact that it will be prudent to attempt to obtain his opinion prior to the filing of the planning permission application, the involvement of the *Architecte des Bâtiments de France* will have the effect of extending the examination process period. The expiry of this period will engender a tacit refusal of the planning permission if the *Architecte des Bâtiments de France* rendered an unfavourable opinion or a favourable opinion coupled with prescriptions[6]. The draft bill carrying a national undertaking for the environment, as adopted by the *Sénat* (upper house of French Parliament) on October 8 last, contemplated inserting a new article L111-6-2 into the Planning Code aiming to facilitate the development of photovoltaic panels. However, only domestic systems for the production of renewable energy are concerned[7].

Ground-based photovoltaic panels

Whereas ground-based photovoltaic panels were not explicitly covered either by the Planning Code or the Environmental Code, order no.2009-1414 of 19 November 2009[8] changed the regulatory framework which is enforceable against them in order to define the boundaries of their installation.

Planning authorisation

The installation of ground-based photovoltaic panels was not, as such, subject to the delivery of a specific authorisation[9]. The order of 19

[1] It will therefore be necessary to check the contents of the Urban Development Plan or of the Local Zoning Plan, as well as of the National Zoning Regulations (in particular article R 111-21 of the Planning Code related to the visual aspect of constructions).
[2] It would not seem that article R421-14 will be able to apply. This article requires planning permission for works on existing constructions having the "effect of altering the volume of the building and of boring or increasing openings in exterior walls".
[3] Article R 421-17a of the Planning Code – also ministerial response, Official Journal of the *Sénat,* 22 October 2009 – page 2476.
[4] Article R 421-16 of the Planning Code.
[5] Article R 421-15 of the Planning Code.
[6] Article R 424-3 of the Planning Code.
[7] "Despite any planning rule to the contrary, a planning permission or a development permit or the decision enacted on the basis of a prior declaration of works will not be able to forestall the installation of photovoltaic (…) solar energy systems (…). The provisions of this subparagraph will not preclude a planning permission or a development permit or the decision enacted on the basis of a prior declaration of works from including prescriptions intended to ensure the proper architectural integration of the project into the existing built structure and into the surrounding environment". Exceptions are contemplated in the draft of the text.
[8] Official Journal, 20 November 2009.
[9] Apart from two case scenarios (conservation area, the perimeter of which has been delimited or on a classified site; the establishment of photovoltaic panels with accompanying constructions or facilities requiring a planning authorisation).

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November 2009 amended the Planning Code as follows:

- are exempted from any and all formalities1, developments for the production of electricity from solar energy, installed on the ground, the peak output of which is inferior to 3 kW and the height of which above the ground is inferior to 1.80 metres;
- are subject to a prior declaration of works2, developments for the production of electricity from solar energy, installed on the ground, the peak output of which is inferior to 3 kW and the height of which above the ground is superior to 1.80 metres, as well as those developments, the peak output of which is superior or equal to 3 kW and inferior or equal to 250 kW, whatever their height;
- are also subject to a prior declaration of works, those developments for the production of electricity from solar energy, installed on the ground, the peak output of which is inferior to 3 kW and which are located in a conservation area, the perimeter of which has been delimited, in a classified site or in natural reserves (…)3;
- by way of exception, are thus subject to planning permission those developments with a peak output superior to 250 kW, without any condition with respect to height.

Impact survey

Prior to the order of 19 November 2009, the installation of photovoltaic panels was in principle exempted from an impact survey, the relevant works not requiring any authorisation or prior declaration. The Environmental Code provides from now on that the works for the installation of developments for the production of electricity from solar energy, installed on the ground, the peak output of which is superior to 250 kW, whatever the cost thereof, are subject to an impact survey[4].

Public enquiry

Ground-based photovoltaic panels were not included among those projects which are subject to public enquiry, as listed in an annex to Article R 123-1 of the Environmental Code. The order of 19 November 2009 amended the table in annex I of Article R 123-1 of the Environmental Code. From now on, works for the installation of developments for the production of electricity from solar energy, installed on the ground, the peak output of which is superior to 250 kW, must be preceded by a public enquiry.

The provisions of the order of 19 November 2009 will enter into effect on the 1st December. Various exemptions however have been contemplated.

Concerning the obligation to file a planning permission application, it is contemplated that this obligation is only intended to apply in two case scenarios:

- when the ground-based solar plant includes installations or constructions having been the subject of a decision of no objection to the prior declaration or of a planning permission prior to the entry into effect of the order;
- when the solar plant was exempted from all formalities under the Planning Code and that the works were undertaken or completed at the date of entry into effect of the order.

In addition, with respect to the obligation to carry out an impact survey and to submit the project to public enquiry, the order provides that these obligations are not applicable to projects, the planning permission application for which were filed prior to the date of publication of the order, that being 20 November 2009.

[1] Article R 421-2 of the Planning Code. Unless the developments are established within a conservation area, the perimeter of which has been delimited or on a classified site.
[2] Article R 421-9 of the Planning Code. Outside conservation areas, the perimeter of which has been delimited or classified sites.
[3] Article R 421-11 of the Planning Code
[4] Article R 122-8 of the Environnemental Code.

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Steps to be accomplished in order to operate, connect and sell the electricity produced by photovoltaic

By Jean-Luc Tixier, *Partner, specialized in real estate law and public law.*
And Céline Cloché-Dubois, *lawyer specialized in Public law and Environmental law.*

The commissioning of photovoltaic facilities implies complying with certain formalities which respond to different logics and for which the producer will be faced with different correspondents.

The operating license

Under the terms of article 6 of law no.2000-108 of 10 February 2000 related to the modernisation and development of the public electricity service, the production of electricity implies obtaining an operating license issued by the ministry in charge of Energy, prior to the establishment of the production facilities, to the extent where the installed capacity exceeds 4.5 MW[1]. On the other hand, a mere declaration will be required when the installed capacity is inferior or equal to 4.5 MW[2].

The facility must be commissioned within a period of three years following the obtaining of the operating license or the delivery of the receipt of declaration.

Connection to the grid

Connection to the grid must be the subject of a contract between the operator and the grid administrator. Connecting to the grid involves several agreements:

- a connection agreement: this will be established on the basis of a technical and financial proposal3 from the grid administrator which must be accepted by the operator. This agreement will determine the delivery point, the costs and deadline for the execution of the connection works;
- an operating agreement: this will be established between the producer and the administrator of the public electrical grid; this will identify the persons in charge of operating the production facility as well as their correspondents designated by the administrator of the public electrical grid and will define the operating relations that they will entertain. The applicant will have to be in a position to provide evidence of the operating license in order to execute this agreement;
- public grid access agreement (CARD): once the connection and operating agreements have been entered into, the producer will enter into a public grid access agreement with the grid administrator. The purpose of this agreement is to define the technical, legal and financial terms of the injection of electricity produced into the public grid and of the extraction of electrical energy necessary for the operation of the production facility's auxiliary equipment.

Sale of the electricity produced

Are eligible under the obligatory purchasing system those facilities which produce electricity from solar radiation energy, the installed capacity of which is inferior or equal to 12 MW[4]. The future producer must apply for:

- a certificate giving rise to the obligation to purchase (CODOA): the applicant has to lodge with DREAL (- Regional Authority for the Environment, National Planning and Housing - if the latter has been instituted or, failing which with DRIRE - Regional Authority for Industry, Research and the Environment) an application file. The CODOA will be issued within a two month period by the prefect. We would specify that the CODOA is no longer required for

[1] The operating license application file has been changed, to be completed, by the order of 19 November 2009.
[2] However, in accordance with article 6-1 of order no.2000-877 of 7 September 2000 related to the license to operate electricity production facilities inserted by the order of 19 November 2009: "By derogation to article 6, any photovoltaic facility with a peak output inferior or equal to 250 kW, even when the operator has requested the benefit of the purchase obligation contemplated in article 10 of the law of 10 February 2000 mentioned above, is deemed to be declared."
[3] The contents and terms of which are defined by the bylaw of 23 April 2003.
[4] This limit on capacity is determined as per production site. For the purpose of assessing compliance with such restrictions, two electricity producing machines operated by the same person or by the companies that such person controls directly or indirectly within the meaning of article L233-3 of the Commercial Code, can not be considered as situated on two separate sites, if the distance between them is inferior to 500 metres.

facilities with an installed peak output inferior to 250 kWp1;

- purchase agreement: the applicant will send to EDF a full purchase agreement application. This application will determine the applicable rates. EDF will send it an agreement established according to the purchase agreement templates approved by the minister in charge of Energy: EDF is bound to execute this agreement, to the extent where the application is complete and that the applicant has provided all of the additional documentation referred to in the agreement. The term of the agreement is 20 years as from the commissioning of the facility, that is to say its connection to the grid.

[1] Article 2 of the order of 10 May 2001 amended by order no.2009-252 of 4 March 2009.

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The draft bylaw determining the terms of purchase by EDF of photovoltaic produced electricity: in limbo

By Christophe Barthélemy, *Partner specializing in general public law and in public economic law*. He focuses more specifically on energy law (gas, electricity) in France and in Europe, in the regulated sectors (transportation, distribution, storage: rates, negotiation of concessions, access to essential facilities, energy quality …) and the competitive sector (evolution of operators, nuclear, thermal or renewable production projects; marketing; energy control; electric transportation and mobility…), providing both advisory and litigation services.
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A regulatory act will only produce legal effects upon publication thereof. It is possible however for mere drafts to have extremely concrete effects, leading subjects of law to anticipate the entry into effect thereof. Such is the case for the draft bylaw determining the terms of purchase by EDF of photovoltaic produced electricity, which will repeal the current bylaw which dates back to 2006. The ambition of its drafters is to enable France to catch up with Germany and Spain in this field, in particular in order to contribute to the 23% share of renewable energy sources in final energy consumption by 2020.

This draft, which was made public in the early stages of September 2009, provides for entry into effect as at 1st January 2010, save for certain provisions which would be carried into effect on 1st June. The changes contained in this draft, therefore provide incentive to project carriers, which are to see their financial advantages reduced, to hasten these projects along.

The main changes are fourfold

The text first announces a steady downturn of rates from 2012 onwards, in order to ensure that the blow is cushioned, the administrative authorities being eager to avoid a too sharp application of the brakes as recently decided in Spain.

An interim rate would be created for facilities realized on professional buildings without forming the main waterproofing component; a great number of projects stand to benefit from this innovation, but some could loose the benefit of the higher rate. The rate of purchase of energy produced by ground-based panels should vary as per *département,* to the advantage of Corsica and the Overseas *départements*, as well as continental *départements* whose exposure to sun is limited, but in order to avoid projects being concentrated in the southernmost areas.

Finally, the rate would be "frozen" (for 20 years, as this is currently the case) at the date of the complete application for connection to the public grid, and no longer at the date of the complete application for a purchase agreement with respect to EDF, which should be favourable to applicants, in any event post-2012.

Ultimately, through this text, should it come to be, the government is attempting to organise with the same momentum, the rise and subsequent fall of a "bubble" based on a guaranteed and controlled income. If it is true that the financial terms of this activity should remain relatively reliable, this will not of course mean that there will be no risk at all, whether of a technical or legal nature.

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Draft Finance Bill for 2010: new industry specific taxes applying to new energy production facilities

By Cathy Goarant-Moraglia, *Tax Partner, co-heads the local taxes department*. She is active within the framework of the management of local taxes encumbering real estate programs from their design phase up until their completion as well as within the framework of major or marketing restructuring operations. She also conducts assignments related to due diligence, assistance, technical consultancy and defence of undertakings in all business sectors.
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At the present time, wind parks and photovoltaic facilities come within the ambit of facilities producing electrical energy as addressed by Article 1478 III of the Tax Code which renders them taxable under business tax, as from their month of their connection to the grid[1].

Within the framework of the cancellation of business tax, and in order to compensate for the loss of financial resources due to the removal of the taxable basis related to the equipment of these facilities, the Draft Finance Bill for 2010 contemplates the creation of articles 1635-0 quinquies, 1519 D and 1519 F setting forth a presumptive taxation which will apply, in particular, to electricity production facilities using the mechanical force of the wind and to photovoltaic electricity production plants.

The new presumptive taxation would be due each year by the operator of the electricity production facility on the 1st January of the year of taxation and will apply to facilities, the installed electrical capacity of which, within the meaning of law no.2000-108 of 10 February 2000 related to the modernisation and development of the public electricity service, is superior or equal to 200 kW.

This new taxation, the annual rate of which would be determined at 2.20 euros per kW of power, is coupled with a great many return requirements which require the operator to ensure permanent and meticulous follow up of its operations.

Thus, the party liable for the tax must send a return to each *commune* concerned, at the latest on the second business day following the 1st May of the year of taxation, including the number of energy producing facilities operated and their capacity.

In the event of the creation of a facility or the change of operator, the above mentioned return will have to be filed prior to the 1st January of the year following that of such creation or of such change.

Finally, in the event of the definitive discontinuance of the operation of a facility, the operator will be bound to report such to the tax authorities, that the production unit is attached to, prior to the 1st of January of the year following that of the discontinuance, when such discontinuance occurs during the course of a year, or prior to the 1st of January of the year of the discontinuance, when the latter enters into effect as of 1st January.

It is essential to note that although intended to compensate for the cancellation of business tax, this presumptive taxation should not be eligible to the 3% cap on added value, contrarily to the Territorial Economic Contribution.

The draft bill provides that review, recovery, litigation, guarantees, sureties and liens in these matters will be governed by the rules related to the local activities contribution.

[1] See our article "The regime of new energy production facilities having regard to local taxes", Real Estate Newsletter no.14

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[27] See our article "The regime of new energy production facilities having regard to local taxes", Real Estate Newsletter no.14

The taxation of real estate transfers

In real estate matters, sales entail the payment, on the one hand, of registration duty and, on the other hand, of a tax on the capital gains realized by the seller.

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Registration tax concerns all sales of buildings located in France and those applying to buildings located abroad, provided they have been recorded by a deed executed in France (subject to the application of international treaties). The duties payable are for the account of the purchaser. However, the tax authorities can claim payment from the seller when the purchaser is insolvent.

The regime applicable to capital gains in real estate matters is variable as this will depend on the seller's tax regime and tax residence. In certain cases, it can even depend on the tax regime applicable to the purchaser[28]. This article is not designed to detail in an exhaustive manner all of the regimes which are applicable but rather to bring show just how diverse they are.

In addition, the regime of registration duty and capital gains tax will differ depending on whether the sale applies directly to a building or to the securities of a company or partnership which holds a building.

As concerns the direct sale of a property asset, registration duty at the rate of 5.09% is payable, as calculated on the basis of the sale price. The tax authorities can however replace the expressed price with the fair market value of the building if this should be higher. Under the terms of article 257-7°- 1-b of the Tax Code, certain sales of buildings are exempted from registration duty, but subject to real estate VAT. For instance, the first transfer of a building in favour of a person who is not a real estate dealer, within a period of five years from the completion thereof, will be subject to real estate VAT and to land registration tax at the rate of 0.715%.

In matters of capital gains, the sale of a building by a French resident implies distinguishing several case scenarios. Thus the capital gains realized by an individual are subject to *ad valorem* duty at 16% (28.1% including social deductions[29]) after application of taper relief at the rate of 10% per holding year beyond the fifth. If the seller is a company subject to corporate income tax, the capital gains will be subject to corporate income tax at the standard rate of 33.33%[30], regardless of the holding period of such building by the company. Finally, if the seller is a company or partnership which is translucent from a tax standpoint, the regime applicable to the taxation of capital gains will depend on the tax regime applicable to the shareholders or partners.

If the building is sold by a non resident, subject to international treaties, the capital gains will be subject to the one third levy (reduced to 16% in certain cases) under article 244 bis A of the Tax Code. This levy concerns the sale of buildings situated in France, with the exception of buildings assigned to a professional activity. We would specify that this levy concerns the capital gains realized occasionally by non residents, real estate profits realized on a habitual basis being subject to a 50% levy contemplated by article 244 bis of the Tax Code.
The sale of a building can also take place via the assignment of the corporate interests of a company or partnership that includes a building in its assets. Several possibilities are conceivable having regard to transfer taxes.

First of all, if the company or partnership benefits from tax transparency (civil partnership or capital company the exclusive purpose of which is the rental or management of the buildings that they own or the construction of buildings in view of

[28] Temporary externalization regime of article 210 E.

[29] Subject to exemptions.

[30] Effective rate of 34.43% with the 3.3% contribution

their division into fractions intended to be allocated to their partners or shareholders), the assignment of these corporate interests is deemed to apply to the buildings held by the company or partnership and accordingly subject to registration duty at the rate of 5.09% calculated on the price of assignment. However if the assignment gives rise to the payment of real estate VAT, a mere fixed duty (125 euros) will be due.

Next, article 726 of the Tax Code subjects to registration duty the assignments of holding interests in predominantly real estate holding legal persons.

Real estate predominance is appraised having regard to the composition of assets of such legal person, at the date of the assignment or during the course of the year prior to the assignment, with the following ratio with (i) in the numerator, on the one hand, the fair market value of the buildings and of the *in rem* property rights that it holds in France, and thus whether or not it assigns such to its own business operation and, on the other hand the fair market value of the interests that it holds in predominantly real estate legal persons, to the exclusion of interests in listed corporations, low-rent housing corporations and in mixed economy corporations conducting an activity in the field of building and management of social housing accommodation; (ii) in the denominator, the effective gross value of all assets, French or foreign.

"In addition, the regime of registration duty and capital gains tax will differ depending on whether the sale applies directly to a building or to the securities of a company or partnership which holds a building."

If real estate predominance is established, the assignments of interests issued by the company or partnership are subject to a registration duty of 5%, whether these are shares or partnership shares.

As a reminder, assignments of shares and partnership shares of a company or partnership which is not a predominantly real estate holding entity are subject to a 3% registration duty, capped at 5,000 euros concerning the assignment of shares, and benefiting from a tax relief in the presence of partnership shares (new regime in effect since 6 August 2008).

As regards capital gains, there are specific rules applicable to the securities of predominantly real estate holding companies (hereinafter "PREHC").

Yet again the situation here is complex. First of all the concept of real estate predominance retained in terms of capital gains is different to that retained for registration duty. In addition the definition of real estate predominance can vary according to the category of capital gains taxation.

For instance, capital gains on the assignment of the securities of an unlisted PREHC realized by a French resident subject to corporate income tax are excluded from the long term regime and are thus subject to corporate income tax at the standard rate of 33.33%. Within this framework, will be considered as a PREHC those companies or partnerships whose assets are composed for more than 50% of the effective value thereof, at the date of assignment of the securities or at the close of the previous financial year, of buildings, rights applying to buildings, rights pertaining to real estate financial leasing agreement or of securities of other PREHCs. Unlike the definition retained for registration duties, buildings or rights essentially assigned to business operation are not taken into account for the appraisal of the 50% fraction.

As concerns capital gains realized by individuals, occasional assignments of the securities of a PREHC come under the regime of real estate capital gains as set out above[31] if the company or partnership comes within the ambit of income tax (this is the case for SCIs: real estate partnerships). Unlike the definition retained for corporate income tax, real estate predominance is appraised at close of accounts for the previous three years. Moreover, the rights pertaining to real estate financial leasing agreements are not retained for the appraisal of real estate predominance.

In a final respect, capital gains on the assignment of the securities of a PREHC realized by non residents are, similarly to direct sales of buildings, subject to the one third levy (reduced to 16% or to 19% in certain cases) contemplated by article 244 bis A of the Tax Code. The concept of real estate predominance is here relatively close to that retained in matters of capital gains of individuals.

[31] i.e. taxed at the rate of 16% with taper relief.

Income and capital gains on corporate buildings: certain improvements in terms of capital gains

The income on the operation of corporate buildings is subject to corporate income tax according to standard rules

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Various specificities can moreover be reported as regards the depreciation of buildings on account of the application of the components method which generally entails, for investment property, a lengthening of the tax depreciation period for the constructions, whereas land always remains non depreciable from a tax standpoint, only provisions for depreciation being able, but under exceptional circumstances, to be made free of tax.

As concerns provisions, the regime has also been tightened up to the extent where the provisions for depreciation recorded in respect of a financial year on investment property are only deductible now for the fraction exceeding unrealized capital gains recorded at the close of the financial year, with respect to all of the properties of this nature booked in the assets. Are concerned by this limitation those real estate assets booked as capital assets and which are not allocated by the undertaking to its own industrial, commercial or agricultural activity, or to the exercise of a non commercial profession, to the exclusion of those assets which are made available or rented out in a principal respect to related parties within the meaning of Article 39-12 of the Tax Code allocating these assets to their own activity. Capital gains (on assignments or contributions) on buildings and shares of unlisted predominantly real estate holding companies are also subject to tax at the standard rate. On the other hand capital gains on the assignment of investment securities held for more than two years, in listed predominantly real estate holding companies, are subject to corporate income tax at the reduced rate of 19% (plus possible social contribution of 3.33%). Likewise, a temporary mechanism provides however for the taxation under corporate income tax at the reduced rate of 19% (for financial years closed as from 1st January 2009), marked up as the case may be by the same social contribution, as concerns net capital gains realized on the occasion of the contribution or the assignment, prior to 1st January 2012, of buildings (held with undivided ownership, under usufruct or as a tenant under a building lease or under an emphyteutic lease) or of rights pertaining to real estate financial leasing agreements to a company raising funds from the public by means of securities necessarily giving access to the capital or approved by the Financial Markets Authority, the main purpose of which is the acquisition or construction of buildings in view of the rental thereof (SIIC or SCPI for instance) or to a subsidiary of a SIIC or of a Sppicav holding at least a 95% stake, provided that this company enters into a covenant in the instrument of assignment to hold the buildings or the rights received during a minimum period of five years.

"The mechanism has also been extended to the assignment of buildings or* in rem *property rights to financial leasing companies."

If the assigning company is the subsidiary of a SIIC or of a Sppicav, the reduced taxation will moreover be subordinated to the condition that this company is placed under the exemption regime of SIICs during at least five years from the financial year during which the acquisition took place, being specified that this condition is satisfied in the event of temporary suspension of the regime in favour of the parent company (law no. 2008-1425 of 27 December 2008, Art. 24, V). The mechanism has also been extended to the assignment of buildings or *in rem* property rights to financial leasing companies having concluded, for these assets, a contract with one of the companies referred to above, provided that they intercede in the context of the deed of assignment in order to enter into the covenant to conclude this contract and to hold the rights pertaining thereto for a period of five years.

Construction: reminder regarding planning taxes

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A planning permission or a prior declaration of works constitute the operative event triggering the relevant planning taxes and contributions, which are both numerous and diversified. An inventory can however be drawn up, grouping them together under their objectives.

1. Taxes intended to contribute towards the general effort of providing facilities to local authorities

The basic tax is the Local Facilities Tax (TLE), which is a tax burdening construction projects, allocated to the financing of the *commune's* general expenditure on urban development. This tax is based on the floor areas developed, which are taxed on a presumptive basis. Various cases of compulsory or optional exemptions are provided for[32].

TLE is combined with a great many other taxes, including the local tax on sensitive natural zones (*taxe départementale pour les espaces naturels sensibles* – TDENS), the local tax in favour of the local architectural, planning and environmental councils (*taxe départementale pour le financement des conseils d'architecture, d'urbanisme et d'environnement* – TDCAUE), and taxes which are specific to certain territories: the supplemental TLE in the Ile de France Region and the specific facilities tax in the Savoie region.

The tax for preventive archaeology (*redevance d'archéologie preventive*) is for its part intended to finance archaeological digs prior to the execution of certain projects.

The payment of the levy for exceeding the statutory density cap (*versement pour dépassement du plafond légal de densité*) provides for a contribution from developers whose projects exceed a certain density[33]. The development of a construction will thus be subordinated to the payment, by the beneficiary of a planning permission, of a sum corresponding to the value of the land that would be necessary to comply with the density cap.

Finally, the owner of a building can be subject to the tax on the creation of office and industrial premises in the Ile de France region. This tax is intended to create an incentive for the delocalisation of these activities outside the Paris region. We would specify that for the purpose of this tax, will be construed as the creation of any such premises, the conversion of premises which were previously assigned to another use.

Concerning this tax in particular, a question often arises regarding the limitation period for the implementation of its recovery. Indeed, the recovery notice must, according to article L520-2 of the Planning Code "be issued within two years following either the delivery of the planning permission, or the filing of the returns contemplated by articles L520-9 and R 422-3, or, failing which, the beginning of the works".

Thus, in order to raise an objection against the administrative authorities with respect to the expiry of the limitation period, it will be imperative to produce any one of the instruments referred to under that article.

We would note that according to the administrative authorities the "beginning of the works" does not cover the unlawful creation of office space, but works which are not subject to a planning permission or to a prior declaration of works, so that according to it, no time bar could be asserted against it in this case. It could be argued that this interpretation is inconsistent with the terms of the statute and would thus be unlawful. However case law has not had the opportunity to provide a ruling on this matter.

The issue related to the starting point of the limitation period remains to date unresolved.

[32] See paragraph 3.
[33] This tax was cancelled by law no. 2000-1208 of 13 December 2000 known as the SRU law (law related to Solidarity and to Urban Regeneration) but remains in effect in those *communes* that have not cancelled this tax.

2. Contributions to the financing of public facilities

In order to improve public roadways, an assignment of land, free of charge, of up to 10% of its surface area can be required of the beneficiary of an authorisation applying to the creation of new buildings or of new surface areas developed.

Likewise, developers can be held to the payment of a contribution for public roadways and networks. This contribution will enable a *commune* having decided to develop an urban roadway (creation or redevelopment of an existing road) or to install, alongside this road, the networks necessary to the establishment of constructions, to place the cost thereof on the owners of the land adjacent to such road or to such networks. Such is in principle paid at the time of construction, but can be paid in an anticipated manner so as to ensure that it is developable in the future.

Three other presumptive taxes can be imposed. These are: sewer hook-up tax (which is not chargeable, from the delivery of the planning permission or from the prior declaration of works, conversely to the other taxes and contributions, but upon effective hook-up of the construction to the system), the contribution for lack of parking space, or yet still the contribution for the creation of exceptional public facilities, the latter being chargeable against beneficiaries of authorisations to build, the subject matter of which is the creation of industrial, agricultural, commercial or crafts facilities (water treatment plants for an industrial site, access to an isolated agricultural enterprise, access routes to a shopping centre or to a light industrial zone…).

3. Contributions within the framework of urban development projects

Two types of contribution can be imposed on the occasion of urban development projects.

First of all the contribution due in respect of general development programs: by deliberation, the municipal council will ratify, within a limited perimeter, a program of public facilities intended for the urban development of this sector and will decide to place on the burden of developers all or part of the costs corresponding to the needs of the future inhabitants or users of said sector.

Moreover, the public authorities, on the initiative to create a ZAC (Concerted Development Zone), can decide to exclude the constructions to be developed within the zone from the scope of application of TLE provided that the cost of the facilities to be created is placed on the burden of the zone developer (this must concern in a minimal respect those facilities referred to in article 317 quater of annex II of the Tax Code). In this case scenario, it will admittedly be the zone developer who will be liable for these contributions, but it will have the possibility of passing such on within the framework of the price of the land or of the development rights.

“Authorisations to build trigger several cumulative taxes, which often represent a considerable fraction of the project’s cost.”

In the case scenario of a ZAC in which the zone developer does not acquire the totality of the land, an agreement will have to be entered into between the *commune* (or the competent EPCI) and the property developer, specifying the terms according to which the latter will contribute to the cost of the zone’s facilities. This agreement will consequently constitute a mandatory exhibit to be attached to the planning permission application file.

4. Responsibility for proprietary facilities

Besides the above mentioned taxation which concerns the financing of public facilities, property developers will be under the obligation to finance the proprietary facilities necessary to the development of their constructions. This concerns hook-ups to existing public networks, this financing obligation being understood as the hook-up of proprietary facilities to existing public networks opposite the land.

Land corporations' liability to the new "Territorial Economic Contribution"

The inclusion of rentals of buildings under the scope of application of the new Territorial Economic Contribution is undoubtedly one of the flagship measures of the draft finance bill for 2010 which tends, overtly to consolidate the numerous reassessment attempts currently operated by the tax authorities.

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1. Current situation of land corporations with regard to business tax

Currently, only furnished rentals and sub-rentals implementing material and intellectual means come within the ambit of business tax as activities with a professional business character.

Indeed, an activity even when carried on in a habitual manner will only have a professional business character if it is conducted with a profit making objective and if it is not restricted to the administration of private assets. Thus, an owner granting a rental over serviced land or over unfurnished premises is not liable for business tax in this respect.

In addition, administrative guidelines contemplate the existence of a specific sector based principle of taxation with respect to those activities which are liable and those which are not liable to business tax. According to this principle, all of the components of income related to the activities excluded from the scope of application of business tax need not be taken into account in the calculation of the added value used either for the cap or for the minimum contribution.

To this extent, for the calculation of their added value, land corporations are today allowed to exclude the income and expenses related to unfurnished rentals as well as to sub-rentals conducted without the implementation of material or intellectual means.

2. Situation of land corporations with regard to the new Territorial Economic Contribution

The draft finance bill for 2010 contemplates the cancellation of business tax and its replacement with a "Territorial Economic Contribution" (CET) made up of a "local activities contribution" (CLA) and an "additional contribution" (CC). Thus, for the CLA, the "activities related to rentals or sub-rentals of buildings, other than activities related to rentals or sub-rentals of unfurnished buildings for a residential use, are deemed to be conducted in a professional business capacity". The activity related to the (sub) rental of professional buildings would thus become a taxable activity under the future CET, from a revenue of 100,000 euros or more.

However, the significance of the scope of this measure referred to in the new article will lead to the liability of (sub) rentals to CC, to the extent where such covers natural or legal persons, as well as companies without legal personality carrying out an activity in the terms set out, in particular, under article 1447, the very one which governs the scope of application of the new CLA.

Land corporations will thus have to settle the CC up to the amount of a percentage appraised according to the turnover realized and applied to their added value, essentially made up of rent, the rate of which will vary between 0 and 1.5%.

Moreover, and to the extent where CLA should remain insignificant, failing possession of the premises rented out, the land corporation will not be able to benefit from the 3% capping mechanism in respect of CET.

However, and in order to soften the blow for land corporations with respect to this liability's entry into effect, the draft finance bill provides for a ten year spread of the added value, taken into account, resulting from the activity of (sub) rentals of professional buildings.

Effective date of notice to quit subsequently to the LME Law

Under the terms of the order of 30 September 1953, notice to quit had to be served according to local customary practices and at least six months in advance. Customary practices being extremely variable from one region to another (Easter, St Michaels, Mayday, etc.), these had become a source of legal uncertainty, which explains why they were withdrawn by law 2008-776 of 4 August 2008, known as the LME Law (law on the modernisation of the economy)

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The new wording of article L 145-9 subparagraph 1 of the Commercial Code now provides that notice to quit has to be "served for the last day of the civil quarter and at least six months in advance". This article is applicable to notices to quit served from 6 August 2008, date of entry into effect of said law.

When the contractual expiry date of the lease (or the triennial expiry date) corresponds to the last day of a civil quarter, the implementation of the new provisions raises no difficulty at all. The lease will end at the date of the contractual term provided that the notice to quit has been served six months in advance.

On the other hand, when the term-end of the lease does not coincide with the last day of a civil quarter, the application of article L145-9 raises various difficulties of interpretation: does the rule related to "civil quarter" apply only to the notice served during the period of tacit continuation of the lease or also to notices served for the contractual term-end of the lease? The answer to this question is unsettled and is currently subject to debate between legal authors.

For certain legal authors, the date of the civil quarter should only be retained for leases which continued beyond their contractual expiry date. When serving notice to quit for the date of expiry of the lease or at the end of a triennial period, notice has to be served for the date contemplated in the contract. According to a second group of legal authors, the "civil quarter" rule must always apply, even at the end of the lease.

A ruling of the 3rd civil chamber of the *Cour de cassation* dated 23 June 2009, rendered under the ambit of the former statutes, recently revived this debate. In this ruling, the court considered that the "customary term-end could only be retained in the event of tacit continuation of the lease".

Is this solution transposable under the ambit of the new statutes? In the affirmative, the "civil quarter" rule would only be applied when the lease continues tacitly. When notice is served for the contractual term-end, this date would prevail over that of the civil quarter.

This deduction, recommended by certain authors would seem to us be somewhat hasty to the extent where there is no need to draw a distinction where the statute does not.

However, until the *Cour de cassation* has ruled under the ambit of the new rules, one should remain somewhat conservative. Notice should be served for the contractually contemplated expiry date, being specified that in the event of dispute, the effective date of the notice would be postponed until the last day of the civil quarter, without its validity being able to be challenged, to the extent where the six months prior notice period before the contractual term has been complied with.

Examples

Case scenario 1: leases whose expiry date coincides with that of a civil quarter.

The lease expires on 30 June 2011, notice will therefore have to be served on 30 December 2010 (six months in advance) for the last day of the civil quarter (30 June).

Case scenario 2: leases which are continued tacitly.

The lease expires on 30 June 2009, notice can therefore be served at any moment and will be effective on the last day of the civil quarter. If such is served on 1st September 2009, it will be effective on 31 March 2010.

Case scenario 3: leases whose expiry date does not coincide with that of a civil quarter.

The lease comes to an end on 15 April 2011, notice will in any event have to be served on 15 October 2010 (six months in advance). Such notice will be effective on 15 April 2011 or 30 June 2011 if the "civil quarter" rule prevails.

Remedies open to the tenant, victim of building defects affecting the rented object

Tenants may suffer directly from building defects affecting the building rented, as well as from remedial works and possible court proceedings initiated by the landlord against the builders.

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In the event that such disorders occur, the tenant is not entitled to act against the builders on the grounds of the legal warranty contemplated under article 1792 of the Civil Code. In a ruling rendered on 16 December 2008, the *Cour de cassation* recently recalled that as the tenant is not the owner of the premises rented, but merely the beneficiary of a right of enjoyment, it is not entitled to implement the legal warranty contemplated under article 1792 of the Civil Code (appeal no. 08-14.714). The tenant is left with the possibility of acting on the grounds of tortious liability against the builders.

With respect to relations with the landlord, the tenant's legal remedies can be limited in the presence of a clause containing a waiver by the tenant of its right to act against the landlord on the grounds of hidden defects under article 1721 of the Civil Code covering defects which are not apparent at the date of signature of the lease.

However, the effect of this waiver clause has just been thwarted by a the *Cour de cassation* which has just overruled a first instance ruling throwing out a tenant's claim for compensation with respect to a waterproofing defect on a terrace on the grounds that the lease contained a clause of waiver to invoke the hidden defect warranty.

The *Cour de cassation* criticized the court of appeals for not having answered the grounds of the appeal based on articles 1719 and 1720 of the Civil Code, that is to say the obligations of delivery, maintenance and of warranty covering peaceful enjoyment of the premises (appeal no.08-11.011). The *Cour de cassation* is consistent here with its case law tending to revert to the obligations set out under article 1719 of the Civil Code protecting the peaceful enjoyment of the premises, and thus, despite the tenant's waiver to exercise a remedy against the landlord.

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