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REAL ESTATE NEWSLETTER

Dossier on
Case Law - Real Estate

News

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Editorial

We have decided to devote this new issue of the Real Estate Newsletter exclusively to certain novelties which have been introduced, from a real estate standpoint, during the year 2009 and which appear to us to be symbolic of the evolution, from a tax and legal standpoint, of real estate matters in France.

We would thus note that legislative activity has, as always, remained intensive from a tax standpoint. Whether concerning indeed the extension of the scope of application of transfer tax to assignments of the securities of foreign predominantly real estate holding companies, the reform of article 209 of the Tax Code, the objective of which is to better catch income of a real estate nature, the various modifications and qualifications made yet again this year to the SIIC regime (extension to foreign listed companies, facilitating partnerships between SIICs and SPPICAVs, extension of the regime for the neutralization of capital gains on assignments), more indirectly the entry into effect of the protocol of 13 January 2009 amending the US/France tax treaty of 31 August 1994, or the new UK/France tax treaty, which both include significant amendments in relation to real estate, or yet still for illustrative purposes various qualifications with regard to administrative matters and case law regarding the regime applicable to professional furnished rentals… the legislator and the tax authorities have once more hovered between extensions to the scope of application of taxes and relaxing of tax rules in order to encourage certain restructuring operations.

From a legal standpoint, we have focused more especially on evolutions in the case law of the Supreme Courts with regard to different subject matters such as commercial leases granted on the private domain of a local authority, complex operations in matters of planning permits and the confirmation of the possibility from now on to resort to multiple planning permits for the development of a single project, referred to as a complex project, and the specific difficulties that arise, in the context of call option agreements carrying a promise to sell, from the promisor's right of retraction, and thus the question that can arise as to whether there are still any differences, and which ones, between a mere offer and a call option agreement carrying a promise to sell.

Last of all, we will touch on the extremely interesting development of the "green" lease which has appeared in France of late. A standard commercial lease which includes clauses designed to improve the environmental performance of a building, and which has recently become a major concern of real estate professionals and that can not be dissociated from the principles announced by the 1st Grenelle roundtable law of 3 August 2009 and from the objectives that the legislator should be conveying in the 2nd Grenelle roundtable law to be enacted this year. Regarding this latter issue, major market operators are not hesitating to predict that there will be a genuine revolution in forthcoming years in the relations between proprietors and public authorities and between landlords and tenants. ■

Richard Foissac, Partner

DOSSIER ON: Case Law - Real Estate

Territoriality of registration duty and assignment of shares of predominantly real estate holding companies: epilogue

By JACQUELINE SOLLIER, *Partner, specialized in tax law, providing both tax advisory and litigation services, in particular within the framework of acquisitions and the restructuring of real estate groups.*
jacqueline.sollier@cms-bfl.com

And CHRISTOPHE LEFAILLET, *Partner, specialized in tax law (registration duty and Wealth Tax) and in corporate law. He focuses more specifically on merger and acquisition transactions in the real estate sector.*
christophe.lefaillet@cms-bfl.com

The amended finance bill for 2009 has put an end to the recent debate which existed between the tax authorities and certain courts regarding the issue as to whether the assignment of the securities of a foreign company whose assets are essentially made up of buildings located in France occurring under the terms of an instrument enacted abroad has to be subject to registration duty in France or not.

Indeed, this debate concerned the rules of territoriality regarding the assignment of securities of predominantly real estate holding companies, in particular concerning the combined application of two articles of the Tax Code, that is to say, on the one hand, article 718 of the Tax Code which provides that an assignment of foreign movable assets does not fall within the scope of application of French registration duty if such is operated under the terms of an instrument enacted abroad, and on the other hand, article 726 I-2° of the Tax Code which contemplates the liability under registration duty for assignments of holdings in predominantly real estate holding legal persons, even where these assignments are consummated under the terms of an instrument enacted abroad.

According to the tax authorities, the tax regime applying to the assignment of shares of predominantly real estate holding companies, departs from the general principle of territoriality of tax rules and should lead to the application of registration duty to said assignments. Thus the tax authorities applied a 5% rate to instruments on the assignment of the securities of predominantly real estate holding companies where total gross assets were made up by more than half of immovable property or of interests in immovable property located in France, whatever the nationality of the legal person holding such or that of the purchasers and wherever the place of signature of the instrument.

Several courts overturned this interpretation of the provisions of the Tax Code (Court of Appeal of Aix-en-Provence of 19 November 2009, no.2009-672; Court of First Instance of Grasse of 4 September 2008, no.07-3711; Court of First Instance of Nice of 27 September 2007 no.05-1327). The courts stated that article 726 of the Tax Code defined exclusively the rate applicable to assignments of corporate interests but did not carry an exception to the general principle of territoriality laid down in matters of registration by article 718 of the Tax Code. Having regard to case law, in the absence of an instrument enacted in France, the assignment of partnership interests or of shares of foreign predominantly real estate holding companies in France was not taxable.

The amended finance bill for 2009 altered the Tax Code to confirm the thesis of the Tax Authorities and to put an end to this legal uncertainty by inserting a new article 718 bis which provides that, when operated under the terms of an instrument enacted abroad, assignments of holdings in predominantly real estate holding legal persons are subject to registration duty at the rate of 5%.

It should be noted that real estate predominance will be qualified when the assets of a legal person, whatever its nationality, are essentially made up of immovable property or of interests in immovable property located in France or of holdings in legal persons, whatever their nationality, being themselves predominantly real estate holding entities.

In addition, real estate predominance is appraised at the date of the assignment or at any time during the year prior to the assignment of the holdings concerned. However, there is no reason to consider as a predominantly real estate holding entity that legal person who has lost this status due to the assignment, during the course of the

year prior to the assignment of its own securities, of the buildings or holdings in predominantly real estate holding legal persons that it held as assets.

However, are excluded from the scope of application of article 718 bis of the Tax Code:

- legal persons whose corporate interests are traded on a regulated market in financial instruments or on a multilateral trading system;
- low-rent housing agencies and mixed economy companies conducting an activity in the construction and management of social housing;
- legal persons which do not issue any holdings (for instance: associations, foundations, trade unions).

Once the criteria have been satisfied, the assignments of holdings in a predominantly real estate holding company will thus be subject to a 5% registration duty, save offsetting, as the case may be, of a foreign tax credit, in order to avoid double taxation of the assignment.

Such tax credit corresponds to the amount of registration duty effectively settled in the State where each of the legal persons concerned is registered, in accordance with the legislation of this State and within the framework of a compulsory registration procedure for each of these assignments. This tax credit can be offset against the French tax pertaining to each of the assignments, within the limits of this tax.

This new tax device applies exclusively to assignments carried out as from 1st January 2010.

To this extent, it would seem to us to be clearly established, both by case law and the legislator, that assignments of securities in a foreign predominantly real estate holding company in France, taking place under the terms of an instrument enacted abroad prior to 1st January 2010 were not subject to French registration duties. ■

The reform of article 209 of the Tax Code

By RICHARD FOISSAC, *Partner, specialized in tax matters, he deals in particular with acquisitions and restructuring of listed and unlisted real estate groups and provides advisory services in the context of their dealings. He lectures in tax law at the Universities of Paris I and Nice Sophia-Antipolis.*
richard.foissac@cms-bfl.com

And JEAN-YVES CHARRIAU, *tax Partner. He focuses exclusively on the real estate sector, providing advisory services to a wide variety of investment funds in Europe and land corporations, in particular in respect of the tax issues related to the SIIC or OPCI regimes.*
jean-yves.charriau@cms-bfl.com

Recent developments in the *Conseil d'Etat*'s case law regarding the tax treatment of income derived from French immovable assets of enterprises which are not French residents has introduced a certain amount of doubt as to whether the French tax authorities can catch certain sources of income from the real estate of foreign enterprises in the absence of a tax treaty or within the framework of certain treaties.

The provisions of article 206-1 of the Tax Code according to which are *inter alia* liable to Corporate Income Tax all legal persons operating business or carrying out transactions on a profit-making basis, have been considered for quite some time by the tax authorities as providing, on their own, grounds for the taxation of the income realized on the operation of buildings located in France, failing a bilateral tax treaty and the *Conseil d'Etat* (see in particular the Anstalts precedent) confirmed this analysis.

However the question remained as to whether the taxation under Corporate Income Tax of a foreign legal person could only result from the provisions of article 206 or whether on the contrary such had to result from the combination of the provisions of this statute, which defines the entities liable under such tax, and article 209, I, which defines for its part the income taxable under Corporate Income Tax. It matters little indeed that one should be liable under Corporate Income Tax if there is no taxable income.

But, article 209 of the Tax Code, to the extent it provided that the profits taxable under Corporate Income Tax were those realized in enterprises operated in France and those, the taxation of which was allocated to France under a tax treaty, did not necessarily enable the catchment of real estate income, the realization of which does not convey the existence of a permanent establishment.

And the *Conseil d'Etat*, in a ruling of 31 July 2009 (Overseas Thoroughbred (…)) did not simplify this situation. It ruled indeed that a British company which merely confined itself, in consideration of remuneration, to providing possession of a property asset situated in France, was not operating an enterprise within the meaning of article 209, I and did not have a permanent establishment in France either within the meaning of article 4 of the UK/France tax treaty. Of course, the Court then went on to consider that this treaty nevertheless enabled France to catch the income derived from the French buildings of this company, under article 5 which allocates to the State where the buildings are situated the right to tax the income derived from such, but it thus came to light that French sourced real estate income realized by foreign legal persons is liable to not be taxable in France, in particular where the situation is not encompassed within the framework of a tax treaty.

"The legislator has chosen to give this reform an interpretative value, to the extent that it will apply to pending litigation"

The legislator put an end to the issue by altering article 209 so as to now cover the profits mentioned under a, e, e bis and e ter of subparagraph I of article 164B of the Tax Code.

These constitute four sources of income of a real estate nature.

First of all the income from buildings situated in France or from the interests pertaining to these buildings, and thus whatever the mode of operation thereof.
Then, the profits derived from the transactions defined under article 35 (acquisition and resale, subscription of securities with a view to sell, intermediation for acquisitions, sales or subscriptions…) when these pertain to business concerns operated in France or to buildings located in France, interests in immovable property pertaining thereto or securities of unlisted companies, the assets of which are essentially made up of these properties and interests.

Are also concerned the capital gains referred to under articles 150 U, 150 UB and 150 UC, related to immovable property situated in France, interests related to these properties, shares of property investment funds or of assimilable foreign organisations, corporate interests of companies or groups coming under articles 8 to 8 ter, the registered office of which is situated in France, if these entities benefit from French real estate predominance.
Finally, the capital gains on assignments (i) of the shares of SIICs or SPPICAVs – that certain foreign companies or organisations are assimilated to – to the extent that these benefit from French real estate predominance, (ii) of the partnership interests or shares of companies which are listed in France or abroad, of partnership interests, shares or other interests in unlisted organisations, the assets of which are, at the close of the three financial years preceding the assignment, predominantly of a French real estate nature.

We would note that the legislator has chosen to give this reform an interpretative value, to the extent that it will apply to pending litigation.

We would indicate that this reform has a damageable impact on non resident shareholders holding less than 10% of a SIIC, SPPICAV or an "assimilated" foreign company. Indeed, beforehand only the levy under article 244 bis A of the Tax Code was applied to these foreign shareholders which, in accordance with the recommendations of the OECD, only taxes in France capital gains on assignments where these is a holding of at least 10%. The DLF (French tax legislation department) told us at the time that capital gains realized in the event of holdings inferior to 10% were not intended to be taxed under article 209.

This position was good common sense as, apart from the negative impact of such taxation on the appeal of French listed property companies, we do not see how in practice one would go about taxing in France a foreign company holding, for instance, a few shares of a SIIC or of a SPPICAV, at least when the latter is open to the public…

The problem posed by the new wording of article 209, I, should to our knowledge be corrected by the amended finance bill for 2010. Until then, anyone underwriting a prospectus (for instance in the event of public offerings) will have to choose their words with care…■

Commercial leases over the private domain of a local authority

By JEAN-LUC TIXIER, *Partner, specialized in real estate law and public law. He provides advisory and litigation services to commercial and industrial corporations as well as to property developers, in the field of planning law, construction law, and of sales and rentals of buildings, emphyteutic leases and building leases. He lectures at Paris University (Paris I).*
jean-luc.tixier@cms-bfl.com

And by SOPHIE WEILL, *Lawyer specialized in public law, planning law and development law.*
sophie.weill@cms-bfl.com

In a ruling of 28 December 2009, the *Conseil d'Etat* assessed at great length how the various parts of a building, belonging to a local authority, belonged to the private or the public domain of the latter.

The *commune* of Reims had entered into a lease with a private company known as *SARL Brasserie du Théâtre* in 1991, which authorised the latter to occupy the café premises located within the precincts of the municipal theatre. At term-end of this agreement, concluded for 9 years, the *SARL*, considering that it benefited from "security of tenure", applied for the renewal of this lease, which it was denied by the City of Reims; arguing that the lease had been wrongfully characterized, as constituting, according to the latter, an authorisation to occupy the public domain.

"The Supreme Court invoked four arguments to consider that the litigious premises formed part of the municipal private domain"

The Supreme Court invoked four arguments to consider that the litigious premises formed part of the municipal private domain:

- the rented premises had their own entrance, which is separate from that of the municipal theatre;
- the SARL benefited from an exclusive right to sell beverages and other products, but there was no stipulation forcing it to ensure these services;
- no stipulation ordered it to open its premises on days and at times similar to those of the shows performed at the theatre;
- the premises were not assigned to a public cultural service, and were not an accessory of the municipal public domain even if they were in the same building as the theatre.

In a similar case related to a *brasserie* situated within a building housing the municipal museum of Sarlat-la-Canéda[1], the Supreme Court referred to the fact that the restoration works, constituting special fixtures, had concerned the whole of the building, without excluding the premises in which the *brasserie* business was operated, without giving heed to the nature of the fixtures or to the organisation of the place, thus appraising the museum development project globally.

The ruling under examination conducted an extremely precise and realistic analysis of the physical layout of the place and of the business conditions, excluding an exclusively global approach to the building housing the litigious premises.

The argument pertaining to divisibility of the building concerned had already been invoked in a case concerning the head office of the *Crédit Municipal de Paris*[2], in respect of apartments enjoying direct and independent access to the street, unlinked to the other parts of the development and divisible from the premises assigned to the public service.

As regards the absence of any specific stipulation in the contract, we know that the *Cour de cassation*[3] also denied commercial lease status to a license to operate a community hall which provided for the number of performances authorised, imposed free performances and enabled the *commune* to use the hall under certain circumstances[4].

If it is considered that the City of Reims entered into a commercial lease, it was because the outbuilding concerned, belonging to it, was not assigned to a public service and was outside the scope of its public domain. In actual fact, the arguments that the *Conseil d'Etat* relied on are not unheard of, but their use on a cumulative basis deserves underlining. In proceeding thus, the Supreme Court is manifestly in line with the current trend which is to actually reduce the scope of the public domain. A division into a flying freehold structure or a legal declassification of certain areas remains nevertheless the more reliable solution; this type of litigation standing as proof of this. ■

[1] *Conseil d'Etat*, 1st June 2005, Commune of *Sarlat-la-Canéda*, no.277092.

[2] *Conseil d'Etat*, 11 December 2008, Crédit Municipal de Paris, no.309260.

[3] 3rd Civil chamber, 5 May 1996.

[4] See JCP A, issue of 15 November 2001, no.46, p1808.

The situation of the beneficiary of a call option in the event of promisor's retraction

By JEAN-LUC TIXIER, *Partner, specialized in real estate law and public law.*
jean-luc.tixier@cms-bfl.com

and JEAN-BASTIEN LAGRANGE, *real estate Lawyer. He is active in the various sectors of real estate law (sales, leases, construction, etc.), he focuses more specifically on the negotiation and drafting of documentation, and on advisory and litigation services.*
jean-bastien.lagrange@cms-bfl.com

In the case at hand, a married couple granted a call option carrying a promise to sell (*promesse unilatérale de vente*) various plots of land to a SAFER (a Land Use Planning and Rural Development Society), no deadline having been stipulated for exercise of the option. Prior to the exercise of the option, the promisors retracted. The SAFER then exercised the option via registered post, then subpoenaed the promisors for the specific performance of the sale.

The Court of appeals (Colmar, 29 November 2007) acceded to this request, retaining that in the absence of a deadline allocated to the beneficiary in order to exercise the option, it is up to the promisors, when intending to rescind their covenant, to serve beforehand a formal demand on the beneficiary of the call option to accept or refuse the latter and that failing which, the revocation of the call option has no effect on the acceptance having occurred.

The *Cour de cassation* (3rd civil chamber, 25 March 2009) invalidated this position on the grounds that the judge ruling on the merits of the case did not determine whether the promisors' retraction had been notified on the SAFER prior to the latter declaring that it accepted the offer.

In validating this retraction, the *Cour de cassation* has not subscribed to the position developed by legal authors according to which in the presence of a call option agreement which does not include a deadline, the promisor can terminate the contract provided a formal demand is served beforehand on the beneficiary to accept or refuse the sale.

Since a ruling of 15 December 1993, constituting a reversal of case law, the Court has always refused to sanction the promisor's retraction with specific performance of the call option agreement, its non-performance only giving rise in favour of the beneficiary to damages. Indeed, for as long as the beneficiary of the call option has not stated his intention to purchase, the promisor's obligation merely constitutes, according to the Court, an affirmative covenant. As a consequence, the exercise of the option subsequently to the promisor's retraction excludes any common will to sell and to purchase. The Court thus invites us to draw a distinction between consent to the call option agreement and that consent which is granted irrevocably at the time of the sale.

In this perspective, the *Cour de cassation*'s solution is easily understandable.

"the protection of the beneficiary of a call option agreement will be considerably reduced depending on whether or not his option is coupled with a deadline"

However in proceeding thus, the *Cour de cassation* has considerably weakened the distinction between mere offers which can be withdrawn at any moment for as long as they have not been accepted with reasonable warning and call options, the withdrawal of which requires in principle this prior formal demand.

In a decision of 20 May 2009, the *Cour de cassation* had precisely the chance to recall that when an offer to sell is not combined with any deadline, the offer will only stand during a reasonable period of time.

It appears thus that the protection of the beneficiary of a call option agreement will be considerably reduced depending on whether or not his option is coupled with a deadline.

Potential purchasers would thus be well advised to consider the relevance of retaining freedom by signing a call option agreement, with its underlying disadvantages, or of binding themselves under the terms of a sale and purchase agreement (*promesse synallagmatique*) committing them to purchase.

The parties can however provide for the insertion into the call option agreement of a specific performance clause, to be placed on the burden of the promisor, which is validated by case law (3rd civil chamber of the *Cour de cassation*, 27 March 2008), combined with a deadline for exercise of the option.■

Complex operations: the criteria for resorting to multiple planning permits

By JEAN-LUC TIXIER, *Partner, specialized in real estate law and public law.*
jean-luc.tixier@cms-bfl.com

And VANINA FERRACCI, L*awyer specialised in public law*. She is involved with planning and development law. She has a long standing record of providing assistance both to companies and to local authorities, both for advisory and for litigation services.
vanina.ferracci@cms-bfl.com

In a decision of 17 July 2009 which attracted a certain amount of attention, the Supreme Court asserted that "if it results from these provisions[1] that a construction made up of several parts forming, due to physical or functional links between each other, a single property complex, must in principle be the subject of a single planning permit, they do not impede, when the scope and complexity of the project so justify, in particular in the event of several project owners being involved, the parts of the construction which have an autonomous functional vocation from being the subject of separate permits, subject to the administrative authorities having verified, via a global appraisal, that the regulatory compliance and protection of the general interests that would have been guaranteed by a single permit are ensured by all of the permits delivered."

"The practical terms for the implementation of this solution will need to be illustrated by forthcoming case law."

The main interest of the decision is that it confirms the principle according to which a single and indivisible work has to be the subject of a single permit, in order to afford the administrative authorities the possibility of appraising the compliance of all the aspects of the project with planning rules (which resulted implicitly from earlier decisions).

This decision also has the virtue of clarifying the conditions under which a single real estate project can be the subject of multiple permits: first of all, the multiplicity of permits must not constitute an impediment, at the time of each individual application, on the administrative authorities' global appraisal of the project's compliance with planning rules, and second, such compliance must be ensured by all of the permits delivered in the same manner as if there had been just a single permit.

In doing so, the *Conseil d'Etat* reconciled the principle of legality with pragmatic realities applying to planning projects, which involve multiple project owners and complex legal structuring. It remains that the practical terms for the implementation of this solution will need to be illustrated by forthcoming case law. Indeed, several issues remain unresolved.

First of all, what operations will provide grounds for resorting to multiple permits? According to the decision, only large scale and complex projects make it possible to resort to multiple planning permits for a single operation. The definition of this criteria pertaining to scale and complexity will have to be qualified.

Second, how should one go about making a distinction between the divisible parts of the operation? It will be indispensable to conduct detailed analysis of the operation in order to determine the specific contents of each planning permit; to this end one should revert to the criteria of physical and/or functional links of the overall operation. In the case at hand, it was possible to make a distinction between the stadium and the parking lot. We would however specify that parking lots can be functionally linked to the rest of the operation, thus making the two permit distinction impossible.

The possibility of resorting to multiple planning permits, for the accomplishment of a complex operation, is thus clearly asserted and can, according to us, be contemplated as of now. However, the implementation of such solution will imply a prior review of the physical, material and functional characteristics of each project in order to ensure, in a detailed manner, that the criteria laid down by this decision are complied with. ■

[1] Provisions of article 421-3 of the Planning Code.

The “Green lease”: a new and expanding concept

By ALINE DIVO, *Lawyer specialized in real estate law. She focuses in particular on negotiation and litigation in the field of commercial leases (renewed rent, eviction indemnities, termination), both on the side of tenants and the on the side of landlords. She lectures on the topic of commercial leases at Paris University - Paris I and at the Paris Bar School.*
aline.divo@cms-bfl.com

The 1st Grenelle roundtable law of 3 August 2009 mentions various objectives to be conveyed in the 2nd Grenelle roundtable law to be enacted this year. Two main principles are laid down in this law:
- new buildings for which the planning permit application file is lodged as from 1st January 2011, for public buildings and for buildings of the service industry, and as from 1st January 2012 for all other buildings, must have a primary energy consumption inferior to a threshold of 50 kwh per square metre and per annum;
- for existing buildings, an objective for the progressive reduction of consumption between 2012 and 2020 by at least 38% has been set with an effective obligation to perform works during this period for buildings of the service industry.

On account of the objectives set by the Grenelle Environment Round Table process, tenant/landlord relations must change. Thought will need to be given to the terms according to which responsibility will be assumed with respect to the works concerning the improvement of the building’s energy performance.

"The “green lease” has become a major concern for real estate professionals."

It is in this context that the concept of the “green lease” has come to light in France over recent months, in parallel to the same concept which already exists in Anglo-Saxon countries.

The “green lease” is a standard commercial lease including specific clauses designed to improve environmental performances of buildings.

The “green lease” has become a major concern for real estate professionals. Thus over recent months green leases have “sprouted”, containing environmental parameters in their schedules.

Due to the fact that there are currently no rules regarding this matter, the contents of green leases can be drafted freely. To this extent, there are several ways of integrating environmental considerations into a “green lease”. Thus, provision may be made for various clauses related to the reduction of the consumption of electricity, of domestic fuel and of water, to the reduction of greenhouse gas emissions, to waste minimisation and recycling, to the use of non-pollutant products or materials, to air quality, to the installation of sensing devices measuring energy performance of the various areas of consumption, to the adoption by the building occupants of environmentally friendly behaviour, to the setting up of an annual audit by a specialized agency in order to check whether all parties are in line with their commitments, to the maintaining of a certification or an environmental label.

The “green lease” can also make provision for obligations at the expense of the landlord in terms of improvement of the building or the determination of a system for the adjustment of service charge provisions penalizing those tenants who do not achieve the energy consumption objectives contemplated under the lease.

The only restriction on the parties’ contractual freedom is for the “green lease” to not contain any clauses which are contrary to the rules of public order under the mandatory regime governing commercial leases, such as in particular the tenant’s right to renewal or the triennial revision of rent. Any clause that should infringe a rule of public order under the mandatory regime governing commercial leases would be null and void.

To this extent, one should avoid transposing in an identical manner, without giving any prior thought to the matter, “green lease” templates as drafted by Anglo-Saxon lawyers in accordance with foreign rules which are strictly alien to the mandatory regime governing commercial leases. ■

NEWS

Furnished rentals: their scope of application qualified in 2009

An administrative directive and a decision of the *Conseil d'Etat* have provided useful information regarding the tax characterization of furnished rentals.

By FRÉDÉRIC GERNER,*Lawyer, specializing in tax law. He provides both advisory and litigation services with regard to issues related to direct taxation, in particular in connection with intra-group restructuring and real estate (acquisitions and development, land corporation regimes in particular).*
frederic.gerner@cms-bfl.com

The definition of the "furnished rental" concept within the meaning of tax law has always raised issues that the tax authorities and the *Conseil d'Etat* have both concentrated on clearing, at least partially in 2009.

Of course, the finance bill for 2009 distinctly restricted access to status as a professional renter of furnished premises, which enables business losses to be offset against global income. Nevertheless, the creation of a tax abatement for non professional renters of furnished premises investing in residences with services (article 199 sexvicies of the Tax Code), and the specificities of the regime in terms of deduction of expenses or of taxation of capital gains, have maintained the stakes in connection with the definition of furnished rentals.

"The definition of the "furnished rental" concept within the meaning of tax law has always raised issues"

The question arises in particular of the boundary between furnished rentals and the self-catering industry. The administrative authorities have provided various items of information in this regard in a directive of 28 July 2009 (4F-3-09), indicating that "the operator who provides or has on offer, in addition to accommodation services, at least three of the services mentioned under paragraph b of subparagraph 4° of article 261 D, that is to say breakfast, cleaning of the premises on a regular basis, provision of household linen or front office services, even when these are not personalized, for the reception of customers, on terms which are similar to those on offer in hotel type accommodation operated professionally, comes under the self-catering regime", whereas being in a position, for the renter, to provide these services is precisely the criteria required to opt for VAT on rent and to recover VAT settled on one's investment.

Even if the administrative authorities have added that the furnished rental quality will remain "when these services are provided or are on offer in an accessory capacity" (cleaning of the premises only when there is a change of tenant, front office services restricted to the delivery of keys, etc.), its more stringent position than before is likely to give rise to further debate regarding the conditions in which these services are rendered, on account of the stakes of the issue both in the field of personal income tax and of VAT.

The difficulty recedes when the property is rented to the operator of a self catering activity, providing the services on his own behalf: according to the aforementioned directive, the status as renter of furnished premises will remain vested with the landlord to the extent where the possible rental of the common use areas is accessory to the furnished rental (according to a criteria as to absence of specific remuneration which is not extremely clear), and where the renter does not benefit, either directly or indirectly, from the results of the operator (exclusion of variable rent formulas).

This latter condition was reused by the Conseil d'Etat in a recent decision (16 October 2009 no.301235, Chwartz), to confirm that the regime of the furnished rental applies even if the property is made available to the operator not under a lease but under a management mandate, to the extent where the income of the renter is fixed and guaranteed, which exonerates it from any risk in connection with the operation of the hotel.

The Supreme Court thus made in 2009 a commendable contribution to the definition of the scope of application of furnished rentals, in parallel to the provision by the administrative authorities of useful items of information but occasionally restrictive or ambiguous with respect to the subject matter. ■

Real estate aspects of the new US/France tax treaty

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

The protocol of 13 January 2009 (the Protocol) amending the US/France tax treaty of 31 August 1994 entered into effect on 23 December 2009. The swiftness of the ratification procedure (a period of less than a year between the date of signature and the date of entry into effect of a tax treaty is practically unheard of) shows the relevance of this instrument for both countries.

It includes significant changes in terms of real estate.

1. Definition of treaty residents

From now on, SIICs and SPPICAVs are considered as French residents for the purpose of application of the treaty.

If SIICs are usually considered as French residents within the meaning of tax treaties due to their liability for corporate income tax, the same does not apply to SPPICAVs which are fully exonerated from tax. In addition, one could have doubts regarding the assimilation of SPPICAVs to SICAVs, which were already considered as French residents prior to the amendment introduced by the Protocol. These qualifications are therefore worthwhile.

"Dividends paid out by SIICs and SPPICAVs to their American shareholders owning more than 10% will not benefit from the reduction of rates of withholding tax."

2. Withholding tax on dividends

One of the major breakthroughs of the Protocol is the cancellation of any withholding tax on intercompany dividends.

For dividends with a French source, the effective recipient of the dividends has to be a US resident company having held, directly or indirectly, at least 80% of the share capital of the French company during a period of 12 consecutive months prior to the date of determination of the dividend rights. In addition, the recipient company has to satisfy the criteria contemplated by the clause of limitation on benefits of the treaty (article 30).

This possibility of exoneration from withholding tax, as the benefit of the reduced rate of 5%, does not apply to distributions by French SIICs or SPPICAVs. The latter can only benefit from the reduced rate of 15% if they satisfy the following criteria:

- the recipient of the dividends is a physical person, a pension "trust" or an organisation in charge of administering retirement or employee benefits and this recipient holds a maximum of 10% in the SIIC or the SPPICAV;
- or these dividends come from listed securities and the effective recipient is a person who holds a maximum of 5% in the SIIC or the SPPICAV;
- or the effective recipient is a person who holds a maximum of 10% of the beneficial interest in the SIIC or the SPPICAV.

In all other case scenarios, it is the domestic rate of withholding tax (25%) that will apply to dividends paid out by SIICs and SPPICAVs to their American shareholders. On account of the entry into effect of the Protocol in December 2009, the provisions concerning withholding tax (in particular on dividends) will apply retroactively to monies paid as from 1st January 2009. This evolution of the treaty situation regarding distributions of SIICs and SPPICAVs (that can be found in another form within the framework of the new UK/France tax treaty of 19 June 2008, which entered into effect on 18 December 2009) is in line with the works and recommendations of the OECD in this regard. For portfolio investments, the 15% friction could seem acceptable to operators (especially if it is possible to credit this withholding in the State of residence or if this is the only taxation sustained). On the other hand, it would seem highly likely that long term investors for more than 10% in SIICs and SPPICAVs will attempt to avoid or reduce the domestic withholding of 25% (of course within the limits of anti-abuse rules). ■

NEWS

The provisions of the amended finance bill for 2009 on real estate matters

By SOPHIE MAUREL, *Lawyer specialized in tax law. She focuses exclusively on the real estate sector providing advisory services to investment funds in Europe and land corporations, in particular in respect of the tax issues related to the SIIC or OPCI regimes.*
sophie.maurel@cms-bfl.com

First of all, the legislator qualified the rules regarding territoriality in the real estate sector, both with regard to Corporate Income Tax and to Transfer Tax.

In the past, the rules of territoriality applicable in terms of Corporate Income Tax to certain sources of real estate income have been subject to debate. In the absence of treaty provisions, certain case law decisions, echoed by administrative guidelines, granted France the right to tax the income on buildings situated in France held by a foreign entity solely on the grounds of article 206, 1 of the Tax Code. However this provision only defines the entities liable to corporate income tax without reference to the rules of territoriality, governed by article 209. Recently the "Overseas" ruling rekindled the debate by making reference to article 209 (see the article above). The legislator put an end to the discussion: article 209 I now provides, subject to the provisions of international treaties, for the taxation in France of certain sources of real estate income with a French source, defined by referral to article 164 B of the Tax Code. These are: the income on buildings situated in France, customary real estate profits, and real estate capital gains (capital gains on the assignment of buildings or of the securities of predominantly real estate holding companies). This measure has an interpretative character and is thus applicable to pending litigation. The amended finance bill also qualified the rules of territoriality in terms of registration duty. Before, in the absence of rules of territoriality specific to assignments of the securities of predominantly real estate holding companies, one could consider that an assignment, recorded under the terms of an instrument enacted abroad, of the securities of a foreign predominantly real estate holding company in France, was not liable to French transfer tax. Case law recently went along with this analysis, contradicting the position held in administrative guidelines. Here again, the legislator put an end to the discussion: according to the new wording of article 718 bis of the Tax Code, instruments enacted abroad entailing the assignment of the securities of an unlisted company, the assets of which are essentially made up of buildings situated in France are liable to transfer tax in France at the rate of 5%. The text also provides for a tax credit mechanism corresponding to the registration duty settled abroad. The SIIC regime has also been the subject of certain arrangements. From now on, companies listed on a market complying with the requirements of the directive of 21 April 2004 on markets in financial instruments will be entitled to opt for the SIIC regime. The relinquishment of the criteria related to the listing on a French market is aimed at compliance with community law (the principle of free movement of capital). Indeed, beforehand, foreign companies wanting to opt for the SIIC regime had to have a permanent establishment in France and to have such listed on a French market. Finally, the law facilitates the creation of partnerships between SIICs and SPPICAVs by enabling subsidiaries subject to corporate income tax held jointly by more than 95% by a SIIC and a SPPICAV, or by several SPPICAVs, to opt for the SIIC regime. Quite rationally, the specific neutralization regime of capital gains on assignments between a SIIC and its subsidiaries or between subsidiaries, is extended to assignments between a SIIC and a subsidiary held jointly by this SIIC and a SPPICAV or between companies subject to the SIIC regime (which can cover an assignment between subsidiaries of a same SPPICAV having opted for the SIIC regime). ■

"The legislator has qualified the rules regarding territoriality in the real estate sector"

[1] *The exemption regime is only applicable to capital gains resulting from assignments in favour of unrelated parties within the meaning of article 39,12 of the Tax Code. Article 208 C II bis provides nevertheless for a regime of neutralization of capital gains on assignments within the perimeter of the SIIC, subject to certain conditions and covenants similar to those contemplated within the framework of the favourable merger regime of article 210 A.*

NEWS

The new UK/France tax treaty: the consequences in terms of real estate capital gains of enterprises

By DIDIER GINGEMBRE, *Managing Director, Partner, specialized in tax law, providing both tax advisory and litigation services in all activity sectors. He is reputed for his expertise in real estate matters, in particular by property developer companies and land corporations.*
didier.gingembre@cms-bfl.com

A new tax treaty was entered into on 19 June 2008 between France and the United Kingdom.

The provisions of this treaty apply effectively, on the French side, as from 1st January 2010 or to financial years starting as from this date.

As regards real estate matters, this new treaty has introduced significant change regarding the capital gains on the assignments of buildings carried out by companies.

The *Conseil d'Etat* judged (ruling no.250328 of 25 February 2004, Hallminster case) that, for the application of the previous UK/France treaty of 22 May 1968, real estate capital gains realized by companies came under the provisions related to corporate profits and not those related to gains on capital.

It resulted that these capital gains were exclusively taxable in the State of residence of the assigning enterprise and not in the State where the building was situated (the mere holding of a building not qualifying as the existence of a permanent establishment), even where the income generated by the building was duly taxable in the State where the property was situated. As a consequence a British company assigning a building located in France that it had previously rented out was not taxable in France in respect of the capital gains on the assignment, even where it had been liable in France for tax pertaining to the income deriving from the rental.

This was an atypical situation to the extent where most tax treaties entered into by France grant the State where the building is situated the right to tax not only the income, but also capital gains. The new treaty has in particular the purpose of putting an end to this particular state of affairs. From now on, article 14 related to gains on capital complies with the OECD model and with the principle according to which the capital gains on the assignment of buildings realized by companies are taxable in the State where the building is situated.■

If you would like to contact the authors of this newsletter, please write to the editorial staff which shall pass your remarks on to the persons concerned. You can also write to:

CMS Bureau Francis Lefebvre
1-3, villa Emile Bergerat
92522 Neuilly-sur-Seine
Cedex, France
Tél : 01 47 38 55 00
Fax : 01 47 38 55 55
www.cms-bfl.com

Me Jean-Yves Charriau, jean-yves.charriau@cms-bfl.com
Me Richard Foissac, richard.foissac@cms-bfl.com
Me Didier Gingembre, didier.gingembre@cms-bfl.com
Me Christophe Lefaillet, christophe.lefaillet@cms-bfl.com
Me Julien Saïac, julien.saiac@cms-bfl.com
Me Jacqueline Sollier, jacqueline.sollier@cms-bfl.com
Me Jean-Luc Tixier, jean-luc.tixier@cms-bfl.com