REAL-ESTATE NEWSLETTER

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EDITORIAL

The dismembership of ownership. Whether you see dismemberment as simply another asset management method or as a tax optimisation tool, the legal situation for holders of limited interest arising from such operations is complex enough for us to devote a whole issue of the Real Estate Newsletter to it.

Real estate is probably the area which in recent years has seen the greatest number of such ownership splits, be they with respect to buildings or to real estate securities.

It is these same sub-divisions that the French parliament has sought to restrict, when in 2012 it decided to treat gains on the disposal of temporary usufruct as ordinary income.

Our readers will be able to better assess whether it is opportune to acquire the bare ownership of a building, for resident and non-resident individual investors wishing to develop their real estate portfolio without increasing their short-term tax burden, whether income tax or the French ISF wealth tax. These articles will help investors in identifying the person legally liable for property tax in the event of split ownership. In some cases of dismemberment of property rights, the law has already settled the question of the identity of the person legally liable for property taxes. This applies to the usufructuary, the perpetual leaseholder or the holder of a lease for rehabilitation or construction, which are specifically referred to in article 1400 of the French General Tax Code.

They will see the full complexity of VAT on dismembered rights, since the property tax reform act of 9 March 2010 redefined real property rights not as a service provision but as arising from the building to which they relate.

We will also set out, in the specific context of property investments, the main difficulties of identifying who is liable to tax and of determining taxable income in everyday situations such as the sale of real estate securities or the constitution of a temporary usufruct.

As this is all very much in the news, we will devote an article to the reform of the taxation of building land and examine whether the measures contained in the Finance Act for 2015 are likely to enable a rapid and massive release of building land.

Three in-depth articles on legal issues will inform our readers, on the one hand, of the many questions raised by the decree which implements the "Pinel" Act of 3 November 2014 and the judgment by the Court of Cassation of 24 September 2014 which found that in terms of building leases, the clause which subjects any assignment to the approval of the lessor constitutes a restriction on the lessee's right to dispose of the property, which contravenes the principle of freedom of assignment and is therefore null and void, and on the other hand, of the consequences of Article 6 I and II of the Act of 2014-626 which stipulates that clauses which run counter to the rules of public policy in commercial leases are deemed inexistent, making any action taken against them de facto imprescriptible.

Happy reading and best wishes for Christmas and the New Year, from all of the editorial team.

Richard Foissac, Partner

Disposals of dismembered property: how to determine the person liable for tax and the tax base?

The fiscal measures introduced in recent years have failed to resolve some of the difficulties that arise in the event of the sale of dismembered property. Indeed, new problems have cropped up. Here we set out the main pitfalls which are commonly encountered.

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Whether as part of a reform or the fight against tax optimisation, the taxation of capital gains realised by individuals has undergone many changes recently, some of which have been voted through without proper in-depth consultation.

Parliament could have taken the opportunity to deal with some of the issues which weigh heavy on divestment operations involving dismembered property.

Unfortunately, quite the opposite has happened. We will set out, in the specific context of property investments, the main difficulties of identifying who is liable for tax and of determining taxable income in everyday situations such as the sale of real estate securities or the constitution a temporary usufruct. The principles discussed here are, without exception, transposable to social security contributions.

"The tax authorities have put forward solutions for determining the cost of assigned property, but these comments do not establish the applicable regulations."

Sale of real estate securities subject to corporation tax[1]

The established jurisprudence[2] makes it possible to define the person liable for the tax imposed under the conditions referred to in Articles 150-0 A et seq of the French General Tax Code (CGI). In the case of individual assignments of the usufruct or bare ownership of a given property, the person liable for the tax is, quite naturally, the assignor. For the disposal of the freehold jointly by the usufructuary and the bare owner, the tax is therefore due:

– by the usufructuary and the bare owner, in proportion to their rights, if the proceeds of the sale are distributed among them[3];
– by the bare owner if the proceeds of the sale are reused in a dismembered property[4];
– by the usufructuary if he has a quasi-usufruct over the proceeds of the sales[5].

In the latter two situations, these principles[6] designate the person liable for the tax, but the rules on the establishment of the tax base only partially include the characteristics of the assigned rights. The tax authorities have put forward solutions for determining the cost of assigned property[7], but these comments do not establish the applicable regulations. Furthermore, the regulations do not specify whether the taxable income should be determined separately for the usufruct and bare ownership rights, or whether that income must be determined globally, covering all the rights to the transferred property. Take the example where a company cancels part of its own dismembered shares following the donation of their bare ownership and where the founding donors have kept the usufruct. If the company has significant reserves, the sums distributed to its partners as part of the liquidation will for the most part be income distributed under the provisions of article112 of the CGI. For the bare ownership, the donation value will limit the amount of taxable income pursuant to article 161 of the CGI, and in some cases, a loss may even be registered. Regarding the usufruct[8], the cost used for taxation will be limited to a portion of the initial investment. The liquidation surplus, which in principle is taxable in accordance with regulations on dividends, could be limited if it is possible to consider the overall cost of the split rights and, in particular, the transfer taxes incurred for the transfer of bare ownership. In such situations, the parties to the sale would be best advised to examine the proposed operation as early as possible and to implement procedures leading to the most favourable solution.

Sale of property or shares in SCI not subject to corporation tax (IS)[9]

Since the 2004 reform, capital gains from the sale of real estate or shares in real estate companies which are not subject to corporation tax are subject to a proportional tax which functions almost as a flat rate. In the eyes of the authorities, the tax is related more to the property sold than to the assignors, and there is little concern for the way the tax burden is distributed among the stakeholders. The windfall contribution of 3% or 4% referred to in Article 223 sexies of the CGI, however, stipulates that in the event of the disposal of dismembered property, it should be decided whether the capital gain will be related to the usufructuary or the bare owner[10]. The above principles could be replicated to the case at hand, but in the absence of case law, there are still many doubts as to the correct analysis to apply in each situation. The parties to the assignment will again find it is in their best interests to make a detailed examination of their project in order to decide how best to proceed.

First assignment for consideration of a temporary usufruct

The law is intended to counter tax optimisation procedures which involve granting temporary usufruct of property (real estate or SCI shares in particular) while benefiting from the taxation on real estate capital gains (from which they can even be exempt depending on how long the property is held) rather than receiving revenue for which they would be taxed at progressive rates. To this end, the new Article 13-5 of the CGI is designed for this purpose to subject "the proceeds of the first assignment for consideration of the same temporary usufruct" to progressive tax, without prejudice to social security contributions. In the absence of details on how to determine the tax base, these provisions could render the transfer price (or value) of the usufruct taxable, once the charges related to the sale have been deducted. This rigour seems somewhat overbearing since the operation generally benefits the acquirer and not the transferor of the usufruct (although they are sometimes linked), especially as the tax authorities intend to interpret this provision quite extensively. It focuses in particular[11] on the concomitant assignment to two assignees of temporary usufruct and bare ownership, but nevertheless recognizes that the usufruct is not intended to revert to the assignor, which circumstance is the main reason for considering the sales proceeds as the anticipated receipt of future income. These two analyses, should they continue, would lead to consequences that we feel should be denounced. Not only does the transferor not optimise his tax situation, but would then also be taxable:

– at a much higher rate, in terms of the sale of the usufruct, than he had assigned full ownership of the property[12];

– and on the basis of a partially fictitious income, higher than the profit made in the event of the transfer of full ownership of the property. This is because sale proceeds of the temporary usufruct would only be minus any charges related to the sale, without the fraction of the purchase price of the property in question being taken into account, as the relevant gain on the sale of the bare ownership is only reduced by the corresponding fraction of the purchase price.

Similar or additional distortions also occur in other legitimate situations such as the contribution of dismembered property.

It is true that this system is a deterrent, but the targets have been incorrectly identified, and Parliament and the tax authorities should recognise that they have created groundless obstacles to the achievement of economically sound operations. Parties would therefore be best advised to handle the creation of a usufruct with great care, in order to prevent it from leading to serious consequences which would be hard to remedy.

"This rigour seems somewhat overbearing since the operation generally benefits the acquirer and not the transferor of the usufruct."

1. Subject to the disposal of a first temporary usufruct, see paragraph below.
2. This goes back in particular to a decision by the State Council, dated 28 October 1966, No. 68280.
3. See State Council, 30 December 2009, No. 307165.
4. See, CAA Paris (administrative appeal court) 3 February 2000, No. 96-339.
5. See State Council, 8 November 1967, No. 69696.
6. Quoted by the fiscal authorities, BOI-RP-PM-PVBMI-20-10-20-60.
7. Ibid.
8. If the dismemberment occurred after 3 July 2001, the previous rules are more favourable.
9. Cf. note 1.
10. A similar problem existed with regard to the wealth tax cap or tax shield.
11. Minister's Response Lambert, National Assembly, 2 July 2013, No. 15540.
12. Marginal rate of 64.5% if we take into account the windfall contribution on high incomes, compared to a marginal tax rate of 38.5% after deductions for the holding period.

Regulatory issues involving the dismemberment of financial securities

While the system for the sale of financial securities is not, on the face of it, impacted by an offer of dismembered securities, providers and intermediaries involved in this business should nevertheless ensure that they are providing the investor with clear, accurate information, which is not misleading, and that they have the required approvals.

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Investors looking for dynamic asset and/or estate management may find it advantageous to dismember the financial securities they hold, or acquire dismembered securities. In the first case, they keep the usufruct and pass the bare ownership to their heirs. In the second, they acquire only bare ownership, offering another investor who wishes to enjoy the stable and regular income associated with these securities the opportunity to acquire the usufruct temporarily, under a time-limited dismemberment convention.

In the case of the acquisition of bare owned securities, the investor can – if certain conditions are met – temporarily limit his wealth tax and income tax bases, while ensuring, at the end of the dismemberment period, the availability of the "regrouped" financial securities, with their previous liquidity and financial rights.

From the perspective of the service provider or the intermediary who is working in the interests of the investors, or even anticipating them, caution is called for, given the potentially regulated services rendered in connection with the offer of dismembered securities. In particular, depending on whether the service provider or the broker is associated with the issuance of securities, the services potentially rendered are subject to approval and include banking and financial solicitation. With regard to the investment services potentially rendered, which sometimes depend on the nature of the securities or the terms of acquisition by the investor, we might cite underwriting, investment, order reception and transmission for third parties, order execution, even proprietary trading and investment advice, if the financial security was suggested by the service provider or intermediary.

"It seems dismemberment impacts the duty of counsel owed to the investor."

Rather than go into all of the details of situations in which these investment services are provided, we can focus on order execution services. This service can be said to be provided when the service provider or intermediary hosts a secondary market on the dismembered security in order to add liquidity to the client's investment, and could therefore be required to undertake to the investor to find a buyer if he wants to sell his dismembered shares. He may also undertake to a prospective client to find a vendor of dismembered securities. Moreover, even if the Hamon Act of 17 March 2014 excluded financial securities from the definition of various assets, it is questionable whether the organised offering of usufruct arising from the dismemberment should be seen as the sale of "various assets", subject to approval by the Financial Markets Authority (AMF). It seems to us that a number of legal arguments coincide in favour of considering that the dismemberment of financial securities does not affect the nature of the securities offered. On the other hand, it seems that dismemberment impacts the duty of counsel owed to the investor. Furthermore, when the original securities are "savings" according to the AMF definition of this term, the provider or broker must ensure that it fully informs investors of the risks associated with such investments, especially their lower liquidity, given the fixed period of dismemberment. The authorised service provider or broker, last of all, must ensure that they comply with requirements in terms of remuneration, in particular with respect to the transparency owed to the investor, in accordance with the laws transposing MiFID and soon MiFID 2.

The need to identify the person legally liable for land tax in the case of dismembered ownership

Nature abhors a vacuum ... and so do the tax authorities. That is why in all circumstances and except when an exemption applies, a building, whether developed or undeveloped, is liable for land tax. While there is no doubt about this, it is not always clear who, of the tenant, the leaseholder, the lessee, the beneficial owner, etc., is statutorily liable.

Article 1400 of the French General Tax Code expressly provides that land tax is payable by the owner of the property on 1 January of the given tax year. Therefore, in the case of property leasing or ordinary leases, the owner of the premises is the entity in whose name the land tax is assessed, irrespective of the wording of the contract. Jurisprudence and administrative doctrine agree on the strict application of Article1400, thereby refusing to levy tax on other entities who have contractually undertaken to pay the land tax. Nevertheless, these provisions remain in force between the parties.

In some cases of dismembered property rights, the law has already settled the question of the identity of the person legally liable for property taxes. This is the case, for instance, of beneficial owners, leaseholders or the lessee to a rehabilitation or construction lease, which are specifically referred to in Article 1400, provided, it must be noted, that the dismemberment deeds have been published in the Mortgage Office by the notary who prepared them.

Given that Article 1400 fails to cover all the possible situations, jurisprudence and administrative doctrine have had to determine the issue of who the debtor is in specific, yet entirely conventional contexts.

For instance, when the tenant undertakes construction or improvements on the rented property which are then entered into its accounts as fixed assets, the legal debtor of the tax depends on the wording of the lease.

Assuming that it is stipulated that the constructions revert free of charge to the lessor at the end of the contract, the lessor must be solely liable for tax on both the land and the buildings.

Conversely, if it is stipulated that said constructions/improvements become the property of the owner for consideration, or must be removed at end of the lease, the land tax is shared between the lessor, for the ground and the initial construction, and the lessee for the constructions it has undertaken itself.

"Jurisprudence and administrative doctrine have had to determine the issue of who the debtor is in specific contexts."

Moreover, and in the case of the acquisition within a condominium of a plot giving the right to private enjoyment of an area of land, to the ownership of the buildings built on it and a proportionate share of the common areas, it has been held that the purchaser, as he is not the owner of the land, is not liable to pay land taxes thereon. However, the landowner and the purchasers may, even before the completion of construction, contractually agree that the taxes on the land will be paid by the purchasers, in accordance with a formula they agree on.

When the person legally liable for land tax is also in charge of various reporting obligations (surface area or cost of taxable land), the question of identity should again not be overlooked. Moreover, it is only by being perfectly familiar with a transaction or a contract that you can decide on whether or not it is opportune to draw up specific clauses. Finally, note that these observations can be transposed to the tax on premises located in the Ile-de-France region.

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Property investment in bare ownership: what investment profile?

The acquisition of the bare ownership of a building is an attractive proposition for individual investors wishing to develop their real estate portfolio without increasing their short-term tax burden, whether income tax or the French ISF wealth tax. The desirability of such an investment, however, must be analysed in light of the individual circumstances of each investor, including his place of tax residence.

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Dismemberment of ownership was long confined to the management of property assets within the family, but in recent years has become an increasingly popular form of real estate investment, particularly due to changes in individual taxation. This kind of investment works as follows: an individual acquires the bare ownership of a property at a discount frequently between 40% and 50% of the market value of the building, while the usufruct is entrusted to an institutional lessor for a period of between 15 and 20 years. The investor does not receive any rent during the period of temporary usufruct but at the end of the period has full ownership of the property at no additional cost. The tax benefit of bare ownership investment comes from the absence of taxation during the period of dismemberment.

"The tax benefit of bare ownership investment comes from the absence of taxation during the period of dismemberment."

First, the bare owner investor does not receive any rental income which would be taxable as revenue. Correspondingly, he cannot deduct any expenses related to this investment, unless the usufruct is assigned for social housing. On this last point, Parliament has sought to develop the supply of social housing while at the same time limiting the financial commitments of housing agencies, and so has established a preferential system allowing investors to deduct the interest relating to the acquisition of the bare ownership from their land revenue (Article 31, I-section 1-d of the General Tax Code (CGI)).

Accordingly, when bare ownership is acquired by means of a loan, this system allows an individual with property investments elsewhere which generate income to reduce their taxable income.

Second, the value of the bare ownership does not fall into the remit of the wealth tax, or ISF, (Article 885 G of the CGI), except in certain circumstances if the investor acquires the bare ownership from an owner who retains the usufruct, which will not generally be the case for this kind of investment. However, ever since ISF 2013, any debt incurred to acquire the bare ownership is no longer deductible from the tax base, reducing a tax benefit which is nevertheless far from negligible.

Finally, the usufructuary is only liable for land tax (Article 1400 II of the CGI).

The tax benefit of the investment is also not limited to the period of temporary usufruct. If the building of which the investor has become the full owner is sold, the investor benefits from an advantageous method of calculating the taxable gain. First, the tax administration will use as the purchase price of the property the market value of full ownership of the property at the date of acquisition of the bare ownership. This means that the gain from the initial discount enjoyed by the investor on the purchase price of the bare ownership is not taxed. Secondly, the allowance for the holding period on real estate capital gains is calculated from the acquisition of the bare ownership.

Non-resident investors can also envisage the acquisition of the bare ownership of a property located in France.

Such investors will usually be subject in

France to the same tax rules as a resident, as most tax treaties grant France the right to tax the income, capital gains and wealth resulting from the holding of property located in France.
For a non-resident, the crucial question is whether the tax system in his country of residence will potentially eliminate or reduce the advantage offered by the French tax rules. The analysis will focus on income tax because few states have maintained a wealth tax. The analysis will generally involve both the domestic law of the country in question and, where applicable, the tax treaty between France and the foreign country. Under local law, it is possible that individuals who are residents of the foreign State in question have a territoriality regime on income they receive. In this case, the income and capital gains earned in another State (in this case France) would not be taxable in the foreign State (subject, where applicable, to the non-repatriation of said monies). In this case, the tax advantage granted by France would be fully operative. If the local law does not preclude levying tax on real estate income generated in France, it will also be necessary to consider the provisions of the applicable tax treaty and in particular the double taxation clause. Essentially, there are two possible scenarios:

– either the convention confers taxation rights to France alone and will make any new taxation by the State of residence abroad impossible (through an exemption clause or a tax credit equal to the foreign taxes);

– or double taxation is eliminated by the State of residence granting a tax credit equal to the tax paid in France. In this case, and according to local tax rules, the tax advantage granted by France may be reduced or cancelled out by the foreign tax.

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In particular, it is doubtful that foreign tax law will apply the same tolerance as the French tax administration, which uses as the purchase price of the property the market value of full ownership of the property at the date of acquisition of the bare ownership.
It is therefore essential that a local tax lawyer become involved to determine how income and capital gains relating to a property, ownership of which, on the one hand, is dismembered and which, on the other hand, is located in France.
In general, the tax treatment of bare ownership investments remains, at present, undeniably attractive. Investors need however to remember that this is a long term investment, which is not immediately productive of income and is not intended to quickly generate a capital gain, and for which taxation may be modified by changes in the legislation or the tax residence of the investor. Investment in bare ownership deserves careful consideration and investors should analyse the hypothesis in the light of possible changes in their personal, financial and geographical circumstances.

Clauses incompatible with construction leases: the contract qualification now prevails over the clause

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Construction leases give lessees a special right in rem over real estate: unhindered mortgages and disposals, the freedom to grant certain easements, distrainability and the ownership of new buildings on the property are the direct consequence of this real right. Correspondingly, it is the lessee's responsibility to keep the buildings in a good state of repair and to pay for expenses and maintenance work. Up until now, clauses which were contrary to these essential characteristics led to the requalification of construction leases as ordinary leases or, if applicable, statutory business leases.

On these various points, nothing seemed to differentiate a construction lease from a perpetual lease[1], which is why the solutions put forward for perpetual leases have always been thought of as transposable, mutatis mutandis, to building leases.

Any stipulation which organises (joint and several liability, for example), limits2 or prohibits the assignment of a perpetual lease leads to its disqualification3. The same was true if the lessor planned to replace the lessee and carry out repairs[4].

Finally, the Court of Cassation found that the stipulation of an automatic termination clause in a perpetual lease for non-payment of rent meant that the perpetual leaseholder's enjoyment became insecure in a manner incompatible with the constitution of a real right5 and resulted in the disqualification of the contract.

"The Court of Cassation (...) has judged that qualification of the contract prevails over any conflicting clauses and therefore neutralises them accordingly, breaking with previous case law."

A recent ruling has overturned this by stating that since a construction lease gives the lessee a real property right, any clause which subjects an assignment to the approval of the lessor is a restriction on the lessee's right to dispose and it is therefore null and void (Cass. 3e civ. 24 September 2014 no. 13-22 357 [no. 1082 FS-PB], Carrefour c/ SCI Synergie HM).

The Court of Cassation has therefore adopted a broad interpretation of the freedom of assignment laid down by Article L. 251-3 of the CCH, which is public policy (art. L. 251-8), but more than that, now means that the qualification of the contract prevails over incompatible clauses and neutralises them accordingly, breaking with the previous case-law cited above.

This shift raises several questions:

– would the sanctioning of the clause which improperly limits the freedom of assignment now differ depending on whether it is inserted into a construction lease (nullity of the clause) or a perpetual lease (disqualification of the lease), given that in the latter case, free assignment is not public policy? Or is it null and void in both cases? The fact that such contractual situations are so similar would seem to argue in favour of a positive answer to this last question;

– could the sanctioning of the clause which improperly limits the freedom of assignment also apply to the terms of a construction lease which are not public policy but which are considered essential because they constitute a real property right (free rental, free mortgage, obligation to maintain and repair, etc.)?

1. Except if the purpose of contractual constructions is stipulated, considered valid for construction leases (Cass Civ. 3e, 7 April 2004).
2. A lease which is not freely transferable cannot be perpetual, given the essential nature of unhindered assignment in such a contract – V. Cass. 3e civ. 10-4-1991: RJDA 6/91 no. 471 and Cass. civ. 3e, 29 April 2009 no. 08-10.944 jurisdata 2009-047969.
3. See supra note 2.
4. Cass. 3e civ. 7 October 1992: RJDA 12/92 no. 1113.
5. 3e civ. 14 November 2002, no. 1655: RJDA 2/03 no. 124.

VAT applicable to dismembered real property rights: the complexities of bare ownership

The French Law of 9 March 2010 reforming the VAT system overhauls the rules with regard to real property. The reform changed their classification from the provision of services and they now follow the same rules as for the buildings to which they attach. This change could give rise to a complex system, especially as regards bare ownership.

Article 257 of the French General Tax Code (*Code général des impôts* - CGI) likens real property rights (with the exception of rentals under leases that grant usufruct) to tangible assets that are covered by the rules governing the property to which they relate.
Hence, this provision covers dismembered real property rights (bare ownership, usufruct, etc.), the construction right attaching to land (right to raise the height, easement, etc.) or even a real right simply conferring the benefit of special enjoyment of the asset, as distinct from a usage or residential right. Accordingly, under Article 257, the constitution or transfer of these rights follows the same rules as for the building to which they attach: VAT is applicable by right if the building was completed within the previous five years; buildings completed more than five years ago are exempt, but the seller may elect for the payment of VAT.
The disposal, by a developer to an investor, of the usufruct or bare ownership of a new building is similar to the disposal of the building to which the said rights relate.
Therefore, VAT is payable on the full sale price for a disposal relating to a building completed within the past five years. The purchaser is also liable for the 0.715% land recordation tax.
The usufructuary can reclaim the VAT on the acquisition under common law, i.e. if the building is used for operations that are subject to VAT (rentals subject to VAT).
On the other hand, an individual who acquires the bare ownership of the building may not reclaim the VAT on it himself, since, according to the tax authority, bare ownership is not used for economic activities that are subject to VAT.
However, the tax authority allows the bare owner to transfer this tax to the usufructuary, by means of a declaration, so that the latter can reclaim it, provided that the building is capitalised by the usufructuary and the bare owner, and that the parties are in conditions analogous to those in Article 207-III-3 of Appendix II to the French General Tax Code.
Reference to this provision is problematic, since it assumes that not only the usufructuary uses the building for an economic activity, but also the bare owner, which eliminates the possibility of disposal when the bare owner is not a VAT payer. This is also difficult to reconcile with the previous statement by the tax authority that bare owners do not assign their real right to an economic activity. Therefore, it is important for the tax authorities to clarify the assumptions according to which VAT is transferrable by the bare owner to the usufructuary in order to eliminate all uncertainty.

"Therefore, it is important for the tax authorities to clarify the assumptions according to which VAT is transferrable by the bare owner to the usufructuary in order to eliminate all uncertainty."

Moreover, the parties must draw up a contract to agree the terms and conditions by which the usufructuary will repay the VAT reclaimed on his behalf to the bare owner, as well as the terms and conditions for the repayment of the VAT by the bare owner to the usufructuary in the event of reassessments.
Lastly, what happens if the bare ownership is sold within five years after building completion? In other words, can the bare owner sell on the bare ownership as part of an economic activity? The answer is surely in the negative if the bare owner is a private individual. But this is not necessarily the case if the bare owner is a VAT payer, since as we saw above, the tax authority considers that it is not in itself an investment in the bare ownership of a building …

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Taxation of individuals: will the government's plan to boost the housing market result in large swathes of building land coming on the market in a short space of time?

Deputies in the French parliament recognised the fact that the narrow definition of building land would restrict the possibilities of taking advantage of incentive measures introduced, but the amendment voted by the house subordinates extending the benefit to very strict conditions.

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Based on the position that exempting building land from capital gains tax after it has been held for 30 years is likely to encourage speculative retention of land, this summer the French Prime Minister announced the government's plan boost the housing market . The measures in the package – some of which have already come into force – are included in the draft finance bill for 2015 and will align the tax system applicable to capital gains on building land with the provisions applicable to completed buildings which, through the tax deductions available, are exempt from income tax after a holding period of 22 years and from social levies after a holding period of 30 years.

In order to quickly encourage the sale of large amounts of building land, the plan also provides for:

– an exceptional 30% tax break applicable to the sale of building land for which there is a promise of sale with a firm date agreed between 1 September 2014 and 31 December 2015, provided that the transferee is not related to the transferor and that the sale takes place at the latest by 31 December of the second year after the date of the promise of sale;

– a €100,000 deduction for inter vivos gifts of building land, enacted in an official deed signed between 1 January 2015 and 31 December 2015, if the recipient undertakes to build new housing within a period of four years from the date of the official deed.

For the purposes of applying these measures, building land shall be defined in accordance with Article 257 I.2.1 of the French General Tax Code, namely building land under the meaning of the VAT code on property transactions. Building land may only consist of land that has no buildings whatsoever on it, unless this building is in a condition such as it can be used, as is, for any use whatsoever. For the purposes of VAT, land on which there is a building does not qualify as building land, even if this building is intended for demolition by the purchaser.

"For the purposes of VAT, land on which there is a building does not qualify as building land, even if this building is intended for demolition by the purchaser."

As the draft text submitted by the government stands, many sales of land intended for new builds would not have been considered to meet the definition of building land, a situation that not only deprives the seller of the benefit of the exceptional 30% tax reduction on the capital gains or the tax break applicable to donations, but furthermore brings these sales within the scope of application of the high tax on capital gains from real estate.

Aware of the difficulty, Deputies in the French parliament passed an amendment to extend the 30% tax break to sales of buildings located in communities in what are known as continuous urban development zones with more than 50,000 inhabitants. However, this reduction is conditional upon the transferee undertaking to demolish the existing constructions with a view to building and completing housing units within a period of four years from the date of acquisition. The floor area of the housing units must be equal to 90% of the area authorised by the Floor Area Ratio (COS). In the event of failure to fulfil the undertaking, the transferee is liable for a fine equal to 10% of the sale price.

This amendment slightly improves and extends the time frame of the existing system, which already provided for – under the same stringent conditions – the application of an exceptional 25% reduction in the capital gains tax on completed buildings up to 31 December 2016, for which a promise of sale is signed prior to 31 December 2014. But will it be enough to produce the type of shockwave the government is seeking?

The Decree implementing the "Pinel" Act of 3 November 2014

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The Implementing Decree of 3 November 2014 raises many questions. When the termination provided for in Article L. 145-9[1] is given by recorded delivery letter with acknowledgment of receipt, the termination date is the date of first presentation of the letter (Art. R. 145-1-1). Despite the choice now available between this form of termination and a notice served by a bailiff of process server, the latter remains preferable. Examples in case law relating to residential leases illustrate many instances of litigation arising from notification by recorded delivery letter. Article R 145-35 stipulates that the cost of "major repairs" mentioned in Article 606 of the French Civil Code, as well as where applicable the fees related to the completion of such repairs, may not be charged to the tenant.

Recent case law diverged from a literal reading of this article with respect to contract stipulations. Does the "Pinel" decree cover only the limitative list of "major repairs" in Article 606, or those arising from case law? Will case law reasoning on the Implementing Decree be the same, i.e. extensive, as it has been up to now when it was the contract that referred to the aforementioned Article 606?

Nor can expenses for remedial works to a building that has fallen into decay or to upgrade the rental property or the building in which the property is located to ensure compliance with regulations be charged to the tenant, when such works "relate" to the major repairs mentioned in Article 606 of the French Civil Code. On the other hand, however, if the works required are not covered by said article, they may be charged to the tenant by agreement. It appears that the word "covered" should be understood to mean "affecting the elements referred to". The terminology is unclear and even unsuitable. Depending on the work required, upgrade works to bring disability access up to standard will either not be chargeable or only partially chargeable.

Reimbursement of property management fees paid by the lessor for the premises or the building leased is also prohibited. Only fees for the administration of the asset are allowed, i.e. those relating to the accounting, financial and administrative management of the rent. Fees for "technical management", condominium associations, owners organizations (*association syndicale libre* – ASL) and urban landowners organizations (*association foncière urbaine libre* – AFUL) remain reimbursable (except fees for engagements related to carrying out the major repairs referred to in the abovementioned Article 606 of the French Civil Code).

Taxes, costs or charges relative to vacant premises in the development where the rented premises are located can no longer be charged to the tenant by the lessor.

The breakdown of charges, duties and taxes and the cost of works between tenants may be covered by weighted charges that are notified to them.

According to the last paragraph of Article R. 145-35: "Expenses incurred in respect of embellishment works where the amount exceeds the cost of replacement with identical features are not included in the expenses referred to in section 1 and 2." A literal reading would lead one to reason that, curiously, when the amount of the embellishment works[2] is greater than the cost of replacement with identical features, the cost could be charged to the tenant, whereas, when the amount is less than or equal to this cost, it could not be passed on!

"A summary statement of charges must be sent out by 30 September of the following year, and for condominium charges, within three months."

A summary statement of charges must be sent out by 30 September of the following year, and for condominium charges, within three months.

The effective scope of the Decree thus remains highly dependent on doctrinal interpretation, initially, and then on case law.

1. *All articles cited (L and R) are articles in the French Commercial Code*
2. *A concept that is in itself difficult to define*

Illegal clauses in statutory commercial leases are now deemed unwritten

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Until now, clauses contrary to public order regulations in commercial leases were null and void (French Commercial Code, Articles L. 145-15 and L. 145-16, 1). Hence revocation actions brought against these clauses were subject to a two-year statute bar (French Commercial Code, Article L. 145-60). The French Court of Cassation thus confirmed the tardy nature of the action of a contractor applying for the requalification of a lease-management under a statutory commercial lease, because it is subject to the two-year time bar established in Article L. 145-60, which runs from the date on which the contract was concluded (Cass. Com, 11 June 2013, no. 12-16 103, F-P+B). The argument was the same for an application to change the status of a professional lease to a commercial lease (Cass. Civ. 3, 23 Nov. 2011, no. 10-24 163, Bull. civ. III, no. 199), and for an application to change the status of an emphyteutic lease to a commercial lease, subject to the statutory provisions (CA Limoges, 10 March 2011: AJDI 2011, p. 694). To prevent the situation where actions cannot be brought against illegal clauses after two years, the Pinel Act amends the sanction relating to these clauses. They are now deemed unwritten (French Commercial Code, Article. 145-15 amended; Law 2014-626 Art. 6, I and II-1). Since they do not exist, they cannot be time barred.

Remember that articles L. 145-15 and L. 145-16, paragraph 1 of the French Commercial Code cover clauses that prevent the right to renewal of a lease (French Commercial Code Article L. 145-8 s.), as well as clauses that run contrary to the rules for rent reviews (French Commercial Code Article L. 145-37 s.), the addition of related and or complementary activities (French Commercial Code Article L. 145-47 s.), implementation of cancellation clauses (French Commercial Code Article L. 145-41) and especially the transfer of a lease to the acquirer of the lessee's goodwill or enterprise.

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