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REAL ESTATE NEWSLETTER

Dossier on
Grenelle II and the Greater Paris Area

News

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Editorial

The "Grenelle II" and "Greater Paris Area" (*le Grand Paris*) draft bills contain, logically, a great many rules in terms of urban development and planning, and even in the field of property law for the former. However we were not expecting the draft bill on the Greater Paris Area to adopt, in such a precipitated manner, at the initiative of the *Sénat* (the upper house), a new tax impacting the real estate sector, even if it is merely recycling the tax mechanism contemplated in the Grenelle II draft… which had expressly excluded the Ile-de-France Region. We already underlined (see our Newsletter issue of 30 November 2009) that the real estate sector was under a great deal of tax pressure, on the occasion of the reform of business tax which introduced land corporations into the scope of the new Territorial Economic Contribution. In the Ile-de-France Region, this sector is subject to up to 19 different types of tax levies on commercial property. This did not however dishearten the legislator, who of course runs no risk of buildings being delocalized…

No-one can question the need to finance future transport infrastructures in the Ile-de-France Region or the fact that the real estate sector stands to benefit from an improved transport network (although it would seem doubtful for real estate value to increase in a zone such as La Défense merely due to a new interconnection). What is surprising is the method of adoption of a tax mechanism which, as you will see here, raises a great many questions and brings to light serious technical inconsistencies (both within the framework of the Greater Paris Area and of Grenelle II). Indeed, contrarily to what took place in other countries such as Great Britain, the creation of the Greater Paris Area tax was not the subject of any discussion with the sector's professionals. However, as is explained below by Alain Béchade, who heads the working group of ORIE (regional monitoring group for commercial property) focusing on the taxation of commercial property, this monitoring group including public and private operators has been considering this question for eighteen months and swiftly concluded that the presumptive taxation of capital gains would prove to be a solution less useful than might appear.

Let's hope that the next few months will provide an opportunity to give additional thought to the matter and for considering more rational alternatives, such as increasing transfer tax (ORIE'S proposal of 1%) or a tax on rent. Regarding this issue, we would point out that the surveys used by the British Treasury when adopting a tax mechanism with a similar objective (implemented for instance within the framework of the financing process of the Crossrail line in London) show that, ultimately, the cost of a rental tax is borne essentially by landlords and not by tenants.

This issue also addresses certain legal rules of significance stemming from the "Grenelle II" roundtable (environmental schedule within the framework of certain leases, increasing construction possibilities for buildings which satisfy certain criteria related to energy performance) as well as recent developments in legislation and case-law, particularly intensive during this period. ■

Jean-Yves Charriau, Partner.

DOSSIER ON: **Grenelle II and the Greater Paris Area**

Financing the Greater Paris Area: the project for the creation of presumptive taxation on capital gains

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Article 10 of the draft bill on the Greater Paris Area, adopted definitively by the *Sénat* on 27 May 2010, introduced a new article 1635 ter A into the Tax Code, which provides for the creation of a presumptive tax on capital gains realized on the sales of buildings within the vicinity of the geographical locations of certain public transport infrastructures in the Ile-de-France Region: the Greater Paris Area tax.

This statute transposes, for the Ile-de-France Region, the presumptive taxation contemplated by the Grenelle II draft bill. The aim of this statute is to finance the public establishment known as *Société du Grand Paris* via a fraction of the proceeds on land value enhancement resulting from the creation of transport infrastructures within the framework of the Greater Paris Area. The draft bill provides that, for the Ile-de-France Region's financing of similar projects, the latter will be able to institute an identical tax, the proceeds of which will be allocated to the *Syndicat des transports d'Ile-de-France* (the Ile-de-France transport board): the STIF tax.

If the budgetary objective of the statute is understandable, the contemplated mechanism raises numerous issues and technical inconsistencies.

- The assets concerned are buildings (and related rights) appearing within a perimeter decided on by the State, which may not extend beyond an 800 metre[1] distance from the entrance to a passenger station contemplated by a Greater Paris Area project, a priori such as this will result from a declaration of public utility (DUP). The STIF tax would apply on the same terms for projects of the Ile-de-France Region. Both taxes would only be accrued where there is an interconnection between a Greater Paris Area project and a STIF project.

"In extreme cases, the tax will represent a 5% surcharge on top of the price of assignment."

The Greater Paris Area tax also applies to assignments of the securities of predominantly real estate holding companies within the meaning of article 726-1 of the Tax Code representative of buildings which appear within its area of application. Real estate predominance defined by article 726-1 of the Tax Code for transfer tax differs from that addressed by the levy of article 244 bis A of the Tax Code (see below) which defines for natural persons, the scope of application of the tax. Thus, real estate predominance under article 726 does not exclude, contrarily to article 244 bis A, those buildings assigned by tax payers to their own professional activity.

One could consider that the Greater Paris Area tax will concern companies made up essentially of real estate assets, whether or not situated within the perimeter of the "Greater Paris Area" or of the "STIF", in proportion to the value of (or rather to the capital gains on) the assets located in the area of application of the tax. But how is one to go about calculating the base of this tax where the capital gains realized on an assignment of securities may not correspond to the capital gain on the underlying asset ? And if the company holds more than one building, how is one to go about determining the capital gains pertaining to each of these buildings? Finally, how is one to go about apportioning the proceeds of the taxes if the company assigned holds both "Greater Paris Area" assets and "STIF" assets.

- The parties liable to the Greater Paris Area tax include resident and non-resident natural persons which are subject to income tax, but apparently only if they are subject to the levy under article 244 bis A (regime of real estate capital gains of non-residents) which applies exclusively "subject to tax treaties". In addition, article 244 bis A does not apply to persons which hold a building and operate there a professional activity.

1. There is a blatant inconsistency between the statute restricting this perimeter to 800 metres and the article determining the rate of the tax, which provides for a reduced rate (7.5%) for zones located between 800 and 1,200 metres.

The reference to article 244 bis A created two case scenarios for differential treatment between residents and non-residents. On the one hand, a non-resident holding a French company owning a building assigned to the exercise of a professional activity will not in principle be subject to the tax, whereas a resident, in the same situation will be. On the other hand, a non-resident eluding the levy under article 244 bis A by operation of a tax treaty (e.g. a Luxembourg resident in the event of assignment of a company) does not seem able to be subject to such tax.

The Greater Paris Area tax applies to "companies or groups" subject to corporate income tax or to income tax in France. The concept of a person "subject to corporate income tax" is not clearly defined by the Tax Code, but it would appear logical, on account of the objectives of the statute, for this tax to cover entities benefiting from partial, conditional or temporary exemptions from corporate income tax. The analysis is less obvious for organisations which, if they come within the scope of application of corporate income tax, benefit from a complete and definitive exemption (SPPICAV) or for transparent companies. This tax also covers non-resident entities subject to corporate income tax in France, in particular in respect of the holding of buildings. The statute not making reference to article 244 bis A, tax treaties should not enable these entities to elude this.

- The chargeable event of the tax is each assignment for valuable consideration taking place as from the publication/display of the DUP. Besides certain technical exemptions, are exempted: the first sale off plans (VEFA) and the first sale after the completion of developed buildings (unless they were the subject of an initial sale off plans). This exception would seem favourable to operations for real estate development and the subsequent sale thereof. It would be unusual for the first sale to be exempted whatever the date of construction. It would be logical to exempt the first assignment of new buildings within the meaning of VAT (completed for less than five years).

The exemption for sales off plans could raise an issue of unconstitutionality, on the grounds of the principle of equal tax treatment, if this was considered as leading to block exemptions (see the precedent established in respect of the carbon tax).

.Finally, assignments of assets purchased subsequently to the commissioning of the infrastructural equipment concerned will be exempted. Thus, as from such commissioning, only the initial assignment will be taxed, the increase in value in connection with the infrastructure being deemed to have then been exhausted. However, nothing is provided for in the event of assignment of a building to a company, followed by the assignment of the acquiring company, or in the event of assignment of a company holding a building which should be followed by the assignment of said building by the company, which could entail double taxation.

- The base of the tax is equal to 80% of the "capital gain" defined with reference to the regime of capital gains of individuals (article 150 VA and VB), i.e. the difference between (i) the price of assignment and (ii) the acquisition price, marked-up by transfer tax, by a certain number of expenses and expenditures for works. This cost price should be discounted to present value according to the most recently published INSEE consumer price index excluding tobacco (IPC). Reference to the index on the cost of construction (ICC) would make much more sense. For tax payers coming under the regime of Industrial and Commercial Profits (BIC) or of corporate income tax, the base of the tax will thus be inferior to book capital gains (which includes amortizations/depreciations).

The rate of the Greater Paris Area tax and of the STIF tax is 15% (reduced to 7.5% for zones situated between 800 and 1,200 metres) with a cap of 5% on the price of assignment (including if both taxes are due). In extreme cases, the tax will thus represent a surcharge of 5% on top of the price of assignment !

It should be noted that the base of the tax would be reduced by the amount of capital gains taxed in application of articles 150U to 150 VH. Thus for natural persons (only), the base of the tax would be reduced by the capital gains taxed under income tax. Individuals exempted from income tax on the assignment of their main residence would thus be fully subject to the tax and, in the event of taper relief (10% per annum beyond the fifth year), the tax will be due accordingly. However there is nothing limiting the double taxation of tax payers coming under the Industrial and Commercial Profits regime or under the Corporate Income Tax regime…

The tax will enter into effect for fifteen years as from each DUP or declaration of project.■

Tax reductions for rental investments or main residence: digest of "green" standards

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What tax mechanisms take the environment into account? What impact for the new "low-consumption Building" requirements? What are the differences between new and refurbished accommodation? You will find hereinafter an inventory of the recent provisions made for such matters.

Ecology now forming a new field to be reckoned with, real estate taxation could not sidestep for very long the green wave. Environmental incentives have thus progressively made their way into the various tax reductions applicable to the sector.

Since the first reduction on income tax in favour of tax payers incurring expenditure for energy savings (insulation, renewable energy production systems), there are today a great many technical standards which subordinate the prevailing of a mechanism or of the rate thereof.

In 2010 there was serious consideration as to the cancellation of the "Scellier" tax reduction related to new rental investments where the accommodation purchased should not satisfy the latest BBC2 ecological standards (low-consumption Buildings). An identical measure had been envisaged with regard to investments made in view of a non-professional furnished rental (the "Bouvard" mechanism). On account of the difficulties arising out of such requirements' too abrupt entry into force with regard to real estate developments underway and to standard development time-limits, the legislator finally gave up, so that, from a thermal standpoint, only compliance with the "RT 2005" standards remains compulsory. However, the latter provided for a progressive decrease of the rate of reduction applicable to the "Scellier" mechanism combined with a gross-up of this same rate in the event of complying with the BBC standard (finance bill for 2010, article 82-1-3°).

On the other hand, it should be noted that neither the BBC standard nor the RT thermal standards are required within the framework of the "Scellier refurbishment" or "Bouvard" mechanisms. On the other hand, changes made to accommodation must contribute to the latter satisfying a minimum number of performance criteria in terms of insulation, which leads tax payers to provide a "technical" schedule of condition for the premises prior to the works, and then subsequently to the works.

This being said, if investors concerned by a "Scellier" refurbishment want to benefit from the increased rate to counterbalance the progressive decrease resulting from the finance bill for 2010, the works will have to lead to the accommodation being in line with the BBC standards. However, on account of the very specific characteristics of a development qualifying as a low-consumption Building (orientation of façades, building techniques for the main structure…) and, consequently, of the scale of the works that this would imply on an existing building, this requirement makes it virtually impossible for refurbished accommodation to be eligible under the mechanism for the gross-up of tax reduction rates.

The same applies for that matter to works which consist of converting into accommodation, premises which were assigned to another use, and for which the statutes and the administrative guidelines contemplate the same terms as for new accommodation. From the standpoint of individuals and their main residence, the BBC standard is now present in tax reduction mechanisms related to new real estate, through the gross-up of the credit rate pertaining to loan interest, and the increase of the cap on tax credit in the case scenario of first-time buyers. In light of the diversity of situations and of the multiplication of standards, it appeared appropriate to us to draw up an executive summary of the tax measures impacted (see table above). We note that when tax loopholes sustain various restrictions, the "greener" ones would seem to be spared to a greater extent, albeit at the cost of a reinforcement of the thermal performance criteria. ■

"Neither the BBC standard nor the RT thermal standards are required within the framework of the "Scellier refurbishment" or "Bouvard" mechanisms"

Mechanisms	Rate of reduction Or tax credit	Technical standards/energy performance		
		New accommodation/Sale off Plans	Conversion	Refurbishment
"Scellier" tax reduction (real estate rental investment)	Acquisition in - 2010: 25% - 2011: 15% - 2012: 10%	Compliance with the regulations under RT 2005[1] Windows with the thermal characteristics ≤ 2.9 W/m²K		No compliance with the thermal regulations (windows with characteristics ≤ 2.9 W/m²K)
Gross-up of the "Scellier" tax reduction	Acquisition in - 2010: 25% - 2011: 25% - 2012: 20%	Compliance with the BBC standard[2]		
"Bouvard" tax reduction (non-professional furnished rental investment)	Acquisition in - 2009 and 2010: 25% - 2011 and 2012: 20%	Compliance with the regulations under RT 2005		Compliance with a global performance if floor area > 1,000 sqm Compliance with requirements related to materials if floor area ≤ 1,000 sqm
Tax credit in favour of sustainable development (main residence)	Thermodynamic hot water boiler: 40% Other heat pumps: 25% Glass shell insulation: 15% Opaque shell insulation: 25%			Tax credit corresponding to the expenditure used for thermal upgrading
Grenelle II Project Extension to DOM				
Tax credit in respect of interest on loans taken out for the acquisition of main residence (rate of the first annual instalment and that of the next four years)	Acquisition in - 2010: 30% and 15% - 2011: 25% and 10% - 2012: 15% and 5%	Compliance with the regulations under RT 2005		
Gross-up of the tax credit	Acquisition in 2010: 40% per year during 7 years	Compliance with the BBC or BEPOS[3] (positive energy Buildings) labels		
Tax credit in favour of first-time buyers	The tax credit is equal to the discounted sum of discrepancies between monthly payments due in respect of the reimbursable advance without interest and the monthly payments of a loan granted on standard rate terms. The cap on the advance is 32,500 euros.	Compliance with the regulations under RT 2005 for the planning permissions filed after entry into effect of the order		
Gross-up of the tax credit	Gross-up of 20,000 euros of the cap on the advance	Compliance with the BBC label		
Article 1383-0 bis of the Tax Code: exemption (decided on by the local authority) of real estate tax on developed property for new buildings	Compliance with the BBC label			

[1] *RT 2005: regulations defining the minimum thermal characteristics that have to be complied with by new buildings or by new parts of buildings.*
[2] *The BBC label is awarded to accommodation of which the conventional primary energy consumption is inferior or equal to a value corresponding to 50 kw hours per square metre per annum, adjusted by coefficients which take into account the geographical situation and the altitude of the accommodation.*
[3] *Buildings producing more energy than they consume.*

Self-inspection during a building site

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The draft bill embodying a national undertaking for the Environment, adopted subsequently to its first reading on 11 May 2010 by the *Assemblée Nationale* (lower house), provides in particular for the obligation for any contracting authority or project owner in respect of construction or refurbishment works on buildings subject to a planning permission or to a prior declaration of works, to present, on the outcome of the completion of the works, an affidavit of compliance with thermal regulations (articles 119-9-1 and 110-10 amended of the construction and housing Code). The affidavit will have to be established by a licensed technical inspector.

"Self-inspection during the course of a building site can lead to the exclusion of the decennial warranty."

The idea also defended by practitioners, is to develop over the next few years various self-inspection measures during the course of building sites to avoid discovering impairments of thermal regulations once the works are completed.

A recent ruling rendered by the *Cour de cassation* provides an illustration of the interest that lies in organising contractually such inspection measures. This ruling evokes the consequences of the failure of a self-inspection measure during the course of a building site having regard to the decennial warranty governed by article 1792 of the Civil Code.

As having regard to a disorder related to compliance with anti-seismic standards, considered as a disorder of a decennial nature (*Cour de cassation,* 7 October 2009, no.08-1760), the *Cour de cassation,* in a ruling dated 27 January 2010 (no.08-20.938), judged that the decennial warranty was not applicable to an anti-seismic disorder which was apparent at the time of acceptance. The disorder was diagnosed during the course of the building site, which led the parties to finalise those measures in order to remedy the disorder. However, at the time of the acceptance process, the project owner had doubts regarding the execution of the remedial works. Various reservations regarding the execution of these works were thus mentioned in the minutes of acceptance. The court of appeals of Nîmes dismissed the application for the joinder of guarantor as a party made by the general contractor against the decennial liability insurer, on the grounds that the judicial expert appraisal process had established that the remedial measures had not been executed prior to acceptance, so that the disorder, although of a decennial nature, was apparent at the time of acceptance and thus not covered by the decennial warranty. In its legal arguments in support of the appeal before the supreme court, the contractor asserted that at the time of acceptance, the project owner was unaware of the significance of the disorder that was revealed subsequently to acceptance. The *Cour de cassation* nevertheless confirmed the appeal ruling, judging that a disorder during a building site, which has been the subject of various remedial decisions which were not executed prior to acceptance and of a reservation at the time of acceptance, was "necessarily" apparent at such date.

It results from the aforementioned ruling that self-inspection during the course of a building site can lead to the exclusion of the decennial warranty.

Once a disorder has appeared during the course of a building site, it must be repaired prior to acceptance. Failing which, and the court of appeal qualified this, the plaintiff may only act on the grounds of contractual liability "for failure to clear reservations", unless the disorder invoked results from a new disorder for which no such reservation has been made. Such disorder can occur on the occasion of the remedial works.

In the current context of the thought process surrounding the implementation of methods assessing energy performance, this ruling urges parties to a building contract to clearly define the boundaries of execution of any self-inspection measures during the course of the building site. The aim is not only to anticipate the existence of inspection measures, but also to organise the execution thereof and the possible consequences of the works on overall site progress. Success of the self-inspection measures must be secured by contractual clauses in order to clear apparent disorders prior to acceptance and to identify the contractual obligations of each of the participants in the building process.■

The new terms for exceeding density and girth laid down by the Grenelle II law

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Created by the program act determining the orientations of the energy policy dated 13 July 2005, article L128-1 of the Planning Code authorised, when this has been voted on by the municipal council, the Floor Area Ratio (COS)[1] to be exceeded within the limits of 20% and in compliance with the other rules of the Local Zoning Plan (PLU), "for those constructions which satisfy various criteria of energy performance or including renewable energy production facilities"[2]. Although being comprised in the chapter related to "provisions in favour of energy performance and renewable energy in the housing sector', this mechanism was not limited to residential use constructions.

The Grenelle II law made noticeable amendments to this mechanism: its territorial scope of application was restricted, whereas the possibilities for exceeding have been increased and can be modulated. First of all, the new text of article L128-1 of the Planning Code confines the possibility to exceed to urban areas or to areas to be urbanized. Moreover, certain sectors restrictively listed and which are protected are excluded outright. On the other hand, from now on the rules related both to girth and to floor area density can be exceeded. With respect to this point, a question arises: is "floor area density" to be construed as a reference to Floor Area Ratio (COS) or are other rules concerned, such as site coverage ratio (CES)[3]? The text does not answer this question. Above all, the exceeding can now attain a maximum of 30%. The new wording of article L128-2 enables this to be modulated over all or part of the territory concerned by a vote, and authorises even its cancellation in certain limited sectors, subject to specific justification based on the protection of building heritage, landscapes or monument and urban perspectives.

These new provisions will thus increase construction possibilities for buildings which satisfy certain criteria in terms of energy performance, whilst enabling local authorities to control this tool by modulating it according to local environmental and architectural requirements. Its application remains however subordinated to an express decision of the voting body of the *commune* or of the EPCI (Public Establishment for Inter-communal Cooperation) which is competent[4]. Moreover, whereas beforehand this was expressly excluded, authorised exceeding seems now subject to the Deduction for Exceeding the Statutory Density Cap (VDPLD) in those *communes* where this deduction is still in effect.

In addition, can this mechanism receive full application whereas the text of article R111-21 of the construction and housing Code still refers to exceeding of the Floor Area Ratio contemplated in article L128-1? Indeed the latter no longer refers exclusively to exceeding of the Floor Area Ratio, but to the rules related to girth and to floor area density. Thus, can the possibility to exceed the rules of girth be instituted immediately whereas this is not referred to by the construction and housing Code?

"A mechanism offering increased opportunities for densification, but the enforceability of which hangs on a decision of the local authorities."

Finally, article L128-1 now refers to "elevated" energy performance criteria and to "high-performance" facilities for energy production or recovery. Question: do these alterations have an impact on the appraisal of these criteria whereas these are still determined by article R111-21 of the construction and housing Code and its implementation bylaws, which do not restate these adjectives? In any event, a regulatory modification is required to harmonize the provisions of articles R111-20 and R111-21 of the construction and housing Code with this mechanism. ■

1. Coefficient applied to the surface area of the land, which enables the obtaining of the net external floor area which is constructible.
2. Criteria set out in articles R.111-20 and R.111-21 of the construction and housing Code.
3. Ratio between the surface area of the land and the area of the ground covered by the constructions.
4. The institution thereof ex officio, beyond a period of six months as from entry into effect of the law, in the absence of a vote on the modulation of the exceeding possibility, was cancelled during the parliamentary debates.

Alain Béchade: "We propose to create an economically intelligent tax"

Alain Béchade, *Professor at the Conservatoire National des Arts et Métiers and chairman of the ICH (the Institute of economic and legal studies applied to the Construction and Housing sector).*

After the *Assemblée Nationale* (lower house) last December, the *Sénat* (upper house) adopted on 26 April, the draft bill on the Greater Paris Area. However, the creation of new infrastructures in the Ile-de-France region gives rise, as an indirect consequence, to new financing needs. A working group of ORIE (regional monitoring group for commercial property) focusing on the taxation of commercial property in the Ile-de-France region has been considering this question for over a year. Headed by Alain Béchade, professor at the *Conservatoire National des Arts et Métiers* and chairman of the ICH, this working group will shortly be publishing its final report. Alain Béchade presents here the objectives sought after and the conclusion that the working group has reached.

"The tax must be based on flow, which will therefore not destroy economic wealth."

You led the working group on the taxation of commercial property in the Ile-de-France region. Where did the thought process originate from?

Alain Béchade – The Greater Paris Area is an exciting project, but let us not shroud ourselves in naivety. We are well aware of the fact that this project will need to be financed. However, this should be achieved without excessively burdening the economy in general and without destroying any wealth which is created.

How can this be achieved from a concrete standpoint?

A.B. – Two types of tax need to be distinguished. The first, which is based on the flow of wealth, is legitimate, as this is levied on the circulation of wealth, with an agreement between the parties on the price of exchanges. The second, which is levied on inventories, is detrimental as levied without any transfer of wealth; therefore destroying wealth. Moreover, levied on the basis of an estimated value. However, as Oscar Wilde put it, "we know the price of everything, but the value of nothing". We noticed that elected officials were receptive when we presented this analysis.

There are already taxes intended to finance public facilities in the Ile-de-France region…

A.B. – Commercial property in the Ile-de-France region is subject to 19 different levies (9 are vested with the local authorities, 6 are vested with the State, and 4 are shared between the two). These levies produce a total income of 4.5 billion euros excluding tax and without real estate VAT! I would recall that the tax on office space in the Ile-de-France region was created to finance infrastructures. However, out of the 300 million euros this tax yields each year, only 80 million is currently turned over to the Ile-de-France region. One must therefore combat the "organized embezzlement of tax revenue".

Parliament has adopted the idea of creating a 15% tax on real estate capital gains. What is your take on this?

A.B. – One should abandon this solution which is less useful than it might appear of creating a specific tax on the capital gains concerned. We came up with this idea ourselves at the beginning of our thought process eighteen months ago. But we have matured. The duration, scale, exemptions, dates of effect, distance, harmonisation of rules within the relevant perimeter ... all of this makes it virtually impossible to organise this type of tax fairly. We are looking to propose to create an intelligent tax. A tax must not be the expression of condemnation, but must be divided up legitimately.

What are the principles of your proposal?

A.B. – Our starting point was the fact that the facilities of the Greater Paris Area would benefit all; it would therefore be fair to consider that commercial property should not have to bear alone the burden of the contribution. The tax should not be limited exclusively to commercial property, but should also concern retail and housing property.

The second fact is that the levy must not be based on value but on price, that is to say that it should apply to sales. The tax must be based on flow, which will therefore not destroy economic wealth. Moreover, one

must avoid too intricate a taxation or counterproductive taxation. Without going all the way back to the tax on doors and windows, which brought about a frenzy of filling-in windows, we would recall the example of the new city of Cergy-Pontoise which instituted a tax for enterprises located less than 1,000 metres away from a station and which led to enterprises settling beyond the taxable perimeter. The amount of the investments to be financed is approximately 20 billion euros. A public establishment will need to be created (of the variety of a State-funded industrial and commercial establishment or EPIC) which will be entrusted with the assignment of financing these 20 billion euros. Financing will be secured by raising a loan for this amount which will be repaid by a levy which will be limited over time by a mechanism which avoids destroying wealth.

What would the taxation be?

A.B. – We propose a simple levy by means of a 1% tax of additional registration duty on the transfer of property. This would allow to encompass capital gains, but only impacting those that sell. The collection thereof would be simple, being secured through notaries, and would be limited to a twenty year period, but encumbering all transfers. This tax would not be able to be passed on to purchasers, which already pay registration duties, but would remain for the expense of sellers, as the latter are the parties cashing the capital gains.

"We propose […] a 1% tax of additional registration duty on the transfer of property. This would enable to encompass capital gains, but only impacting those that sell."

What is likely to be the revenue from this new tax?

A.B. – In submitting real estate transactions to 1% of additional duty, this would secure a revenue of 1 billion euros a year. Over a twenty year period, this should finance the 20 billion necessary to infrastructural projects.

What other courses of action did you discard?

A.B. – We examined a great many other courses of action, but we effectively discarded them. Follow a few examples. A gross-up of the internal tax on oil products at the regional level would have been difficult to bear as petrol is already heavily taxed. A tax on public transport would have gone up against the objective of encouraging their use and would have been contrary to the objectives of sustainable development. The creation of a toll upon entering the Paris urban area would have penalized inter-regional travel but not intra-regional travel. Reviewing the cadastral assessment basis of local taxes is an issue which does not concern just the Ile-de-France region and which is a political mine-field. This tax also presents the inconvenience of being an inventory tax. A gross-up of the tax bracket of the tax on the creation of office space would only procure limited revenue. This tax yields 80 million euros a year; the discounting thereof on the ICC index would yield 50 million approximately. A gross-up of the annual tax on office space would generate 100 million, but this is also an inventory tax. And as far as the idea of collecting a small charge on the parking revenue, this would be complicated to put into practice, and the amount of revenue is not easily determined.

What is the current status of your work and what is the opinion of the public authorities?

A.B. – We have prepared a progress report and we will be publishing within a month or two the final report. ORIE is composed of representatives of both public and private operators. It is not our role to take sides; the assignment is not to lobby but to enlighten the public authorities. We hope to enlighten debate. If, in the context of ORIE, we also started reasoning on the basis of the creation of a tax on capital gains, and that we subsequently abandoned this idea, it could be said that we are a year and a half ahead on the thought process! We still have time as the works on these infrastructures have not yet started. We need to take our time to see the thought process through, in the light of the crisis. The objective being to come to terms with an intelligent tax that is apportioned legitimately between all economic operators.■

The "Green lease": the materialization phase of the concept

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When examining the draft of the Grenelle II bill, the *Assemblée Nationale* adopted on 11 May 2010, after a first reading, an amendment contemplating the insertion into the Environmental Code of an article L125-9 under the terms of which an environmental schedule would be mandatory for a certain category of lease.

In order to not penalize small corner shops or isolated office space within buildings, the scope of application of the environmental schedule was confined to leases concluded or renewed over premises of more than 2,000 sq m for an office or retail use or over commercial premises located within a shopping centre.

"The scope of application of the environmental schedule was confined to leases concluded or renewed over premises of more than 2,000 sq m for an office or retail use or over commercial premises located within a shopping centre."

The amendment provides that an order will define the contents of this environmental schedule. Said schedule may contemplate the obligations which are binding on tenants in order to limit the energy consumption of the premises concerned. One should note that no punitive measures are contemplated in the event of absence of the environmental schedule. The consequence in law in the event of absence of such schedule is thus left to the appraisal of the courts.

It is provided that tenants will have to grant landlords the right to gain access to rented premises for the execution of works of improvement of the energy performance. The question arises as to whether the landlord will be entitled to carry out the energy performance improvement works in the rented premises freely. This will depend on the wording of the lease. We would recall that by virtue of article 1723 of the Civil Code, landlords can not, during the term of the lease, alter the form of the property rented. In application of this principle of immutability of the rented thing, the latter can therefore not carry out their works without the tenant's prior consent, subject to urgent repairs as set forth in article 1724 of the Civil Code. Any violation of article 1723 of the Civil Code is penalized by the reinstatement thereof to its initial condition.

In most leases, the parties agree to an exception to article 1723 of the Civil Code. In the case where the exception to this article is unambiguous, landlords will be entitled to carry out within the rented premises these energy performance improvement works without the tenant's consent.

In the event where the exception to article 1723 of the Civil Code is not expressly set out or does not exist, the landlord shall not *a priori* be entitled to carry out such works. However, we would note that the courts allow landlords to make certain alterations to the rented premises, in particular to adapt these to standards of modern comfort or to improve them. In the event of tenant's refusal, landlords could attempt to invoke the benefit of this case law.

Moreover, the question arises as to whether the landlord will have to indemnify the tenant in the event of disturbance to enjoyment during the execution of the works for the improvement of energy performance. By virtue of article 1719-3° of the Civil Code, the landlord is under the obligation to provide the tenant with peaceful enjoyment of the premises. On the grounds of this article, the tenant could claim compensation. However, such will not be the case if the lease provides that the tenant will suffer without indemnity or reduction of rent, by exception to articles 1723 and 1724 of the Civil Code, all repairs and all works carried out by the landlord in the premises, whatever their duration, even if such exceed a forty day period.

One would be well advised to bear these rules in mind upon entry into effect of the Grenelle II law. In the amendment it is contemplated that all of the foregoing provisions will enter into effect as from 1st January 2010 with regard to leases concluded or renewed as from such date and within a period of three years after entry into effect of the law embodying the national undertaking for ongoing leases.■

Withdrawal from a company (squeeze-out) is not equivalent to the re-sale of the securities

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.*
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As a matter of principle, assignments of the securities of predominantly real estate holding companies are subject to registration duty at the rate of 5%. By exception, article 1115 of the Tax Code in its wording prior to law no.2010-237 of 9 March 2010, exempts real estate dealers from the payment of this duty provided that they enter into the covenant to re-sell the securities within a period of four years.

In the presence of a real estate dealer who has withdrawn from a company within the four year period, the question arose as to whether such an event, which is materialized by the repurchase by the issuing company of its own corporate interests followed by their cancellation, constitutes a re-sale within the meaning of article 1115 of the Tax Code.

In a ruling dated 2 February 2010 (no.09-10.384), the *Cour de cassation* responded in the negative by refusing to assimilate, for the application of the favourable regime of article 1115 of the Tax Code, the withdrawal from a company to a resale of its securities. The *Cour de cassation* based its decision on the fact that "the partner withdrawing from a company can only claim the benefit of the redemption of the value of his corporate interests" and, that in the case at hand, the tax payer "had received buildings in consideration of the value of the shares cancelled".

"the repurchase of securities operated within the framework of the withdrawal of a partner is not to be analysed as an assignment of securities to a third party"

The notion of re-sale not being defined by the tax legislator, in all likelihood the *Cour de cassation* will have resorted to Civil law to settle this dispute, whilst keeping in mind that article 1115 of the Tax Code being a derogatory text, it necessarily had to be construed stringently.

In this regard, article 1582 of the Civil Code defines a sale as an "agreement by virtue of which one party covenants to deliver some thing, and the other to pay for it". Article 1604 of the same code defines delivery as the "conveyance of the thing sold under the authority and possession of the buyer".

The withdrawal process departs quite noticeably from these notions to the extent where the withdrawing partner relinquishes the securities that he held in the issuing company, which are subsequently purely and simply cancelled. His objective is not so much to transfer the securities to a third party, but to withdraw from the share capital of the issuing company in consideration for the redemption thereof.

In addition, in a sale, the price is negotiated freely and does not necessarily correspond to the economic value of the asset. On the contrary, in the context of a withdrawal, the partner may only obtain redemption in respect of the securities purchased in view of their cancellation. Thus, the value redeemed corresponds more to the indemnification pertaining to the withdrawal of the partner than to the price paid in consideration for the delivery of some thing.

It should be noted that the position of the *Cour de cassation* converges with that of the *Conseil d'Etat* which has already ruled that the repurchase of securities operated within the framework of the withdrawal of a partner is not to be analysed as an assignment of securities to a third party (ruling no. 296052 "Fiteco" of 31 July 2009).

This solution entails serious consequences for tax payers which, no longer being in possession of their securities, can no longer satisfy their covenant to resell within a period of four years and which, to this extent, will have to pay the registration duty initially exonerated related to the acquisition of the securities.

Finally, it should be noted that, since the amendment of article 1115 of the Tax Code operated within the framework of the reform of real estate VAT (amended finance bill for 2010), the scope of this solution has been enlarged as, since 11 March 2010, the favourable regime of article 1115 of the Tax Code has been extended to all taxable persons under VAT and no longer exclusively to real estate dealers (provided the purchaser enters into the covenant to resell the asset within a deadline increased to five years). ■

A third index for commercial rent review

By Arnaud Reygrobellet, *Professor at Paris University, Paris X, and of Counsel with CMS Bureau Francis Lefebvre. He is a member of the legal doctrine team, monitoring recent developments in business law.*
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One should recall that, under the patronage of the *Conseil national des centres commerciaux* (the National Shopping Centre Council), an inter-professional agreement signed on 20 December 2007 enabled the creation of a new index referred to as the Commercial Rent Revision index (*indice des loyers commerciaux* or ILC). The objective was to define a more relevant indicator than the traditional index for the cost of construction (ICC), accused of inducing inflationist effects. However, a law was required to validate the new index; this was accomplished with the law of 4 August 2008, completed by an order of 4 November 2008. The result being that commercial leases can be indexed, at the choice of the parties, either on the basis of the ICC, or on the ILC, the ICC retaining however the objective of applying, for legal review of rent, to contracts for which no choice has been expressed.

"Only the publication of an order specifying both the terms of calculation and the scope of application of the index will enable this index to be applied in a lease."

However, the ILC does not cover all commercial leases. Indeed, article D112-2 of the Monetary and Financial Code specifies that are excluded from the scope of application of this index those "commercial activities carried on in premises with an exclusive office use, including logistical platforms, as well as industrial activities." This exclusion is due exclusively to the components which are used in the calculation of the ILC, that are ill-adapted in particular if they are applied to activities of the tertiary sector. Hence the idea that, according to the same process as that which led to the creation of the ICC, it would be useful to implement an index which is specifically designed for leases with an exclusive office use.

Thus arose, out of consensus between landlords and tenants during the MIPIM in March 2009, the rent index for service industry activities (*indice des loyers des activités tertiaires* or ILAT). The objective was to conceive a (quarterly) indicator which is not only adapted to the types of activity concerned but which is also more stable and globally less inflationist than the ICC. Like the ILC, the ILAT will be a composite index structured as follows: 50% of the annual average of the consumer price index (excluding tobacco and rents); 25% of the annual average of the ICC and 25% of the annual average of the gross national product, in value.

In this instance also, this inter-professional agreement required legislative enactment. This process was fairly intricate. Indeed, the finance bill for 2010 already contemplated introducing the ILAT into legislation. However, the provision was censored by the *Conseil Constitutionnel* in its decision of 29 December 2009 (at the same time as the renowned carbon tax) not in substance, but because it was an illegal budget rider. In other words, such a provision had no place in a finance bill. A new legal text therefore had to be awaited. This has just been enacted with the law related to "individual contractors with limited liability", adopted definitively but not yet carried into force on 16 May 2010. Are thus amended, both articles L112-2 and L122-3 of the Monetary and Financial Code, to provide comfort as to the validity of this index inserted into a commercial lease; and articles L145-34 and L145-38 of the Commercial Code, to incorporate the ILAT into the mechanism for the capping of rent during the course of the lease or at the renewal of the latter.

At last we would indicate that only the publication of an order specifying both the terms of calculation and the scope of application of the index will enable to this index to be applied in a lease. Of course, the introduction of the ILAT into an ongoing lease may only take place with the consent of both parties.■

Upward-only indexation clauses

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The erratic variations of the INSEE index for the cost of construction, which underwent as from 2006 an exponential rise, before subsequently dropping into negative figures over the last three quarters of 2009, has thrown new light onto indexation clauses which are designed to only play upwards.

In the practical context of "investor" commercial leases, one will usually encounter two types of clause. On some occasions, it is provided that indexation will only apply in an upward fashion or yet still that it may not have the effect of reducing rent to an amount which is inferior to the current rent, which is the same thing; On other occasions, it is stipulated that indexation may not entail a reduction of the initial rent.

In a world of stability which was accustomed, over the years, to a positive variation of indexes of approximately 2 to 3% a year, indexation clauses were not considered as strategic stakes economically speaking and the issue of their validity did not provide lawyers with an axe to grind. Things are very different today, with the threshold of 8% annual increase having been crossed on several occasions in 2008, and at a time where rental values are on the downturn… Contentious proceedings have thus multiplied. However, indexation clauses conceived to only apply in an upward fashion pose serious difficulties both with regard to the rules of the Monetary and Financial Code and to the rules of article L143-39 of the Commercial Code.

Article L112-1 of the Monetary and Financial Code indeed lays down the principle of an "automatic" indexation which is only legal on the terms defined in article L112-2. The automatic character presupposes that indexation must be allowed to play upwards and downwards. It would seem that, in this legal framework, only automatic indexation would be valid. Case-law will have to settle the issue.

Article L145-39 of the Commercial Code provides that the review of rent on the basis of rental value can be applied for by one or the other of the parties each time that, by operation of the escalator clause, the rent ends up being increased by more than a quarter fraction in comparison to the price previously determined contractually or by court decision. It is this text which substantiates the validity of the indexation clause in a commercial lease which, otherwise would be illegal, no voluntary revision of rent being able to be stipulated apart from the statutory triennial revision. The upwards-only indexation clause not only adversely affects the principle of reciprocity laid down by this text, but moreover distorts its application. The 25% threshold will thus be more swiftly attained, if one is to only take rises into consideration.

In a recent ruling, the court of appeals of Douai seemed to validate this type of clause by judging that the upward indexation was licit, but did not however contain the positive or negative variation requirement set forth by article L145-39 of the Commercial Code (CA Douai, 21 January 2010: Sté Palocaux v. Sté Chattawak Distribution).

One should however note, on the one hand, that the question of nullity was not raised by the parties; and on the other hand that the court was only questioned on the admissibility of the rent revision action of article L145-39 of the Commercial Code, the court intervening as the judge in charge of rental matters.

In another ruling dated 22 April 1981, the court of appeals of Colmar, declared on the other hand, the upwards-only indexation clause to be null for violation of article 28 of the order of 30 September 1953 (now article L145-39 of the Commercial Code; CA Colmar, 1st chamber for civil affairs). As always, the *Cour de cassation* will have the last word. But the consequences of nullity would be drastic, as not only would rent be unable to be indexed for the remaining duration of the lease, but the landlord would have to refund the difference between the amount of the initial rent and the amount of indexed rent unduly collected.

We would add that the landlord may of course invoke the two year limitation period under the statutory regime governing commercial leases against any nullity action, but that this line of defence could collapse if the nullity is raised by way of a plea in objection as a means of defence or yet still if the nullity is invoked on the basis of the Monetary and Financial Code. ■

The first few weeks of application of the real estate VAT reform

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The reform of VAT applicable to real estate transactions entered into effect on 11 March 2010. The scale of this reform has logically created a great many difficulties related to putting it into practice, all the more so that the implementation order is still awaited. Two administrative guidelines of a general nature (one related to VAT, the other to tax on transfers for valuable consideration) will be published, but not for several months yet. The administrative authorities have merely adopted a few transitional measures in a set of guidelines dated 15 March 2010.

Have therefore been treated thus, the case of transactions subsequent to 11 March 2010, but which were the subject of preliminary contracts signed beforehand. The principle should lead to an application of the rules in effect at the date of the notarised deed recording the transfer. However, the administrative authorities admit that they will allow for exceptions to this rule when the VAT reform has taken place between the date of signature of the preliminary contract and the reiteration by authentic deed, in order to take into account the fact that the change of the tax rules may alter the economic balance of the contract.

The transaction can therefore remain subject to the rules applicable at the time of signature of the preliminary contract. Of course, nothing will stop the parties, if this is in their interests, from invoking the benefit of the new rules, adopted subsequently to the conclusion of the preliminary contract.

The guidelines of 15 March 2010 provide a few illustrations. Among these, one deals with the sale of constructible land to individuals. Whereas such a transaction carried out by a taxable party no longer allows for any derogatory regime, it is nevertheless admitted that it will continue in all case scenarios to be subject to margin VAT to the extent where a preliminary contract was signed prior to 11 March 2010 under this regime.

More generally, the administrative authorities seem to consider that sales of constructible land which had been purchased under a mechanism of self-liquidation of the VAT must be subject to margin VAT. Undoubtedly guided by the illegality of the self-liquidation mechanism, the administrative authorities prefer analysing these acquisitions as not having given rise to any right to deduct, which leads today to exit tax based on margin.

"many questions remain, concerning for instance real estate dealers or financial lessors"

In another sector, the administrative authorities specified that any and all assignments by a taxable party of a building completed for less than five years are from now on subject to VAT (and no longer just the first one). For all that, the sale of a new building after 11 March 2010 is liable not to be taxed if this was not the case at the time of signature of the preliminary contract. For buildings completed for more than five years, assignments remain exempted from VAT under the new regime. However, it is now possible for sellers to opt for voluntary taxation (which will enable them correlatively to benefit from the right to deduct for any expenditure in connection with their building). Sale and purchase and call option agreements entered into prior to 11 March could not have anticipated this possibility of an option, but, provided that the parties reach an agreement, nothing precludes this from being exercised.

Beyond these specific cases, a great many questions remain, concerning for instance real estate dealers or financial lessors, whose tax regime has been profoundly modified by the reform.

Until the publication of the implementation order and of the two guidelines, the administrative authorities accept to respond from time to time to applications for tax rulings and a set of guidelines on social housing should be published shortly.

The transitional period remains intricate to manage, as the application of the new text entails issues which remain yet to be addressed. With just a few weeks hindsight, practitioners are now in a position to propose numerous solutions. ■

Restructuring SIICs, Inter-SIIC operations and subsidiaries

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The tax authorities have published no less than six tax ruling decisions concerning the SIIC regime between 2009 and now. Most of these rulings concerned restructuring operations on SIICs and their subsidiaries; and one concerned the appraisal of self-audit procedures regarding the condition related to the holding of less than 60% of capital or of voting rights.

Tax ruling no.2009/61 concerned the tax consequences, for a company, of the transition from status as a SIIC to that of a subsidiary of a SIIC, further to the acquisition of the whole of the share capital of the SIIC in question by another SIIC.
In this situation, it is considered that the ex-SIIC remains within the exemption regime as an exempted subsidiary under article 208 C-II of the Tax Code, without applying the consequences of exiting the SIIC regime to the extent where however it remains a SIIC subsidiary until the expiry of a ten year period calculated as from its initial option. Whereas the transition from status as a SIIC to that of subsidiary of a SIIC does not entail the company's liability for corporate income tax, the administrative authorities will nevertheless demand that the company formally exercises the option for the SIIC regime within the deadline required by law, that being before the end of the fourth month from the start of the financial year in respect of which it intends to be governed by the SIIC regime.

"The last tax ruling published concerns the appraisal of the self-audit procedures with respect to the condition related to the holding of less than 60% of capital or of voting rights."

In tax ruling no.2010/08, the administrative authorities confirmed that a change of shareholder of a SIIC subsidiary company coming from an assignment or from a contribution between two SIICs does not entail for the subsidiary either the consequences related to exiting the SIIC regime or those related to the discontinuance of business, to the extent where article 208 C-II provides that SIIC subsidiaries must be held for at least up to 95% by a SIIC or jointly by several SIICs, directly or indirectly.

Various qualifications have also been made to the tax regime of merger premiums resulting from the absorption by the permanent establishment of a foreign company of its French subsidiary coming under the SIIC regime (tax ruling no.2009/14) and of the obligation to distribute the capital gain realized on the cancellation of the securities of a SIIC by another SIIC when there is a revaluation variance on the balance sheet of the combined company (tax ruling no.2010/16).

In the first case, the administrative authorities recalled, on the first hand, that the merger can be placed under the favourable regime, subject to obtaining prior approval (article 210 C II of the Tax Code); on the other hand, they analysed the merger premium (which must be distributed for 50% of its amount in application of article 208 C bis-II of the Tax Code) as capital gains resulting from the cancellation of the securities of the combined SIIC and determined on the basis of the fiscal value of the securities of the combined SIIC at the date of cancellation of the securities. In the second case, the administrative authorities dealt with the problem of revaluation variance and accepted for the revaluation variance which prevails on the balance sheet of the combined company at the date of effect of the merger, not be taken into account, for the purpose of calculating the tax premium to be distributed.

Finally, in a last tax ruling (no.2010/09), the administrative authorities indicated that self-audit procedures must, for the purpose of appraising the condition related to the holding of less than 60% of the capital or of the voting rights, by one or more persons acting in concert, be: on the one hand, taken into account in the denominator (as securities representing the issued capital); and, on the other hand, added to the numerator (as securities considered as indirectly held by the majority shareholder presumed to be acting in concert with the SIIC). However, being deprived of voting rights, these shares must not be retained either as the numerator or the denominator for the purpose of determining the 60% holding ratio of voting rights. ■

A preliminary question of constitutionality regarding the law of commercial leases

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One of the first "preliminary questions of constitutionality" put to the *Cour de cassation* in a non-criminally related matter concerns the law of commercial leases (question of 22 March 2010). It is the mechanism contemplated in article L145-41 of the Commercial code which is under criticism: the text limits the effective character of a termination clause inserted into a lease agreement by providing that the latter may only be carried into effect one month after a summons has remained unsuccessful. In practice, this means that if the tenant performs during this period, the landlord will not be entitled to invoke the benefit of automatic termination and to apply for the tenant's eviction. In addition the tenant can ask the judge to grant an extra cure period (of up to two years) on the grounds of article 1244-1 of the Civil Code.

This mechanism, which is extremely protective for the tenant, is criticised for "adversely affecting the right to maintain the economic balance of legally concluded agreements" stemming from article 4 ("Liberty consists in the freedom to do everything which injures no one else") and 16 (the principle of Separation of Powers) of the Declaration of the rights of man and of citizens of 1789.

This is not the first time that the rules specific to commercial leases have been confronted with rules of higher value. Until now, it was the principles of the European convention on human rights (ECHR) that were invoked, in vain, in order to attempt to reverse certain rules. And on several occasions, the *Cour de cassation* considered first, as concerns landlords, that the mechanism related to the renewal of leases did not adversely affect the protection of property, guaranteed by the 1st protocol to the ECHR (ruling of 27 February 1991), then that the requirement related to registration at the Commercial and Companies Registry imposed on the tenant for the purpose of soliciting the renewal of the lease did not constitute a disproportionate impairment to "security of tenure" (ruling of 18 May 2005).

One can thus consider it highly unlikely for the question asked on 22 March 2010 to be communicated by the *Cour de cassation* to the *Conseil constitutionnel* (for this, the question would need to be new or present a serious character) and it is even less likely, should it be decided to communicate the question, that the legal provision in question will be declared unconstitutional.■

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