REAL ESTATE NEWSLETTER

Monday, 3 June 2013

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Feature

Commercial leases

News

C/M/S/ Bureau Francis Lefebvre

EDITORIAL

The practice of commercial leases covers very different realities, whether they involve the types of buildings concerned (shops, offices, etc.), their location (city centre, shopping centres, etc.), or when the lease is signed (building completed or to be built).

A commercial lease is governed by both the specific status, codified in the Commercial Code, and the common law of leasing. As status is public policy for only some of its provisions, and supplementary common law for a large part, freedom of contract ultimately finds a broad opportunity for expression. This freedom is expressed in different ways depending on whether the author of the proposition is the lessor or the lessee. Nevertheless, in theory, contradiction of interests calls for a search for balance suitable for the signing of the lease. However, more operational reasons drive one or the other party to absolutely want to enter into the lease (quality of the coveted location, lessee's creditworthiness) despite wording that is not always as precise as it should be on some points.

Beyond the basic recommendation that the wording of a lease should be compatible with the specific features of the leased premises (leasing of a whole building or only part, location of the premises within a co-owned property, high-rise building, classified facilities, etc.), changes in contractual practices and tax doctrine call for precision; the various contributions to this issue of the "Real Estate Newsletter" illustrate this reality.

With regard to status, the difficulties in determining the respective scopes of the various possible indices should not be underestimated; in view of the proven uncertainties, cautious behaviour can bring about conviction.

The interpretation of a vague obligation in favour of the obliged party consistently prevails in case law. For service charges stipulated as recoverable, the most recent decisions confirm that only a clear expression of both the principle and the methods of recovery will lead to a reliable, effective mechanism. Use of the "green appendix" to transfer a new responsibility for standards compliance work to the lessee will likely be examined through the same prism. In terms of pollution removal, which is the responsibility of either the lessor in compliance with an obligation of delivery or the lessee when returning the leased property, this interpretation leads to a rigorous definition of the requirement of a site "clear and free of any pollution". The autonomy of the tax law continues consistently when the lease contains a commitment for the lessor to provide services to the lessee or when the rent is indexed to the tenant's earnings. Similarly, the tax treatment of rent-free periods, which have become frequent, also has its share of questions (direct taxation) if not surprises (with regard to VAT).

Enjoy! ■

Jean-Luc Tixier, partner

Offices in the Greater Paris region: a complex international market

By **Denis François,** Chairman and CEO of CBRE Valuation

The Greater Paris region's office market represents around 54 million sq m, making it Europe's largest, on par with the Greater London market. The Greater Paris region's market has become very international since 1980s. In addition, its other key characteristic results from the domestic market's very high concentration in the Greater Paris region and explains its complexity and volatility.

In an economic environment of stagnation/recession, the impact of economic activity on the office market is felt rather quickly, generally within a period of around six months, given that the economy is highly volatile and companies are increasingly reactive.

Vacancy rate and take-up

The vacancy rate is the first indicator. Overall, for the Greater Paris region, it is slightly below 7%, which is generally considered a good balance. However, this average rate makes very wide disparities: whereas vacancy within Paris itself is around 5%, some sectors have vacancy rates reaching 10% or even 15%. Under these conditions, the growth of market rents is obviously radically different. The second indicator is take-up, i.e., all space taken by office users (tenants + buyer-users). Despite the crisis, take-up varied from 2005 to 2012 between 2 million and 2.7 million sq m (2,380,000 sq m in 2012). Nevertheless, first quarter 2013 reflects a marked decline of more than 20% compared with first quarter 2012 figures, which suggests a take-up closer to 2 million sq m. In general, longer lead times have been observed between the time when a search is expressed and the final negotiation with the owner.

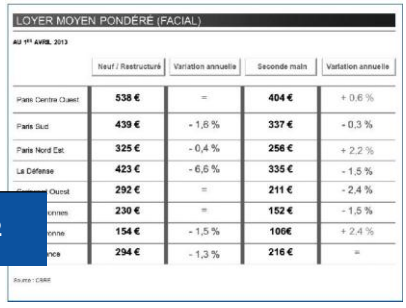
Market rental values

These are often referred to as "market rent" or "base rent" (which is subject to misinterpretation since accrued rent constitutes a notion different from the rent observed in private transactions on the market).

Too often, in the past, professionals and especially the press have mainly been interested in prime market rents, i.e., new or fully renovated top-quality buildings located in the central business district.

More and more, the focus is now rightly on market rent averages by major sector, which better reflect the range of market rental values and vary depending on the building's quality from 1 to 2 in the Paris region. The table shown here provides the average rents as at 1 April 2013 by Immostat sector[1]. These averages even out the highest and lowest rents (in central Paris, the highest rents are around €750/sq m excluding taxes and charges per year). The average for central and western Paris is €538/sq m/year for new buildings and €404/sq m/year for second-hand buildings. Lastly, if we look at the overall average of market rents for the Greater Paris region, we can see that it is slightly down compared with previous years. It is €294/sq m for new buildings compared with €216/sq m for second-hand. One of the market's indicators, statistically understudied and only very rarely made public when concluding rental transactions, is missing: gifts, rental benefits, or rent-free periods. These commercial benefits have existed since the 1990s and have never disappeared, even in times of stress on the rental market (scarce supply/abundant demand). Today they are very important for large buildings. The difference between the headline rent and the real economic rent, i.e., after deducting the financial impact of these various benefits, should therefore be assessed. With regard to valuation, the treatment of these "gifts" can differ depending on how they are calculated. These gifts can also complicate the interpretation of a transaction value, if it is not specified that the "gifts" remain the responsibility of the seller or, on the contrary, are borne solely by the buyer. The main data about rents give headline rents.

Everything suggests that 2013, though dreaded, should be decent in terms of flows with a downward trend on market rents but with strong disparities in changes.■



1- Immostat is a body of the largest property marketers that defines the market's geographical sectors and analyses flows.

Indexation: the applicable indices

The possibilities offered under the stipulation of an indexation clause have expanded greatly since the legislature instituted, alongside the construction cost index (ICC), the commercial rent index (ILC) in connection with the economic modernization act of 4 August 2008, then the tertiary activities rent index (ILAT) during the adoption of the act for simplification and improvement of the quality of law of 17 May 2011.

Parties can now choose to index a lease's rent according to the construction cost index or opt for one of the new indices within the limit of their respective scope. Although the construction cost index remains the applicable benchmark index regardless of the subject of the lease, use of the commercial rent index or the tertiary activities rent index is strictly governed by law.

The commercial rent index thus applies to "commercial and craft activities" (CMF Art. D. 112 2, para. 1), and the tertiary activities rent index applies to *"tertiary activities other than commercial and craft activities [that] particularly cover the activities of professionals and those carried out in logistics warehouses"* (CMF Art. D. 112-2 para. 2).

In practice, the respective scope of these indices is not always easy to determine.

First of all, the industrial activities that were expressly excluded from the scope of the commercial rent index in the initial version of Article D. 112-2 of the French Monetary and Financial Code disappeared in its current version, and there is no mention in the activities referred to with respect to the tertiary activities rent index. Should it then be considered that industrial activities would not fall within the scope of the commercial rent index or the scope of the tertiary activities rent index so that only the construction cost index would be applicable?

Another difficulty in determining the scope of the ILAT lies in the use of the notion of "tertiary activity". Reference to this notion is relatively ambiguous insofar as it has no clear legal or regulatory definition.

Difficulties are also encountered with regard to shop leases involving the exclusive use of offices, commonly referred to as "office-shops" (bank branches, real estate agencies, etc.). For these entities, should the quality of the premises (the shop) be favoured, resulting in application of the commercial rent index, or should priority be given to the business activity, which would lead to the application of the tertiary activities rent index? The lack of clarity in the current version of Article D. 112-2 of the French Monetary and Financial Code does not settle the question.

"The respective scope of these indices is not always easy to determine."

The choice of an index implies a thorough analysis of the nature of the activity authorized by the lease, bearing in mind that the penalty is particularly severe, seeing that if the chosen index is incorrect, the indexation clause is considered void as contrary to public policy. When in doubt, the author of a legal document should therefore refrain…and choose the ICC, which has a legal presumption of lawfulness and, in any case, provide for a substitution index in the lease.■

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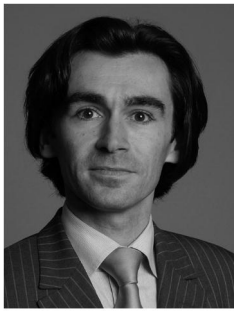
Would the rent-free period no longer be a rent reduction?

For certain tax authorities, rent-free periods granted in return for a firm commitment on the lease's term would be an illusion, hiding a payment of rent by offsetting with a service rendered by the tenant, consisting in the commitment made on the firm term greater than the statutory minimum. This theory is based on a very questionable foundation and endangers the legal certainty previously established on the subject. There is therefore an urgent need to clarify the situation.



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Many commercial leases include an initial rent-free period. Yet, certain tax authorities consider this rent-free period not to exist when it is granted in return for a commitment from the tenant to a firm lease term (which is often the case). There would be an offset between the rent and the price, of an equal amount, of a tenant's receivable due from the lessor, arising from the service that would the firm commitment on the lease's term constitute. As a result, there are VAT increases for the lessor, who is unaware that rent was collected over the rent-free period, and for the tenant, who did not realize that the price of a taxable service rendered to the lessor was collected solely because of the firm lease term commitment.

One of the particular features of commercial leases lies in Article L. 145-4 of the French Commercial Code, which stipulates that *"in the absence of a contrary agreement"*, the lessee *"has the option to give notice at the end of a three-year period"*.

Since *"being compelled not to do something or to tolerate an act or a situation"* is a VAT-taxable service (Article 256 IV of the French General Tax Code), the administration concludes that the tenant who agrees to waive the legal right to three-year termination provides a service to the lessor within the meaning of this tax.

Yet, this assertion seems hasty, since it fails to verify a key point: in order to waive a right, it is still necessary to have this right... However, the possibility of three-year termination by the tenant is excluded once the lease is entered into.

Consequently, asserting that the tenant waives the right to three-year termination implies admitting that this right pre-exists the lease, which does not seem obvious to us.

In fact, we believe that this right arises only with the signing of the lease to which it is likely to apply.

If it is excluded from the outset, it never existed other than virtually.

The theory of offsetting is also contrary to ECJ case law, according to which a tenant who undertakes, even by way of payment by the owner, to become a tenant and pay the rent does not provide a service to the owner.

Then how can we explain that the commitment to remain a tenant can constitute a service with respect to VAT, when the commitment to be become a tenant is not such a service?

Furthermore, even if such a service exists, its payment through offsetting with a portion of the rent would still assume that this service is separate from the lease.

If this "service" is only an element of the lease, the notion of offsetting with the lease is meaningless.

However, it is not reasonable to claim that the "service" of waiving the lease's termination has an autonomous existence in relation to the lease. It exists only through the lease, and it is not certain that the lease would exist without this waiver.

> ***"The weaknesses of the theory of offsetting are all the more unfortunate given that it creates major uncertainty for all commercial leases in existence or under negotiation."***

The weaknesses of the theory of offsetting are all the more unfortunate given that it creates major uncertainty for all commercial leases in existence or under negotiation.

It is therefore time to stop the experimentation that makes taxpayers victims, because in the end, the rent-free period actually appears to be merely the rent reduction that everyone saw previously. ■

Rent-free period: deferred cash without deferred charges?

The rent-free period is a negotiating instrument with an advantageous financial aspect, taking on the appearance of free rent sometimes lasting as long as several tens of months, that should not conceal the care that tenants must give to defining its legal, accounting, and tax classification.

The VAT has taught us (cf. page 4) that a non-payment of rent benefiting the tenant should not be considered the result of the improbable compensation of the relations of a helpful tenant and a forgetful lessor.

However, the cause of this rent exemption must still be positively defined by reserving, first of all, a particular fate for rent-free periods obtained by a tenant who must perform work. Such a tenant is then penalized twice by bearing the expenditure increasing the cost of occupying the space, which most often will be effective, or generate economic benefits, only after this work is completed. Not recognizing rent therefore appears logical and legitimate, not only financially, but also in accounting and taxation terms.

Quite a different matter is the situation of a tenant occupying premises during the rent-free period. This occupancy, identical to that recognized when the contractual rent will be due, demonstrates that the rental service is of equal intensity for these two periods.

In determining earnings for accounting and tax purposes, would it then be necessary to give credence to the legal and financial payments of rent charged by distinguishing two periods: the often initial non-rent period followed by a second period subject to contractual rent, independent of the first? On the contrary, would it be necessary to consolidate these two periods by considering them united by a common intensity of occupancy?

It is precisely this last approach that has been adopted by the accounting authorities and by *Conseil d'Etat* case law.

The accounting authorities recommend, in both the national accounting regulations and in IFRS, spreading out service charges so that the economic benefits provided by the building from period to period are properly represented. This involves using the method most representative of how the tenant derives benefits when using this property. Initially expressed in opinion no. 29 of the Order of Chartered Accounts, this analysis was reiterated in September 2012 by the accounting law commission of this Order's high council.

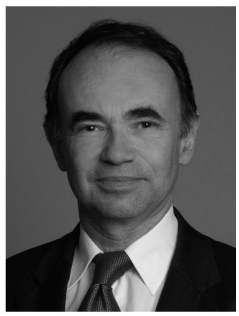
The second (*Conseil d'Etat*, 29 November 2000, no. 192 100 and 192 109) makes the taxation of rent conditional on the performance of the service, dismissing an unequal distribution of the rent when the rental service is of equal intensity during different periods. In this last situation, rent is then deducted linearly over the entire occupancy period, including rent-free periods.

"In case of actual, constant occupancy, a tenant may deduct rent for which payment will be partially deferred."

Achieving this accounting and tax goal of rent linearization first involves determining an average monthly rent for the entire actual occupancy period. Then, for rent-free periods, the difference corresponding to the shortfall of the rent contractually due for these periods over the previously determined average rent will be deducted as accrued charges.

In subsequent periods making the contractual rent payable, the rent for accounting and tax purposes will continue to be spread out through a write-back of the accrued charges for the share of the rent charged exceeding the average rent.

Thus, in case of actual, constant occupancy, a tenant may immediately deduct rent for which payment will be partially deferred.■



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Commercial lease: an autonomous tax classification

It is not because a lease agreement is entered into between parties under the legal framework of the commercial lease that the income derived by the lessor must be subject to tax in the category of business earnings when the lessor is a natural person.

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If the lessor is a commercial enterprise whose earnings are subject to industrial and commercial profits (BIC), the same will apply to rental income regardless of the lease's characteristics.

However, for an individual, it should be recalled that the French General Tax Code provides for a classification of rental income according independent characteristics:

– if the lease pertains to furnished or equipped premises, the lessor is subject to the tax on industrial and commercial profits;

– if the lease pertains to bare premises, the rental income falls under the category of property income, even if the lease is commercial in nature in legal terms.

However, there are exceptions to this second situation. If the lease provides for the lessor's provision of other services (caretaking, cleaning, IT, etc.), the rental will be considered commercial for tax purposes. Similarly, if the contract provides for rent, if only partially indexed to the tenant's earnings (turnover, profits, etc.), the lessor will be deemed to participate indirectly in the lessee's business activity, even with regard to a bare rental without provision of services (cf. CE 11/12/2009 no. 301504, SCI Aristide Briand).

> ***"The very existence of a variability clause will mean that the entire rent – including the fixed portion – pertains to a business activity."***

This rule requires considerable vigilance, particularly for lessors who invest through a property investment company (SCI), which could automatically be subject to corporate tax (IS) because its earnings are subject to tax in the BIC category. In this regard, note that the tax authorities admit that a property investment company can engage in a business activity incidentally without calling its fiscal translucency into question if *"the amount excluding taxes of [its] commercial receipts does not exceed 10% of the amount of [its] total receipts excluding taxes"* (BOI-ISCHAMP-10-30-20120912 n° 320). An occasional crossing of this 10% threshold may even be permitted, on the condition that the average of the receipts excluding taxes for the current year and the previous three years does not exceed 10%.

Note, however, that it is not because the amount of the fixed rent collected by an SCI would represent more than 90% of its receipts – the variable share of rent being less than 10% – that the company will avoid corporate tax. In fact, the very existence of a variability clause will mean that the entire rent – including the fixed portion – pertains to a business activity, as the SCI is unable to take advantage of this concession by the authorities.

For example, where the rent has been set according to a percentage of the tenant company's annual earnings, payable in irrevocably forfeited instalments amounting to 10% of gross receipts, the *Conseil d'Etat* has ruled that such a method of calculation would entail the lessor property investment company's contribution to the tenant company's business earnings. As a result, it was subject to corporate tax (cf. CE 03/03/1976).

Lastly, note that even if the amount of the variable rent is zero, in view of the tenant's earnings, the mere presence of the clause in the lease will be enough to consider all of the collected rent to be commercial in nature. Similarly, the fact that the lessor refrains from collecting the variable share stipulated in the lease agreement would not be enough to strip the rent collected by the SCI of its commercial nature (cf. CE 28/05/1984).

Service charges: what clauses should be included in the lease?

Two recent decisions raise questions about the wording of the clause relating to recoverable charges in commercial leases where the principle is freedom of contract. More precisely, the question is whether the lease must expressly mention each charge in order to be able to demand the payment of charges by the tenant or if a precise, unambiguous distribution suffices.

In the ruling handed down on 13 June 2012 (no. 11-17114), the question raised was whether the lessor could demand reimbursement from the tenant for the domestic refuse removal charge. The *Cour de cassation* set aside the appeal decision that had allowed this reimbursement by recalling that the tenant could only be held responsible for the domestic refuse removal charges by virtue of a contractual stipulation. In the ruling handed down on 6 March 2013 (no. 11-27331), the matter was whether the lessor could demand payment for restoration, roof repair, and communal heating replacement work for the building in proportion to the area occupied by the lessee as long as the lease made the lessee responsible not only for repairs pertaining to the leased premises, but all others, of any nature whatsoever, including the major repairs defined in Article 505 of the French Civil Code. Here again, the *Cour de cassation* set aside the ruling that had permitted this reimbursement, as it was not established that express stipulations of the commercial lease made the tenant responsible for restoration, roofing, and communal heating work. The advice given by some commentators on these rulings to prepare an exhaustive conventional list of charges that may be recovered from the tenant fits in with the prudence called for by the principle according to which an imprecise obligation is interpreted in favour of the obliged party (Article 1162 of the French Civil Code; cf. Court of Appeals of Versailles, 6 September 2007: RJDA 2/08 n° 103; Court of Appeals of Paris, 2 April 1992: Administrer, October 1992, p. 94). However, the clauses of the leases in question were not devoid of ambiguity, and it is not certain that this is the imperative lesson to be learned from these decisions.

"An imprecise obligation is interpreted in favour of the obliged party."

More particularly, with regard to property tax as well as the annual tax on certain premises in the Greater Paris region to which the lessor is subject as owner, it is customary to include a clause in the lease stipulated that they can be billed back to the tenant. This ability to bill the tenant stems from the reasoning that the tenant should bear all charges related to the premises in possession.

The issue of billing the territorial economic contribution (CET) back to the tenant is more complex and is not obvious, since the CET involves not the building's owner but the exercise of the specific activity of the lessors. Thus, billing tenants for the lessor's CFE would not be logical, since this tax is calculated on the property rental value of the premises occupied for its own activity and not on that of the premises leased out, which is taxed directly in the tenant's name. Regarding the CVAE, it is calculated based on a percentage of the added value produced overall by the company, which varies according to its turnover. Billing tenants for the CVAE paid by the lessor would raise the issue of its distribution among the various tenants, since it is calculated by taking into account all of the lessor's assets or even other activities with no connection with the leasing.

From this point of view, we feel that billing tenants for the CET could raise objections from tenants with regard to both its principle and the methods for calculating the amounts billed. Contractually, only taxes levied on the leased building (property tax, office tax, etc.) should be considered rebillable, with the exception of those on the lessor's business activity (corporate tax, CET, etc.). ■

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Tax treatment of eviction compensation: an equation with several unknowns

The tax treatment of eviction compensation varies according to its subject and its beneficiary's tax status. Special attention must therefore be given to the terms of compensation and its formalization.

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Eviction compensation, legally owed by the lessor to a tenant company whose lease is terminated or not renewed (cf. Article L. 145 s. of the French Commercial Code), is subject to a tax treatment that depends on, for the lessor, the reason for the eviction and, for the lessee, the nature of the charge or damage that it compensates. For the lessor, the eviction compensation is thus likely to constitute the cost price of an asset if it allows the lessor to resume the tenant's operation, sell or demolish the building, or switch its use to residential. However, it will constitute a charge that can be deducted from its taxable earnings if the purpose of the eviction is to improve the financial conditions of the leasing situation or use the premises to engage in a business activity other than the tenant's activity.

For the lessee, the eviction compensation will represent immediately taxable operating income under common law conditions when its purpose is to compensate for a charge (reinvestment costs, moving charges, etc.) or lost profits (loss of future receipts). If it is intended to compensate for the loss of an asset (right to lease or business capital in particular), it will follow the capital gains regime: this classification may be of particular interest if the tenant company's earnings are subject to income tax (and not corporate tax), since it will be able to confer a right to a reduced-rate tax regime or even an exemption (applicable, under certain conditions, to capital gains realized by SMEs).

Where appropriate, the compensation will be divided into two portions: one compensating for the loss of assets and the other compensating for charges. In order to assess the nature of the change or the loss covered by the compensation, both the wording of the legal document formalizing the agreement between the parties and the reality of the facts (lease termination conditions, real value of the right to lease, fate of the tenant company, etc.) will be taken into account.

"The classification of the compensation will be assessed with regard to both the wording of the lease and the reality of the facts."

With regard to VAT, regardless of the classification given by the parties, it is necessary to research whether the purpose of the sum paid is to repair the damage suffered by its beneficiary or it actually constitutes consideration for a service rendered, in this particular case, to the lessor.

In the first situation, the compensation is not subject to VAT and has no impact on its beneficiary's situation with regard to rights to deduction.

In the second situation, the sum falls within the tax's scope and must eventually be subject to it because of the rules applicable to the operation for which it actually constitutes consideration.

In order to distinguish whether all or part of the compensation falls within the VAT's scope or not, a precise analysis of the facts and stipulations agreed upon between the parties will again be necessary.

Thus, whereas eviction compensation at the end of a lease's three-year period makes up for, as such, the harm suffered by the lessee and is not, in principle, taxable in this regard, the sum collected by the tenant for the early release of the premises is likely to constitute consideration for a service rendered to the lessor, with the Community judge even deeming that this service is covered by the VAT rules applicable to real estate leasing.

Tenants, be vigilant about the contents of the environmental appendix!

Since 1 January 2012, the environmental appendix (known as the "green appendix") has been mandatory for all leases entered into or renewed for offices or shops of more than 2,000 sq m. Starting on 14 July 2013, this obligation will also apply to leases in progress. The content of said appendix is defined by a decree of 30 December 2011. In practice, there are two major appendix categories: "light" appendices incorporating the respective disclosure obligations provided for in the aforementioned decree and other "heavy" appendices containing several pages (sometimes more than a dozen) that impose many new obligations not covered by the regulatory texts on the tenant. Some appendices establish specific commitments for improvement of the building's environmental and energy performance, even going so far as to provide for the lessor's possibility of enforcing the lease termination clause in the event of breaches of the obligations that they set out. Curiously, many tenants consider the environmental appendix to be a minor document and often neglect to negotiate it. This attitude can be harmful, since some lessors take advantage of the insertion of the green appendix during the lease's renewal to create new obligations for the tenant particularly pertaining to work to ensure compliance with standards. Recall that under current case law, work to ensure compliance with standards is the lessee's responsibility only if the lease expressly provides for it. Imprecise clauses or clauses drafted in overly general terms are interpreted in favour of the tenant in accordance with the provisions of Article 1162 of the French Civil Code. Therefore, when the initial lease is drafted in a sense that is unfavourable for the lessor concerning responsibility for work to ensure compliance with standards, it is tempting for a lessor to insert a clause into the green appendix specifically making the tenant responsible for this work and specify that *"in case of differences between the stipulations of the environmental appendix and those appearing in the lease, the stipulations of the environmental appendix shall take precedence"*. For example, the following clause may appear in a green appendix: *"All work to ensure compliance, safety, accessibility, environmental and energy regulations, as well as regulations resulting from the Grenelle II act and its implementing decrees, particularly with regard to energy, acoustics, air quality, illuminated signs, transport, and waste disposal, whether they pertain to the building, common areas, or private areas, will remain the responsibility of the lessee."* In addition, a certain category of lessors asks tenants to insert a green appendix into the lease, even when it pertains to premises of less than 2,000 sq m. It is obvious that the tenant and lessor may have a common interest in the "greening" of the leased property, particularly with regard to cutting costs. However, it should be ensured that the contractual obligations relating to the property's energy and environmental performance are balanced between the parties. The tenant must be aware of the new commitments contained in the environmental appendix and the related financial impacts, especially in a context of economic crisis.

"Some lessors take advantage of the insertion of the green appendix during the lease's renewal to create new obligations for the tenant particularly pertaining to work to ensure compliance with standards."

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Taking environmental law into account when drafting commercial leases

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Consideration of environmental law and especially classified facilities law[1] when drafting commercial leases deserves special attention for both the lessor and the lessee. Yet, the obligations of the parties are often obscured and far from being negligible particularly when a classified facility (ICPE) is intended to be operated by the lessee on the leased property.

Lessor's obligation of disclosure towards the lessee

Pursuant to Article L. 125-7 of the French Environmental Code[2], the lessor of a plot of land is required to inform the tenant in writing of information made public by the State mentioning a risk of soil pollution affecting the land under the lease. Otherwise, if pollution is found and makes the land unsuitable for its purpose specified in the lease, the tenant has the possibility of requesting the termination of the lease or obtaining a rent reduction within a period of two years after the discovery of the pollution.

"A commercial lease can be more demanding in terms of restoration and pollution removal than the regulations."

Delivery of the leased property

Some leases can be entered into under the determining condition of prior pollution removal of the property by the lessor. Such a clause imposes a true obligation of results on the lessor. Also, where considered, it is advisable to be particularly vigilant and precisely define the extent of the pollution removal to be performed, include the lessee by sending all reports and records, and invite the lessee to site meetings. The *Cour de cassation* actually dismissed the lessor's responsibility in such a case even though residual pollution persisted[3].

Tenant's obligations at the end of the lease When the operator of a classified facility plans to put an end to its activity on a site, the operator is then subject to compliance with various obligations: notification of the authorities of the cessation of activity, securing of the site (waste disposal, elimination of fire and explosion risks, etc.), preparation of a restoration report, and restoration of the site. Only the lessee, in the capacity of last official operator (i.e., duly declared/authorized by the prefect), is responsible for the site's restoration with respect to the authorities. Such lease-end obligations are not neutral. In the first place, although in common lease law the simple act of physically leaving the leased premises constitutes a legal return of the premises, this is not the case when the last operator operated a classified facility. In this case, the lessee will only be considered to have returned the premises after fulfilling the obligation of restoration of the premises[4]. As a consequence, the lessee will be liable for occupancy compensation until the date when proof is provided that all restoration measures have been implemented. In the second place, it should be noted that although the extent of the lessee's obligation is determined in relation to the site's future use under the conditions set by the Environmental Code, a commercial lease can be more demanding in terms of restoration and pollution removal. Thus, when a commercial lease requires the lessee to return the leased property clear and free of any pollution, the lessee will be considered not to have fulfilled the contractual obligation as stipulated in the lease with respect to the clause for return of the leased property if traces of pollution remain, even if the lessee complied with the legal and regulatory provisions for restoration corresponding to the established use[5].■

1. *Articles L. and R. 511-1 et seq. of the French Environmental Code.*
2. *A Conseil d'Etat decree must still define the rules for applying this article.*
3. *Court of Appeals of Paris, 7 March 2012; confirmed by Cass. 3rd civ. chamber 9 April 2013, n° 12-20344.*
4. *For example: Cass. 3rd civ. chamber, 10 April 2002. This principle applies even when the commercial tenant has been evicted with an offer of eviction compensation (Cass. 3rd civ. chamber, 19 May 2010).*
5. *Court of Appeals of Versailles, 3 January 2012*

Transfer of a commercial lease in a merger or partial transfer of assets

The law provides for specific measures when the transfer of a commercial lease occurs as part of the tenant company's merger or a partial transfer of assets.

Restructuring is not sufficient reason to break a lease agreement. A merger results in the transfer of all of the disappearing company's assets and liabilities to the existing or new companies that collect them (Article L. 236-3 of the French Commercial Code). Similarly, the partial transfer of assets subject to the legal regime for spin-offs constitutes a transfer of all assets and liabilities. It is because of the particular importance of the lease agreement for the company's activity that the legislature has expressly considered its automatic continuation in case of restructuring operations. In accordance with Article L. 145-16, paragraph 2 of the French Commercial Code, in the event of merger of companies or partial transfer of assets subject to the legal regime for spin-offs in accordance with Article L. 236-22 of the French Commercial Code, the company resulting from the merger or the beneficiary company of the contribution is, notwithstanding any contrary stipulation, takes the place of the company to which the lease was granted in all rights and obligations resulting from this lease.

According to the Court of Appeals of Paris[1], the substitution provided for in this article occurs automatically, *"regardless of the contrary or restrictive clauses of the lease, as the assignment of the lease is encompassed in the transfer of all assets and liabilities"*; in addition, this legal subrogation mechanism is public policy. In other words, the transfer of the lease occurs automatically without any formality other than those provided for by corporate law.

The result is that the lessor may not invoke restrictive clauses of the lease imposing special formalities for a lease assignment. Consequently, a clause that would require the lessor's approval in the event of assignment could not be applied in the event of a merger or partial transfer of assets subject to the legal regime for spin-offs. The lessor also may not invoke failure to fulfil the formalities provided for by Article 1690 of the French Civil Code. Mergers as well as partial transfers of assets subject to the legal regime for spin-offs therefore do not have to be reported to the lessor. The lessor of premises leased to absorbed or transferring companies only has the right to petition the court for additional guarantees, in accordance with paragraph 3 of the aforementioned Article L. 145-16.

"The transfer of the lease is automatically carried out without any formality other than those provided for by corporate law; as a result, the lessor may not invoke restrictive clauses of the lease."

In addition, the question has been raised of whether, within commercial companies, paragraph 2 of Article L. 145-16 of the French Commercial Code applied to limited liability companies (SARL), insofar as Article L. 236-22 appeared to consider only public limited companies (SA). In a ruling of 30 April 2003, the *Cour de cassation* maintained[2] that this paragraph applies to partial transfers of assets between SARLs on the grounds that SARLs, like SASs, can decide to apply the legal regime for spin-offs to them. As a result, this paragraph was amended by Article 16 of law no. 2012-387 of 22 March 2012.

In the end, Article L. 145-16 of the French Commercial Code is currently applicable to any partial transfer of assets between business corporations, even of different forms, placed under the legal regime for spin-offs.

On the other hand, a company's transfer of a portion of its activities to another company, without the parties to the agreement having applied the legal regime for spin-offs to the transfer, complies with the common law for assignment of claims governed by Article 1690 of the French Civil Code. As a result, the transfer of a commercial lease done in connection with such a transfer of activities without notifying the lessor cannot be enforced against the lessor.■

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1. Court of Appeals of Paris, 16 June 2000, RJDA 2000, no. 1100.
2. Cass. 3rd civ. chamber, 30 Apr. 2003, no. 01-16.697.

Real estate investment and Community discrimination (we haven't heard the last of it)

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1. Previously 16%. 2. Cf. Real Estate Newsletter of 28 November 2011, p. 7

The issue of the tax treatment of the sale of buildings located in France by non-resident natural persons has been the subject of extensive case law. Residents of France benefit from a rate of 19%[1] (excluding social security deductions), whereas non-residents are subject to the one-third deduction under Article 244 bis A of the French General Tax Code.

You may recall that on 25 February 2011, the administrative court of Montreuil held, on the basis of free movement of capital, that persons who are residents of States outside the EU should receive the same treatment as residents[2]. The court had rejected the application of the "standstill clause" provided for by Article 64 of the TFEU, which makes it possible to maintain restrictions existing before 31 December 1993, on the grounds that real estate investments were not "direct investments" within the meaning of the European classification. However, the *Conseil d'Etat*, in a Holzer ruling of 28 July 2011, held that this "standstill clause" was applicable on the grounds that Article 64 of the TFUE concerns *"direct investments, including real estate investments"*. The administrative court of Marseilles, in four rulings of 13 March 2012, put up a resistance by deciding that the "standstill clause" was not applicable in the case of purely pecuniary real estate investments, with the reporting judge engaging in a very detailed analysis of the notion of real estate investments while lamenting that the point was *"never under discussion before the Conseil d'Etat"*.

The issue was extended to sales of SCI shares by a ruling of the administrative court of Lyon of 29 January 2013, which held that the difference in taxation rates for a gain from the sale of a building by a French SCI based on whether the partners live in the EEA or not constitutes discrimination not covered by the "standstill clause".

We therefore look forward to a final decision from the *Conseil d'Etat* on the matter. ■

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