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# Real Estate transactions in France: Legal and tax aspects

July 2018

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## A. Purchasing entities: Main characteristics of the most commonly used companies to structure a real estate acquisition

### 1. Partnerships

#### 1.1 *Société civile immobilière (SCI)*

The main purpose of the SCI (Real estate partnership) is the management and rental of real estate. The SCI is subject to the legal provisions on the *société civile* since there are no specific rules applicable to this partnership.

There is no minimum share capital requirement.

These partnerships must be composed of at least two partners. Each partner is liable for the company's debts in proportion to their stake in the share capital of the partnership.

SCIs are managed by one or more managers (*gérant(s)*) which may be either individuals or legal entities.

Transfers of shares are subject to the other partners' unanimous approval, unless specified otherwise in the partnership agreement.

#### 1.2 *Société en nom collectif (SNC)*

The SNC (Unlimited partnership) is a commercial legal entity which is composed of at least two partners. All partners must be registered merchants (which excludes minors incapacitated and protected, adults, civil servants etc.)

There is no minimum share capital requirement.

Partners are jointly and severally liable for all the debts and obligations of the partnership.

The partnership must be managed by one or more managers (*gérant(s)*) which are not jointly and severally liable for the partnership's debts (unless they are also partners).

Transfer of shares is subject to other unanimous approval of the other partners.

Public offerings of its shares are not possible.

### 2. Limited liability companies

#### 2.1 *Société anonyme (SA)*

The SA is a commercial limited liability company which can offer its shares to the public in accordance with the Regulations of the *Autorité des marchés financiers* (French Financial Market Authority). This structure is suited to large companies.

A minimum of EUR 37,000 share capital is required for the incorporation of this type of company.

An unlisted SA must comprise at least two shareholders. A listed SA is composed of at least seven shareholders.

In terms of management, there are two options. The company can either be headed by a Board of Directors or by two bodies: An Executive Board and a Supervisory Board.

There are no particular restrictions regarding the transfer of shares between shareholders, unless specified otherwise in the articles of association.

#### 2.2 *Société par actions simplifiée (SAS)*

The SAS (simplified joint stock company) is a commercial limited liability company with no minimum share capital requirement. This company is a flexible structure: its corporate rules and governance are essentially determined in its articles of association.

The SAS must have at least one shareholder. Shareholders' liability is limited to the amount of share capital held.

The company is managed by a President who may either be an individual or a legal entity appointed in accordance with the articles of association. Other management structures may be freely determined in the articles of association of the company.

It is possible, for instance, to provide in the articles of association that the shares are not transferable for a maximum period of ten years, that shareholders may be excluded from the company and that transfers shall be, in any case, subject to the prior approval of the other shareholders.

Public offerings of its shares are not possible.

### 2.3 Société à responsabilité limitée (SARL)

The SARL (limited liability company) is a commercial limited liability company with no minimum share capital requirement. This company must be composed of at least one shareholder and at most of one hundred shareholders.

Shareholders' liability is limited to the amount of share capital held.

The SARL is managed by one or more managers (*gérant(s)*) appointed by the shareholders. The manager, who must be an individual, is vested with the broadest powers to act on behalf of the company.

Regarding the transfer of shares between shareholders, there are no particular restrictions, unless prior shareholders' approval is required in the articles of association. In other cases, the transfer of shares is subject to prior shareholders' approval.

Public offerings of its shares are not possible.

### 2.4 New legal provisions applicable to companies

Pursuant to Article L.561-46 of the French Monetary and Financial Code (*Code monétaire et financier*), introduced by the ordinance of 1<sup>st</sup> December 2016, companies now have to identify and register their beneficial owner(s) at Commercial and Companies Registry. Beneficial owner means one or several individuals who either directly or indirectly hold(s) more than 25% of the capital or voting rights of the company, or, exercise(s), by any other means, supervisory authority over the management, administration or governing bodies of the company or over the general meeting of partners. Companies or legal entities subject to this new obligation are (i) companies and economic interest groups having their registered office in France, (ii) foreign commercial companies having a branch in France and (iii) other legal entities that are required to register under legislation or Regulations. Pursuant to Article L.561-49 of the French Monetary and Financial Code, failure to comply or the filing of inaccurate or incomplete information gives rise to criminal liability (up to six-months imprisonment and a fine of EUR 7,500), as well as specific ancillary liabilities.

## B. Special investment vehicles

French Law recognises two types of structure which qualify as alternative investment funds ("AIF") within the meaning of Directive 2011/61/EU on alternative investment fund managers ("AIFM Directive"): Those whose characteristics are governed by the French Monetary and Financial Code and those whose characteristics are not.

Thus, real estate investment strategies may be carried either through (i) "normal" corporate structures which may, as the case may arise, qualify as an AIF or (ii) specific fund structures. Amongst these specific fund structures, some invest in all types of assets, including real estate, and some invest in a specific asset class. Amongst the latter, French Law recognises two specific types of AIF dedicated to real estate investments: The SCPI and the OPCI which are authorised and supervised by the AMF.

### 1. OPCIs

The OPCI (*organismes de placement collectif immobilier* - open-ended property funds) was added to the French Monetary and Financial Code by Ordinance No 2005-1278 of 13 October 2005 amended by Ordinance No 2013-676 of 25 July 2013.

This new vehicle was first created to replace the SCPI which was designed to disappear. The law was subsequently amended to allow for the continued creation of SCPIs and the co-existence of OPCIs and SCPIs.

#### 1.1 Purpose

The purpose of an OPCI is:

- to invest in existing buildings or in buildings to be erected (including off-plan properties) intended for rental, which it owns directly or indirectly;
- all operations necessary for the use or resale of the abovementioned buildings (implementation of works of any kind including construction, renovation, rehabilitation, with a view to their rental);
- the leasing of immovable properties leased through companies held in assets;
- in an ancillary respect, the management of financial instruments and deposits.

An OPCI may not acquire real estate assets exclusively for resale. Property trading (*marchands de biens*) is prohibited.

## 1.2 Creation and authorisation of OPCIs

OPCIs can either take the form of a *fonds de placement immobilier* (property investment fund or "FPI"), which has no legal personality, or a *société de placement à prépondérance immobilière à capital variable* (Open-ended companies investing primarily in real estate or "SPPICAV"), which is a specific form of company with legal personality.

OPCIs may have different classes of shares and may comprise several sub-funds.

An OPCI can be dedicated to a maximum of twenty (20) investors or to a category of investors, whose characteristics are specified by the prospectus.

The creation, conversion, merger, demerger or liquidation of an OPCI is subject to AMF approval. The application for authorisation, whose contents are set forth by the General Regulation of the AMF (*règlement général AMF*) and the AMF's guidelines, describes in particular the investment policy that the OPCI intends to pursue and its financing choices, in particular the use of debt.

In addition to the authorisation form, application files must include the following documents:

- The internal regulations (FPI) or articles of association (SPPICAV);
- The draft key investor information document (KIID) (unless the OPCI is only open to professional investors or is restricted to specific professional investors (*dédiés*). The purpose of the KIID is to provide an overview of the essential information on the OPCI (objectives, investment strategy, risk profile, fees, past performances and other practical information). As a principle, the KIID's content and format must comply with EU Regulation No 583/2010. In addition, if the OPCI is open to retail investors, a key information document ("KID") compliant with EU Regulation No 1286/2014 ("PRIIPS Regulation") has to be drafted. OPCIs may benefit from an exemption and a KIID compliant with EU Regulation No 583/2010 may suffice until 31 December 2019;
- The draft prospectus containing:
  - . A detailed explanation of the rules of management and operation of the OPCI;
  - . Specific information on the OPCI's investment rules and on the types of assets (real estate assets, financial instruments, liquid assets, etc.) the OPCI may hold;
  - . Specific information on the risks identified on the OPCI and information on costs and fees.
- A commitment letter from the management company stating that it has the necessary organisational structure and internal procedures and resources to ensure compliance with the applicable rules;
- Undertakings from the independent property appraisers;
- If applicable, marketing documents;
- For SPPICAVs: Corporate documents (organisation chart, curriculum vitae of the President and information on other offices held by Directors);
- For OPCIs reserved to a maximum of twenty (20) subscribers: A commitment letter from the management company stating that (i) the number of subscribers in the OPCI may not exceed twenty persons or, if applicable, that the OPCI is reserved to a specific category of investors; and (ii) the OPCI is not subject to any form of publicity to, solicitation of or marketing to the public;
- For OPCIs managed by a French management company wishing to market its shares/units in France: An application form for marketing the OPCI shares/units in France.

The minimum amount of the net assets of an OPCI (SPPICAV or FPI) is EUR 500,000.

### 1.2.1 FPIs

An FPI is an OPCI with no legal personality.

It is a co-owned structure comprising real estate assets, financial instruments and other assets with units that are issued and acquired by holders at their net asset value, plus or minus expenses and commissions, as applicable.

The FPI is set up by a managing company, responsible for its management, and which shall draw up the fund rules.

Unitholders are only held to the debts of the FPI up to the amount of its assets and in proportion to their units.

The management company represents the FPI vis-à-vis third parties.

### 1.2.2 SPPICAVs

A SPPICAV is a *société anonyme* or *société par actions simplifiée* with a variable share capital.

A SPPICAV is not only governed by the provisions of the French Monetary and Financial Code but also by the provisions of the French Commercial Code (*Code de commerce*) applicable to *sociétés anonymes* and/or *sociétés par actions simplifiée*.

Contributions to an OPCI may be made in cash or in kind of real estate assets excluding

contributions of services. An OPCI may also be formed by the merger, demerger or conversion of an SCPI. The General Regulation of the AMF sets out the conditions and limits of such contributions.

The initial capital of a SPPICAV is equal at all times to its net asset value, less distributable amounts.

Admission to trading on a regulated market of shares is possible for SPPICAVs incorporated as *sociétés anonymes*, but prohibited for SPPICAVs incorporated as *sociétés par actions simplifiées*.

Such listing is extremely rare in practice, as the AMF is reluctant to condone these.

### 1.2.3 OPPCIs

The French Monetary and Financial Code provides for a category of OPCI restricted to professional investors. Such OPCIs, which may take the form of either an FPI or a SPPICAV, are named *organismes professionnels de placement collectif immobilier* ("OPPCI").

Subscriptions to OPPCIs are limited to professional clients.

Pursuant to Article L.533-16 of the French Monetary and Financial Code, a professional client is a client with the necessary experience, knowledge and skills to make their own investment decisions and to properly assess the risks involved. Article D.533-11 of the French Monetary and Financial Code lists the categories of investors which qualify as professional clients by nature.

Investments in professional OPCIs are reserved to investors whose initial subscription is equal or superior to EUR 100,000 and/or for all other investors if the subscription is made in their name and on their behalf by an investment services provider acting within the framework of a portfolio management investment service under certain conditions.

Subscribers which are not professional investors must invest a minimum level of funds (EUR 100,000). Such minimum amount does not apply if the subscription is made in the name and on behalf of an investor (whether professional or non-professional) by an investment services provider acting within the framework of a portfolio management investment service under certain conditions.

The depositary or the person appointed in the prospectus (often the entity in charge of promoting the vehicle) is to ensure that subscribers meet all of the criteria for subscribing for this type of OPCI.

The creation of an OPPCI is submitted to AMF approval. However, OPPCIs benefit from lighter rules pursuant to the French Monetary and Financial Code. In particular:

- Exemption from the rules relating to indebtedness;
- OPPCIs need only to appoint one independent property appraiser;
- The 5% quota on liquid assets does not apply;
- No limits on non-controlled shareholdings;
- No limits on undeveloped, non-building land;
- The 20% quota on real estate holdings does not apply;
- Exemption from the rules on financial instruments, indebtedness, warranties and securities provided for in Articles R.214-92 to R.214-117 of the French Monetary and Financial Code.

## 1.3 Operation of OPCIs

### 1.3.1 Eligible assets of OPCIs

The French Monetary and Financial Code provides a list of assets that may or must be held by OPCIs, as well as regarding their indebtedness. Such rules are summarised in the table below:

REAL ESTATE ASSETS	
- Real estate properties and rights <i>in rem</i> on such properties.	
- Shares of unlisted real estate companies whose shareholders' liability may exceed their contributions.	Conditions : - Companies drawing up annual and half-yearly accounts; - Assets made up of buildings acquired or built for the purpose of renting or of real rights; - Controlled by the SPPICAV; - Financial instruments not traded on a regulated market.  Shares in an entity whose shareholders are liable indefinitely, jointly and severally for debts are not eligible.

- Shares of unlisted real estate companies whose shareholders are liable for debts of the companies up to the amount of their contribution.	See conditions above. An OPCI may hold shares of non-controlled companies under certain conditions and up to a certain limit. Shares of such companies are not eligible assets for FPIs. Only SPPICAVs may hold such shares.
- Shares of listed real estate companies.	Shares of such companies are not eligible assets for FPIs. Only SPPICAVs may hold such shares. A SPPICAV may hold such shares for up to 9% of its assets.
- Shares or units of OPCIs or equivalent foreign investment funds.	Eligible under certain conditions.
<b>OTHER ASSETS</b>	
- Listed financial securities.	
- Shares or units of undertakings for collective investments in transferable securities ("UCITS") or shares or units of AIFs.	
- Deposits and liquid financial instruments.	Only certain types of instruments, as listed by the French Monetary and Financial Code.
- Cash and liquid asset.	As defined by the French Monetary and Financial Code.
- Shareholder loans.	Granted to real estate companies in which the OPCI holds directly or indirectly at least 5% of the capital.

### 1.3.2 Real estate quotas and regulatory ratios

In addition to rules on eligible assets, OPCIs' assets must comply with rules on real estate quotas and on regulatory ratios. Such rules are summarised in the table below:

- Real estate assets and rights <i>in rem</i> on such assets, including listed real estate shares.	At least 60% of the assets.
- Real estate assets excluding listed real estate shares.	At least 51% of the assets (for SPPICAVs only).
- Cash, deposits and liquid assets.	At least 5% of assets.
- Units or shares of OPCIs.	Up to 10% of real estate assets.
- Real estate properties (directly or indirectly owned by the OPCI).	At least 20% of real estate assets.
- Shares of the same listed real estate company	Up to 20% of said company (including any listed real estate company) and up to 10% of the OPCI's assets per issuer (excluding for any listed real estate company).
- Units or shares of the same UCITS.	Up to 20% of the same UCITS and up to 10% of the OPCI's assets per UCITS.
- Units of the same class of financial instruments issued by the same entity.	At most 20% of said company.
- Indebtedness.	Up to 40% of real estate assets.

### 1.3.3 Administration, management, evaluation

The duties as Chief Executive Officer, Deputy Chief Executive Officer and Chairman of the Management Board or single Chief Executive Officer of a SPPICAV are ensured by a portfolio management company duly authorised by the AMF (*société de gestion de portefeuille*).

Subject to the powers expressly conferred by Law on shareholders' meetings and to the powers it reserves specifically to the Board of Directors, and within the limits of corporate purpose, the management company, in its capacity as Chairman and Chief Executive Officer, is vested with the broadest powers to act in all circumstances on behalf of the SPPICAV.

The Board of Directors determines the policy applicable to the SPPICAV's activities and oversees implementation. Within the limits of corporate purpose and subject to the powers expressly conferred by Law on shareholders' meetings, it shall examine all issues pertaining to orderly operation of the SPPICAV and shall regulate with its decision those issues that concern it. The Board of Directors shall carry out such checks and controls as it deems appropriate.

The Regulations of the FPI will provide for the establishment of a Supervisory Board composed of representatives of the unitholders. The Board will be composed of no less than two members and not more than nine members. It cannot interfere in the management of the fund. The General Regulation of the AMF lays out the conditions according to which it is to carry out its assignment, the terms and conditions for the appointment of its members and the resources available to them. The members of the Supervisory Board are liable for personal misconduct in the performance of their duties. They shall incur no liability for acts of management and consequences thereof.

The Supervisory Board shall, where it deems it necessary and at least once a year, draw up a report providing an account of its assignments. The General Regulation of the AMF lays out the conditions according to which this report is brought to the attention of unitholders.

A depositary - either a French credit institution or an authorised French investment firm - must be appointed, with the role of holding in custody the OPCI's assets other than real estate assets, monitoring the cash flows of the OPCI, checking the inventory of all assets and the validity of investment decisions.

Within six weeks from the end of each half-year period of the financial year, the management company shall draw up an inventory of the assets of the OPCI under the supervision of the depositary.

The management company draws up the annual accounts of the OPCI and a written report on the management of the OPCI, whose contents indicate in particular the OPCI's situation in terms of debt and liquidity. This report is made available to shareholders under conditions and within the limits specified in the General Regulation of the AMF.

Two real estate appraisers approved by the AMF are also appointed to draw up valuations on a regular basis to determine net assets. Only one real estate appraiser is necessary for professional OPCIs.

Real estate appraisers must have the necessary experience, skills and structure to perform their duties in the field of real estate valuations.

The SPPICAV and the management company shall be liable, individually or jointly and severally, as the case may be, vis-à-vis third parties or shareholders, for breaches of the Laws or Regulations applicable to SPPICAVs, for violations of the company's articles of association, and for their own misconduct.

### 1.4 Shareholders – Rights and obligations

The OPCI may comprise different categories of units or shares in accordance with the conditions set forth in the Regulations of the FPI or the articles of association of the SPPICAV according to the provisions of the General Regulation of the AMF.

The General Regulation of the AMF sets forth the conditions for the issue, subscription, sale and redemption of units or shares issued by the OPCI.

An OPCI may comprise more than one sub-fund if the Regulations of the FPI or the articles of association of the SPPICAV so provide. Each sub-fund shall give rise to the issue of one or more categories of units or shares representing the assets of the OPCI allocated to it.

The General Regulation of the AMF sets forth the conditions (i) of the French Market Authority's approval regarding the constitution of each sub-fund and (ii) of determination of the assets' net asset value allocated to the corresponding sub-fund, taking into account the net asset value of each class of units or shares.

The distributable profit of an OPCI is determined in accordance with specific rules laid down by the French Monetary and Financial Code. An OPCI has the legal obligation to distribute a large portion of this result, i.e. at least 85% of the result derived from the real estate assets and at least 50% of the capital gains achieved by a SPPICAV, and at least 85% of the capital gains achieved by an FPI, under the conditions provided for by the French Monetary and Financial Code (**please refer to Chapter I - Sections 4.1.1 and 4.1.2**).

Shareholders of an FPI are only bound by the debts of the FPI up to the amount of its assets and in proportion to their shares.

The shareholders of the SPPICAV have a liability limited to the subscription value of the SPPICAV's shares.

The shareholders of the SPPICAV have the prerogatives granted to them by Law and the articles of association (approval of annual accounts, conversion of the SPPICAV, merger, demerger, dissolution etc.).

### 1.5 Liquidation

By exception to the provisions of the French Commercial Code, the liquidation conditions and the distribution of assets are determined by the SPPICAV's articles of association.

The terms of liquidation are determined by the Regulations of the FPI.

The management company shall act as liquidator, under the supervision of the depositary; Failing which, the liquidator will be appointed by Court at the request of any shareholder, from among authorised portfolio management companies.

## 2. SCPIs

Among civil companies, the SCPI is a specific form dedicated to the acquisition and lease of real estate.

### 2.1 Corporate purpose

Its corporate purpose is:

- The direct or indirect acquisition of real estate to be let, including buildings to be completed, whether for a commercial or residential use;
- The acquisition and management of real estate built by the company exclusively for the purpose of rentals.

With regard to the indirect acquisition of real estate, the company can hold shares in non-listed companies meeting the following criteria:

- The liability of the shareholders must exceed their contributions, but cannot be joint and several;
- The assets held by the company must be real estate acquired or built for the purpose of rentals;
- Other assets can include shareholder's loans granted by the SCPI;
- The company cannot hold shares in companies where shareholders face unlimited, joint and several liability;
- The company can hold shares in other SCPIs or in OPCIs.

Moreover, SCPIs can sell a portion of their real estate, subject to the following conditions: (i) such assets have not been bought with a view to their resale (ii) such sales are not carried out habitually (iii) the total value of assets sold within one financial year does not exceed 15% of the real value of the SCPI's real estate assets as of the last financial year (such limit to be extended to the following financial year in the event no sale has been completed within one or two successive financial years).

### 2.2 Creation of SCPIs

An application for the authorisation of an SCPI must be submitted beforehand to the AMF. The contents and form of the application are described in guidelines issued by the AMF.

In addition to the authorisation form, the application must include the following documents:

- The articles of association;
- The minutes of the constituent general meeting that appointed the Supervisory Board and the statutory auditors;
- The certificate of deposit of the funds representing the initial capital subscribed by the founding parties;
- The prospectus;
- The KIID;
- A memorandum providing detailed information on the founding parties;
- The subscription form;

- The notice to be published in the French *Bulletin des annonces légales obligatoires* – BALO (Bulletin of compulsory legal notices);
- The bank guarantee;
- An undertaking on the proposed collection plan;
- The work program of the incumbent auditor, drawn up in terms of the number of hours per control heading and broken down as per type of assistance, if applicable, the amount of fees provided for in respect of such assistance and the hourly rate contemplated;
- The certificate of registration of the auditor;
- The file of acceptance of the real estate expert (commitment and agreement);
- The acceptance of the depositary and agreement with such depositary.

Founding parties must subscribe and pay the total amount of the initial minimum share capital, i.e. EUR 760,000. The shares subscribed cannot be sold before a period of three years as from the issuance of the AMF visa.

The share capital of an SCPI can be fixed or variable. However, where the share capital is fixed, the articles of association can provide for a maximum amount up to which the management company can proceed with a share capital increase without the prior authorisation of the shareholders' meeting.

Within one year from the opening of the subscription period, a portion equal to 15% of the maximum amount of the share capital has to be subscribed via a public offering.

If such share capital increase is not completed, the SCPI will be liquidated and the contributions refunded to the shareholders.

### 2.3 Operation of SCPIs

SCPIs, much like OPCIs, must be managed by an authorised management company and appoint a depositary responsible for the custody of the SCPI's assets and supervising certain decisions taken by the management company.

The management company is appointed either by the articles of association or by the shareholders' meeting and can be dismissed by the shareholders' meeting.

The management company and the depositary must provide sufficient assurance as to their organisation, technical and financial resources, the good repute and experience of their Directors. They shall take appropriate measures to ensure the safety of operations.

The management company is the legal representative of the SCPI and has all powers to acquire real estate on behalf of the SCPI and to enter into any contracts for the management thereof.

The management company may thus take out loans on behalf of the SCPI and grant security over the assets of the company for the purpose of its activity.

The management company is responsible for preparing the annual accounts, the management report and attaching to this report a statement of the book value, the realisable value and the reconstitution value of the SCPI.

It has to convene the shareholders' meeting within six months from the end of the financial year to submit the annual accounts.

The management company is competent to decide on the distribution of interim dividends, to fix the amount and date of payment thereof.

The management company is civilly liable, notably for its management mistakes and may also be criminally liable, in particular, for infringements of the provisions of the French Monetary and Financial Code.

A Supervisory Board, composed of at least seven members, appointed from among the shareholders by the general meeting, is responsible for assisting the management company. At any time of the year, the Supervisory Board may carry out the checks and controls it deems appropriate and may request any document or ask the management company for a report on the situation of the SCPI. The Supervisory Board may issue an opinion on the resolutions that are submitted to the shareholders' meeting.

### 2.4 Shareholders – Rights and obligations

The shareholders' meeting is the body empowered to appoint and dismiss the management company, to appoint the members of the Supervisory Board and the statutory auditors. It approves the accounts, decides on the distribution of profits, amends the articles of association, and resolves to dissolve the SCPI.

Shareholders are entitled to dividends and liquidation proceeds.

They are liable for the debts of the company, up to twice the amount of their contribution, being specified that the articles of association may limit this liability to the amount of their contribution. This liability may only be incurred if the SCPI has been pursued beforehand and unsuccessfully.

## 2.5 Transfer of shares

Purchase and sale orders for shares must be recorded on a purchase register held at the SCPI's registered office under the responsibility of the management company. The management company must periodically establish an execution price by comparing orders entered onto the register. Orders are executed at the execution price.

Transfers of shares are recorded in the register of shareholders. This registration is deemed to constitute the act of transfer and makes the transfer enforceable against the SCPI and third parties.

Where the SCPI has been incorporated with a variable capital, the shareholders may withdraw from the SCPI, resulting in a cancellation of the shares and a reduction of capital, in accordance with the terms and conditions set forth in the articles of association and within the limits of the capital base.

## 2.6 Mergers, liquidation

An SCPI may be merged with another SCPI, holding comparable real estate, i.e. composed mainly of buildings for a commercial use or of residential buildings.

An SCPI can also contribute its assets to an OPCI.

There are no specific provisions in the French Monetary and Financial Code relating to the dissolution and liquidation of an SPCI. The applicable rules are those set forth in the French Civil Code (*Code civil*) for civil partnerships.

## 3. SIICs

A *société d'investissements immobiliers cotée* (SIIC) is a listed real estate investment company, eligible for exemption from corporate income tax on their real estate income, if an election is made to that effect and subject to certain conditions relating to distribution of profits.

### 3.1 Purpose

To qualify as a SIIC, the company must meet various criteria. One pertains to its corporate purpose - i.e. the acquisition or construction of immovable property with a view to its rental, or to the direct or indirect ownership of interests in legal persons whose corporate purpose is identical **(please refer to Chapter I - Section 4.2.1)**.

The SIIC must be listed, as from the first day of the financial year the company registered for SIIC status, on a regulated financial market located in a Member State of the European Union or the European Economic Area.

### 3.2 Share capital

SIIC companies must have a minimum share capital of EUR 15 million. Satisfaction of this criteria is assessed on the first day of the financial year in which the option is made and is assessed continuously during the regime's implementation period.

### 3.3 Shareholding rules

The SIIC company's share capital must also meet the two criteria below:

- No shareholder may hold 60% or more of the SIIC's share capital. This ownership cap is assessed in terms of share capital and voting rights. Accordingly, the regime may not apply to companies in which 60% or more is held by one or more persons acting in concert within the meaning of Article L.233-10 of the French Commercial Code.

Persons are deemed to be acting in concert within the meaning of Article L.233-10 of the French Commercial Code when they have executed an agreement to acquire or sell voting rights or in order to exercise voting rights, so as to implement a policy vis-à-vis the company. In certain situations, the Law presumes the existence of such an agreement.

The 60%-rule does not apply to shareholders which themselves are SIIC companies. Therefore, it is not prohibited for several SIICs, acting in concert, to hold 60% or more of the share capital of another SIIC. The interest taken into account is assessed directly or indirectly.

The 60%-rule must be satisfied from the beginning of the financial year, and is assessed on an on-going basis.

However, the cap may be temporarily exceeded due to the completion of a limited list of transactions:

- Offers for the acquisition or exchange of shares;
- Restructuring operations referred to in Article 210-0 A of the French Tax Code (mergers, demergers, universal transfers of assets and liabilities);
- Conversions or repayments of bonds in shares.

In such cases, the ownership requirement is deemed satisfied if the rate is reduced to 60% at the end of the period of filing of the income tax return regarding the financial year concerned with the overrun of the threshold.

In the event of non-compliance with the ownership threshold at the end of that period, the SIIC will be subject to the standard corporate income tax for the financial year concerned, without the SIIC regime being terminated. If the criteria is satisfied anew during the next financial year, the SIIC may then again rely on its exemption regime.

- At least 15% of the SIIC's share capital must be owned by persons who individually own less than 2% of the capital.

Satisfaction of such capital dispersion requirement is assessed solely at the time the SIIC becomes subject to the regime and identically in terms of capital and voting rights. Thus, only shareholders holding directly or indirectly at the same time less than 2% of the share capital and less than 2% of the voting rights are taken into account to determine the 15% rate.

## 4. Tax issues

### 4.1 OPCIs

There are two categories of OPCI: The SPPICAV and the FPI.

The Fiscal rules governing OPCIs are summarised below.

#### 4.1.1 Tax regime applicable to SPPICAVs

SPPICAVs are totally exempt from corporate income tax on all income and profits derived by the company from the activities that are within the scope of its declared purpose. Additional contributions on corporate income tax are not applicable to SPPICAVs either.

However, this exemption is subject to the following distribution obligations imposed by Article L.214-81 (II) of the French Monetary and Financial Code:

- 85% of the results of the previous period (rental income that they receive directly or indirectly);
- 50% of the net capital gains from disposals of real estate assets during the current or previous period, directly or indirectly through partnerships that are not liable for corporate income tax;
- 100% of the fraction of net results of the previous period derived from products distributed by share companies that are more than 95% owned by their parent company and that have opted to be exempted from corporate income tax on their real estate activities.

SPPICAVs are also exempt from the annual 3% tax on real properties.

In principle, converting a company that is liable for corporate income tax into a SPPICAV brings about the same consequences as a disposal of a business, meaning that any profits yet untaxed and any underlying capital gains derived from the company's assets will be immediately taxable at the reduced rate of 19%.

Where SPPICAVs continuously own at least 95% of their capital indirectly or indirectly, the subsidiaries of SPPICAVs whose purpose is identical to that of a SIIC (listed property investment company) can opt for exemption from corporate income tax that applies to SIICs. The same applies to subsidiaries that are jointly held by several SPPICAVs or by several SIICs and SPPICAVs. The condition pertaining to ownership of at least 95% of the capital directly or indirectly must be complied with continuously throughout the entire financial year.

#### a. Individual investors in SPPICAVs that are French tax residents

Individual investors that are French tax residents are taxed on the share of income distributed to them by SPPICAVs, under the same regime as for dividends. This means that they pay the *PFU* (i.e. *flat tax*) single flat-rate withholding tax at the global rate of 30%, including a flat-rate of 12.8% for income tax and an overall rate of 17.2% for social contributions.

The 40% allowance is cancelled for dividends that are chargeable to *PFU*. Furthermore, no expenses (not even a portion of the *CSG* tax) are deductible against taxable income.

The profits derived from disposals for remuneration or from redemptions of SPPICAV shares are

taxable in the same way as capital gains on stocks and shares by individuals, and are chargeable to *PFU* at the total rate of 30%.

Individual shareholders can, however, opt expressly and irrevocably for taxation on all of their unearned income according to their income tax band. Unearned income is taxed based on a net amount. However, when it is paid from exempt profits, unearned income does not benefit from the 40% allowance.

Finally, the exceptional contribution on high income is also due, at the rate of 3% or 4%, according to the tax household's *revenu fiscal de référence* (base income for fiscal purposes, which includes dividends and capital gains).

#### **b. Corporate investors liable for French corporate income tax**

Income distributed by SPPICAVs to their corporate investors that are liable for French corporate income tax is included in the result on which corporate income tax is chargeable at the rate of 33.33% (plus any additional contributions). This income is excluded from the special regime applicable to parent companies.

Gains recorded from disposals or redemptions of SPPICAV shares are currently liable for corporate income tax at the rate of 33.33% (plus any additional contributions), as these securities are expressly excluded from the tax regime on long-term capital gains.

There are plans for the standard rate of corporate income tax to be progressively lowered to 25% by 1<sup>st</sup> January 2022.

#### **c. Non-resident investors**

Subject to the terms of tax Treaties, income distributed by SPPICAVs to non-resident individuals or companies is taxed at source as income distributed by French companies liable for corporate income tax, at the rate of:

- 12.8% for individuals;
- 30% for companies;
- 75% if the investor is domiciled or established in an *ETNC* (non-cooperative State or territory or NCST).

The tax Treaties signed between France and the states of residence of shareholders of SPPICAVs can provide for exceptions from the French rules, particularly when they recognise SPPICAVs as French tax residents or when they apply, under certain conditions, rates of taxation payable at source lower than 30%, particularly for corporate investors.

Capital gains realised by non-residents from redemptions or disposals of shares in a SPPICAV are taxable in France when the disposer owns, directly or indirectly, at least 10% of the capital of the company whose shares are being disposed of, at the following rates:

- Either at the rate of 33.33% if the disposer is a company;
- Or at the rate of 19% (plus social contributions at the rate of 17.2%) if the disposer is an individual, on the basis of the capital gains reduced by taper relief.

Disposals or redemptions of SPPICAV shares are usually exempt from registration duty, except where (i) the purchaser already owns, or will own as a result of the acquisition, more than 10% of the shares of the SPPICAV, directly or through their family group, or (ii) where the purchaser is a legal entity or a fund that already owns, or will own as a result of the acquisition, over 20% of the shares of the SPPICAV. In such cases, a 5% registration duty is payable.

Similarly, when a SPPICAV buys back its own shares, a 5% registration duty is payable when the shareholder comes under one of the above categories.

#### **4.1.2 Tax regime applicable to FPIs: Application of the rules of “fiscal transparency”**

FPIs must distribute a minimum percentage of the income and capital gains earned over the course of each financial year closed:

- 85% of the fraction of results sourced from real estate assets owned directly by the FPI or through a partnership that is not liable for corporate income tax;
- 85% of the fraction of results sourced from transferrable assets owned directly or through a private partnership that is not liable for corporate income tax;
- 85% of the capital gains sourced from the disposal of real estate assets owned directly or through a private partnership;
- 85% of the capital gains sourced from the disposal by the FPI of transferrable assets owned directly or through a private partnership.

As FPIs are not legal entities, the investors are taxed as though they themselves had received the income it collects, on the condition that the income and profits are actually distributed to them.

In application of the principle of fiscal transparency, investors in FPIs are taxed directly on the share they receive, according to the nature of the income received in the corresponding category of income.

### a. Individual investors in FPIs

Income collected by FPIs is taxed according to type:

- Proceeds from the FPI's immovable property assets that are rented unfurnished are taxed as property income, according to General Law;
- Proceeds from the FPI's immovable property assets rented furnished are taxed as industrial and commercial profits;
- Proceeds from the FPI's transferrable assets are considered as share income received by the shareholders, as at the date of distribution. They are taxable under the category that corresponds to their type (dividends and proceeds from fixed income investments) under *PFU*, at a total rate of 30%, including a flat-rate of 12.8% for income tax and an overall rate of 17.2% for social contributions.

The 40% allowance is cancelled for dividends that are chargeable to the *PFU*. Furthermore, no expenses (not even a portion of the *CSG* tax) are deductible against taxable income.

Individual investors can, however, opt expressly and irrevocably for taxation on all of their unearned income according to their income tax band. Unearned income is taxed based on a net amount, i.e. after deducting the 40% allowance applicable to dividends;

- Capital gains realised by FPIs and distributed to investors are taxed in the hands of the investors, according to the type of asset disposed of:
  - . Under the regime of capital gains realised on real properties by individuals where the real properties or property rights held directly or indirectly are disposed of, or upon the disposal of shares in private partnerships whose assets mainly consist of real estate and that are liable for income tax (after applying taper relief, as the case may be). The rate is 19%, plus social contributions for 17.2%, i.e. a total rate of 36.2%;
  - . Under the category of professional short-term capital gains when furnished rented properties are disposed of by investors who qualify as a professional furnished property landlord (*loueur en meublé professionnel*) (taxable at the incremental rate of income tax);
  - Under the category of capital gains from stocks and shares, when shares and assimilated assets are disposed of (*PFU* at the rate of 30%).  
Disposals of shares in FPIs are taxed as follows:
    - . Under the category of capital gains from business assets where, at the time of the disposal, at least 50% of the value of the fund's assets are invested in real estate recorded in the fund's assets and rented out as furnished, and where the investors are considered as being engaged in the activity of a furnished property landlord;
    - . Securities that have been held for under two years are subject to the short-term capital gains regime (taxed as income at the incremental tax rate);
    - . Securities that have been held for over two years are subject to the long-term capital gains regime (taxed at 19% + social contributions, i.e. 33.2% in total);
    - If neither of the above criteria are satisfied, the capital gains tax regime for real estate applies (i.e. by applying taper relief, and then taxing the net amount at 19% plus 17.2% for social contributions, making 36.2% in total).

### b. Corporate investors chargeable to French corporate income tax

Income distributed by FPIs to corporate investors that are chargeable to corporate income tax is included in the result on which corporate income tax is due, at the rate of 33.33% (plus any additional contributions).

Gains sourced from disposals or redemptions of shares in FPIs are currently liable for corporate income tax at the rate of 33.33% (plus any additional contributions), as such shares are expressly excluded from the long-term capital gains tax regime.

### c. Non-resident investors

Subject to the terms of tax Treaties, income distributed by FPIs to individual or corporate non-resident investors is considered as French-sourced income taxable in France:

- Dividends distributed by FPIs: Taxed at source as income distributed by French companies chargeable to corporate income tax, at the rate of 12.8% for individuals, 30% for corporate entities and 75% for investors domiciled or established in a NCST (non-cooperative State or territory);
- French-source property income distributed by FPIs to an individual: Taxed as income at the incremental rate, in the category of property income, plus social contributions at the rate of 17.2%; taper relief applies;
- French-source property income distributed by FPIs to legal entities is included in the result on which corporate income tax is due at the rate of 33.33% (plus any additional contributions);

- Fixed-income investment products: Not taxed at source, except for distributions to investors established in an NCST (non-cooperative State or territory) (75%).

Subject to the terms of international tax Treaties, capital gains realised by individual, non-resident investors on redemptions or disposals of their shares in FPIs are subject to a 19% withholding tax and social contribution at the rate of 17.2% on net capital gains after deducting taper relief.

Capital gains realised by corporate, non-resident investors on redemptions or disposals of securities in FPIs are subject to a 33.33% withholding tax.

If one of the investors in an FPI is chargeable to corporate income tax at the end of the financial period, the FPI must pay the contribution on rental income. FPIs (and comparable foreign entities) are exempt from the 3% tax on the value of properties they own in France.

## 4.2 SIICs

The SIIC regime, codified under Articles 208 C and 219, IV of the *Code général des impôts* (French Tax Code), has strengthened the real estate sector specificity on the stock market, by creating a class of autonomous assets with higher net returns and facilitating arbitrage transactions on the real estate market.

It also led to a reduction, or even to the disappearance of discounts on real estate companies shares, as compared with their revaluated NAV, and helped to align French real estate companies with their Dutch (FBI), Belgian (Sicafi) or US (Reits) counterparts.

### 4.2.1 Election requirements

The regime is available to SIICs and, subject to certain criteria, to their subsidiaries chargeable to corporate income tax, if the relevant SIIC holds an interest of no less than 95%.

Subsidiaries of SPPICAVs, joint subsidiaries of SIICs and SPPICAVs, as well as subsidiaries held by several SIICs and/or several SPPICAVs may also elect for the SIIC regime, subject to the same criteria.

Such criteria, which must be satisfied cumulatively and for the entire implementation period of the regime, are the following.

#### a. Criteria relating to (i) share capital and (ii) shareholders

**Please refer to Chapter I - Sections 3.2 and 3.3.**

#### b. Criteria relating to corporate purpose

The corporate purpose of SIIC companies must consist essentially of the acquisition or construction of immovable property with a view to its rental, or to the direct or indirect ownership of interests in legal persons whose corporate purpose is identical.

The main activity must consist in the rental of real property intended for a residential, commercial or industrial use (the rental of parking facilities is allowed only if such is incidental to the rental of the above immovable property).

The scope of the exemption is extended to profits derived from:

- The operation or transfer of the usufruct of an immovable property asset;
- The exercise or transfer of the lessee's rights under a construction lease (*Code de la construction et de l'habitat* - French Construction and Housing Code, Art. L.251-1 *et seq.*) or long-term lease (*Code rural* - French Rural Code, Art. L.451-1 *et seq.*); or
- The sub-leasing of immovable property the use of which was temporarily granted by the State, a territorial community (*collectivité territoriale*) or one of their agencies (in practice, this refers to property operated under a concession agreement or an agreement for the long-term occupancy of the public domain).

Where the SIIC's activity is conducted partially abroad, only the part normally taxable in France may be eligible for the regime, provided, as is generally the rule, that the applicable tax treaty grants the State, in which the relevant property is located, the right to tax the management income or the capital gains arising in connection with the sale of the property. Where the right to tax is not granted exclusively to the State in which the property is located, the income generated by the foreign activity is eligible for the regime. However, in such cases, the SIIC may still, when electing, waive the right to take into account the income from such foreign activity.

The pursuit of ancillary activities by the real estate company does not deprive it of the right to duly elect for the regime, provided that the value of the assets necessary for the pursuit of such activities (real estate development, real estate dealer, etc.) does not continuously exceed 20% of the gross value of the SIIC's total assets.

The pursuit of a property finance lease activity – which is frequently carried out by real estate companies that may have been previously subject to the statutory regime applicable to Sicomis – does not deprive these companies of the right to be subject to the SIIC regime, provided that no more than 50% of their assets consist of amounts outstanding under property finance leases.

The income generated by ancillary activities, not corresponding to the main purpose of the company, remains subject to standard taxation.

#### 4.2.2 Interests held by SIICs

Among the interests held by a SIIC, it is important to distinguish opaque companies (subject to corporate income tax) from tax look-through companies (referred to under Article 8 of the French Tax Code: Mainly SCIs and SNCs).

Companies that are subject to corporate income tax, whether as a matter of Law or as a result of an election, may elect for the application of the SIIC regime if they satisfy simultaneously and throughout the entire application period of the regime, the two following criteria:

- On the one hand, to have at least 95% of their capital owned directly or indirectly by one or more real estate companies that have elected for the SIIC regime (or jointly by one or more SIICs and/or one or more SPPICAVs);
- On the other hand, to conduct the principal real estate activity defined above.

The conduct of ancillary activities by these companies, which are 95% owned subsidiaries of the SIIC, does not deprive them of the right to elect for the regime (subject to the 20% or 50% ratio limitation already mentioned above).

As regards partnerships, which are look-through entities for tax purposes, the net income earned by them in an activity identical to that of their partners is deemed achieved by said partners. As a consequence, such income is tax-exempt in the hands of their SIIC partners, or in the hands of the subsidiary of a SIIC having made the election, in proportion to their rights, subject of course to distributions.

#### 4.2.3 Making the election

Notice of the election is filed by the SIIC and by each subsidiary subject to corporate income tax in which an interest in excess of 95% is held and that intends to make an election for the application of the regime, on unstamped paper or by e-mail at the relevant tax office, at the latest before the end of the fourth month following the beginning of the financial year during which the company intends to be subject to the regime.

The election made by the SIICs must essentially be accompanied with a list of their subsidiaries electing for the application of the regime (name, main place of business, Siret registration number and ownership of the share capital). Said list must be updated and supplied each year upon the filing of the income tax return.

The subsidiaries electing must, upon filing of the relevant notice, indicate the corporate name, addresses and Siret number of the SIIC that controls them.

Finally, as such election entails the same tax consequences of a winding-up operation, the election must, where applicable, enclose the commitments to which the conditional alleviation of the consequences of a winding-up is subject and the calculation of the assessment base for the "Exit tax" (French Tax Code, Schedule III, Article 46 ter A).

### 4.3 Taxation of SIICs

According to Article 208 C of the French Tax Code, SIICs are exempt from corporate income tax:

- On their rental income, provided that no less than 95% of the same is distributed;
- On their capital gains, provided that no less than 60% of the same is distributed;
- On the dividends of subsidiaries that elected for the application of the regime, provided that said dividends are distributed in full.

The application of this regime is subject to the payment of a "latent" taxation pertaining to the assets held by real estate companies upon becoming subject to the regime. Such companies must thus pay a tax on the basis of a reduced rate of 19% (the so-called "Exit tax"), the payment of this tax being staggered over four years.

#### 4.3.1 Consequences of submission to the regime

The main consequences of irrevocable election for the SIIC regime are the consequences generally attached to a winding-up operation. Indeed, the adoption of the SIIC regime entails a change in the tax regime, since the company, which was previously subject to corporate income tax, ceases in whole or in part to be subject to said tax.

Pursuant to the provisions of Article 221, 2 of the French Tax Code, the effects of a change in tax regime are as follows:

- Immediate taxation of current operating income. However, due to the fact that elections, made during the first four months of the financial year, have a retroactive effect as from the first day of such financial year, the election does not result in the immediate taxation of the income that is in the process of being earned;

- Taxation of those profits whose taxation had been suspended. In practice, this rule concerns provisions related to the impairment of securities or receivables and provisions for risks and contingencies concerning the real estate sector eligible for the regime. In the case where such provisions have been deducted, they must be recaptured for tax purposes upon winding up.

Profits whose taxation was suspended in relation to ancillary activities should in principle also be recaptured. However, the conditional alleviation of the consequences of a change in tax regime provided for by Article 221 bis of the French Tax Code is applicable to these profits since, notwithstanding the election for the SIIC regime, the subsequent taxation of such profits remains possible. Therefore, provisions related to the remaining taxable sector are not recaptured for tax purposes upon winding up.

The principle of partial alleviation of the effects of a change in the tax regime will not be questioned if the company chooses to re-evaluate its fixed assets upon making its election, for accounting purposes. In such a situation, the company must commit - as regards its fixed assets other than immovable property and interests in partnerships or companies having made the election - to calculate the capital gains made at a later date in connection with the sale of such fixed assets on the basis of the value that such fixed assets had for tax purposes prior to re-evaluation. The same principle applies to shares of subsidiaries subject to corporate income tax and electing for the regime.

As regards immovable property and assimilated assets, the unrealised capital gains are generally taxed immediately as a consequence of the change in tax regime ("Exit tax"). However, the taxation triggered by the election for the SIIC regime on those assets benefits from (i) a reduced rate of 19% provided for by Article 219 IV of the French Tax Code and (ii) an exemption of the additional social contribution.

Similarly, where, after the election has been made for the regime, a company recovers a new eligible asset (in particular due to a merger, conversion of a company limited by shares into a partnership, exercise of a call option, etc.), the unrealised capital gains on this asset must be added back to the net income of the company in equal shares over a period of four years and is subject to the 19% Exit tax.

Losses carried-forward prior to the financial year in which the election was made, may be set off against the net income taxable upon winding up, be it subject to the standard rate of taxation, to the reduced rate for long-term capital gains or to the reduced 19% rate.

Long-term capital losses may be set off against the net income taxable upon winding-up subject to the reduced rate for long-term capital gains and the remainder, if any, may be set off against the income subject to the standard rate or to the reduced 19% rate.

Election for the SIIC regime automatically entails the termination of any tax consolidation regime that may have been applicable to the parent company until that date.

Save for the other consequences specific to the exit from the tax consolidation regime, capital gains "neutralised" during the existence of the tax consolidation regime and which become taxable upon termination of the regime, benefit from the reduced 19% rate if they concern real estate assets. In the same manner, any capital gains whose taxation is suspended (in relation to non-depreciable assets) or that are in the process of being added back (depreciable assets), originating from prior restructuring operations, are subject to the Exit tax.

#### 4.3.2 Exemption regime

The tax-exempt sector of a real estate company that made an election for the SIIC regime is comprised of three categories of revenues, subject to separate distribution obligations:

- The operating income derived from the rental of immovable property and the sub-leasing of immovable property available under a finance lease or whose enjoyment was temporarily granted by the State, a territorial community or any of their agencies 95% of which is to be distributed prior to the end of the financial year following the financial year in which the said income was earned;
- The capital gains arising in connection with the sale of immovable property, rights related to an immovable property finance lease, interests in partnerships and shares in subsidiaries that have made the election, with 60% of such capital gains to be distributed prior to the end of the second financial year following the year in which such gains arose;
- Dividends received from those subsidiaries that made the election for the regime, with 100% of such dividends to be distributed during the financial year following the financial year in which the dividends were received. The same rule applies to dividends received from another SIIC where the company receiving the distribution has held for at least two years at least 5% of the share capital and voting rights of the distributing company.

Dividends received from foreign companies with a status equivalent to SIIC status (Sicafi, SI, REIT, etc.) and from variable capital investment companies whose assets are primarily invested in immovable property (SPPICAV) in which the SIIC concerned holds at least 5% of the capital and voting rights during a period of two years are also tax-exempt, provided that such dividends are fully redistributed during the financial year following the financial year in which they have been received.

For the purposes of the determination of the tax-exempt sector, income from partnerships is deemed to be earned directly by the SIICs or by their subsidiaries that made the election for the scheme. Therefore, such income must be broken down according to its nature in order to ascertain the terms of payment and the amounts to be distributed by the member company.

Only capital gains arising in connection with disposals with third parties are tax-exempt. Otherwise, they are fully taxable, unless they arise in connection with the disposal of property between a SIIC and its subsidiaries that made the SIIC election, or among such subsidiaries. Such neutralisation applies even more broadly to “disposals made among companies subject to the SIIC regime”, provided that such subsidiaries are under a relationship of dependency within the meaning of Article 39, 12 of the French Tax Code.

In such case, capital gains are “neutralised” in respect of the financial year in which such capital gains were made, subject to the condition that the buyer agrees, in the deed of sale, to comply with the obligations imposed under the favourable merger regime (French Tax Code, Article 210 A):

- As regards non-depreciable fixed assets, to calculate the capital gains arising in connection with a subsequent resale on the basis of the value that such assets had in the books of the selling company;
- As regards depreciable fixed assets, to add back gradually the capital gains arising in connection with the sale.

The results from transactions pertaining to the tax-exempt sector give rise to a set-off and may generate long-term capital losses or even a loss that may subsequently be carried over, on standard terms applicable and may be set off against the future income of the tax-exempt sector.

The taxable sector, consisting in income derived from ancillary activities, is subject to corporate income tax according to standard terms applicable. These two sectors are totally separate and may not have any impact on one another.

The complexity of the regime may stem from the coexistence of two operational sectors, one of which is subject to standard taxation, while the other is tax-exempt, but may also stem from the fact that there are, within the tax-exempt sector, several types of income subject to different distribution obligations.

The rationale underlying the regime and the need to specifically determine the amount of income attached to each sector thus induces an obligation to rely on a method for the allocation of the corresponding expenses and revenues.

In an initial phase, the statement of practice published by the French Tax Authorities relies on the principle that expenses and revenues whose allocation does not raise any difficulty are to be exclusively allocated to one sector.

On the contrary, those expenses that cannot be allocated exclusively to one of the sectors are deemed to pertain to the tax-exempt sector based on the following ratio:

$$\frac{\text{Amount of revenues of the tax-exempt sector}}{\text{Total amount of the company's revenues}}$$

However, financial income and expenses are subject to special treatment (BOI-IS-CHAMP-30-20-30 no 70):

- The net financial income (not including depreciation and provision expenses and reversals) is deemed to pertain to the taxable sector;
- Net financial expenses are allocated to the tax-exempt sector solely on the basis of the following ratio:

$$\frac{\text{Gross book value of the assets contributing to the generation of revenues of the tax-exempt sector}}{\text{Gross book value of all assets}}$$

Within the tax-exempt sector, the allocation of expenses must be totally and exclusively allocated, whenever such a solution is possible (e.g. depreciation expenses must be allocated to the determination of the net income of rental operations). When certain expenses are common to the three categories of tax-exempt operations, then their allocation is made on the basis of the following ratio:

Gross book value of assets contributing to the generation of revenues of the tax-exempt sector
Gross book value of all assets

#### 4.3.3 Distribution regime

The SIIC's distribution obligation, which conditions the application of the regime, is assessed globally. Therefore, if any of the distribution obligations, determined per type of transaction, are not satisfied, then the company's exemption as a whole may be reconsidered.

The total amount of the distribution obligation is the aggregate of the amounts obtained by applying the distribution coefficient corresponding to each of the categories of income:

- Limited to the income for tax purpose of the whole of the tax-exempt sector; and
- Capped at the amount of the income for accounting purposes.

Income from partnerships is deemed, for the purposes of determining the tax-exempt sector, to be earned directly by the SIICs or by those of their subsidiaries which made the election. As a consequence, such income is to be broken down according to its nature in order to determine the terms of payment and amounts associated with the distribution obligations incumbent on the member company.

The tax-exempt net income for tax purposes is calculated by totalling all categories of income without distinction (rental activity, sale, dividends).

When the accounting profits of a financial year are lower than the aggregate of tax distribution obligations calculated per category of income, any excess will be carried over to following profit-making financial years until such excess is extinguished.

When the income of the tax-exempt sector is reassessed following a tax audit, the fraction of the reassessed and non-distributed income will be subject to corporate income tax in accordance with standard rules (unless the company distributed an amount of tax-exempt net income exceeding its strict distribution obligation).

A 15% withholding tax is due on dividends paid out by SIICs and their subsidiaries, when such dividends are distributed to French or foreign UCITs (French Tax Code, Article 119 bis, 2 and 187).

#### 4.3.4 20% levy

A 20% levy is paid by the SIIC, as regards its distributions to a shareholder other than an individual, simultaneously meeting the two criteria below:

- Such shareholder holds, directly or indirectly, at least 10% of the dividend rights of the SIIC when the distributions are paid out;
- The proceeds received by such shareholder are not subject to corporate income tax or to any equivalent tax (as a foreign shareholder subject to taxation inferior by more than two thirds to the taxation that such shareholder would have been subject to in France on standard terms).

The levy is not due when the beneficiary is a company subject to the obligation to distribute all of the received dividends (e.g. SIIC, of which at least 10% is owned by companies subject to corporate income tax or to equivalent tax on account of received redistribution).

The taxable base of the levy only includes distributions realized from tax-exempt income under the SIIC regime, after deducting distributed amounts that were previously subjected to the levy.

The levy may not be applied or refunded (it is not a deductible expense for the determination of the income of the distributing SIIC and does therefore not reduce its distribution obligation).

#### 4.3.5 Participation of SIICs in restructuring operations

The restructuring operations (mergers, demergers, etc.) carried out by SIICs or by those of their subsidiaries having elected for the SIIC regime are eligible for the preferential regime provided for by Articles 210-0 A *et seq.* of the French Tax Code .

However, the application of the preferential merger regime is subject to the covenant, entered into by the absorbing company or by the company receiving the contributions, to substitute the absorbed company as regards the distribution obligations with which the absorbed company has not yet complied as of the effective date of the merger.

Capital gains arising in relation to immovable property upon a merger or assimilated transaction are added back in instalments to the absorbing company's net income (French Tax Code, Article 210 A, 3, d) and are part of the net income, 95% of which is required to be distributed.

In the case of a merger, when both the absorbing company and the absorbed company are subject to the SIIC regime, the merger premium is tax-exempt provided that 60% of its amount is distributed before the end of the second financial year following the financial year during which the merger was completed.

#### **4.3.6 Exit from the regime**

##### **a. Suspension period**

A "suspension period" occurs when, for the first time after becoming subject to the regime, a SIIC ceases to comply with the capital holding cap. Such suspension period is applicable only once during the period of ten years following the election and during only one financial year if remediation occurs before the end of such financial year.

During said period, which, again, may not last more than one financial year, SIICs whose exemption regime is suspended, will be subject to corporate income tax on standard terms, subject to a specific feature related to the taxation of capital gains pertaining to immovable property. Indeed, the taxable capital gains on the sale of immovable property are, during said period, decreased in the amount of the depreciation expenses previously deducted from the amount of the tax-exempt income and are taxed at the rate of 19%.

When the exemption regime comes to re-apply to the company in respect of the following financial year, this will entail the taxation of the unrealised capital gains relating to the assets of the tax-exempt sector acquired during the suspension period; Such capital gains are taxed at a rate of 19%. The unrealised capital gains of the taxable sector are not subject to any immediate taxation, provided that the accounting entries are maintained.

##### **b. Definitive exit**

Non-compliance with the criteria required for the application of the regime in respect of the financial years following entry into the regime causes the SIIC and those of its subsidiaries which elected for the regime to exit said regime. Such exit shall have a retroactive effect as from the first day of the financial year during which the company exited the regime.

The following operations are not deemed not to lead to exit from the regime:

- Merger of two SIICs, if the absorbing SIIC enters into the covenant to substitute the absorbed company as regards the distribution obligations which have not been met at the date of the merger;
- Acquisition by a SIIC of at least 95% of the capital of another SIIC, whether directly or indirectly. In that case, the acquired SIIC can become a subsidiary of the acquiring SIIC, if it complies with those of its distribution obligations that have not yet been met, and remains a subsidiary of the acquiring SIIC until the end of the ten-year period from the financial year during which the initial election was made;
- Sale or contribution of a subsidiary between two SIICs. Indeed, in such situation, the relevant subsidiary would continue to meet the required criteria to benefit from the exemption (BOI-IS-CHAMP-30-20-10 No 120).

When exit occurs during the ten year period following election, the SIICs is required to pay an additional taxation (difference between the standard rate and the reduced rate) on the unrealised capital gains relating to immovable property that were taxed on the basis of the reduced rate upon entry into the regime or when new assets became eligible for the regime.

They are also subject to the three following legal consequences:

- They must add back to their taxable income the amount of the profits that were tax-exempt during the period of the application of the regime and still not distributed. If the SIIC definitively exits the regime after a suspension period, then the SIIC is deemed to have exited the regime on the first day of the financial year of the suspension, and distributable profits are determined at the close of such financial year. Subsequent distributions deducted from said amounts may where applicable give rise to the application of the parent-subsidiary regime, while it is impossible to benefit from the regime as regards distributions made by the SIICs or their subsidiaries over the period during which the regime was applied when such distributions are deducted from their tax-exempt profits;
- An additional taxation of 25% is due on the fraction of unrealised capital gains acquired during the exemption period. Such tax is due on the total amount of the capital gains relating to assets of the tax-exempt sector, less one tenth per calendar year of existence within the tax-exempt sector;
- An additional tax is due if the final exit occurs after a suspension period. Such tax is equal to the amount of the tax that the SIIC would have been required to pay had it re-entered the regime.



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## A. General rules

### 1. Brokerage: The statutory regime applicable to real estate agents

In the context of the purchase or sale of real estate property, the parties might decide to resort to the assistance of a real estate agent, whose mission will consist of putting the parties in touch in consideration for a fee.

The activity of real estate agents is governed by a mandatory Law known as the Hoguet Law, the main provisions of which are described below.

#### 1.1 Professional license

The real estate broker, acting as an agent either of the owner of the property or of the purchaser looking to purchase a property, must:

- Be registered at the local Commercial and Companies Registry (*Registre du commerce et des sociétés* – RCS); and
- Hold a specific “professional license” (*carte professionnelle*) for “transactions on property and business concerns” issued by the President of the Regional Chamber of Commerce and Industry (or, in the Ile-de-France region, by the County Chamber of Commerce and Industry). The license must be renewed every three years and its issue is subject to various conditions including an ongoing training requirement.

The employees of holders of professional license are entitled to carry out transactions with the exception of (i) receiving or holding monies in connection with the activities set forth in Article 1 of the Hoguet Law, (ii) providing legal advice, drafting legal instruments other than mandates entered into with the licence holder, and (iii) ensuring managerial functions for an establishment, branch, agency or office. Such employees must hold a certificate, issued by the President of the Regional Chamber of Commerce and Industry (or, in the Ile-de-France region, by the County Chamber of Commerce and Industry), establishing their power and authority.

Persons ensuring managerial functions for an establishment, branch, agency or office under the authority of the holder of the professional license have to serve prior notice on the President of the Regional Chamber of Commerce and Industry (or, in the Ile-de-France region, by the County Chamber of Commerce and Industry).

Any citizen legally established in a Member State of the EEA or of the EU to conduct any activity contemplated in Article 1 of the Hoguet Law may engage in such activity on a temporary or occasional basis in France after submitting, by registered letter with acknowledgment of receipt, prior notice on the President of the Regional Chamber of Commerce and Industry (or, in the Ile-de-France region, of the County Chamber of Commerce and Industry), which is to be served the first time the relevant contractor comes to France to provide services on a temporary or occasional basis. If the related activity or the training for this activity is not regulated in the State of establishment, evidence of a minimum professional experience over the last ten years will be required (there is a contradiction between the Law which provides for two-years of professional experience and the Order which provides for one-years worth of professional experience).

Contractors wanting to continue to benefit from such possibility more than a year after its initial declaration must serve a new prior notice.

An Order dated 17 October 2017 implemented in French law the European professional license that will provide European contractors with another possibility to carry out real estate transactions in France.

#### 1.2 Financial guarantee

A real estate agent involved in transactions on property and business concerns must provide a financial guarantee granted either by an insurance company, a bank or a specific public financial entity (such as the *Caisse des dépôts et consignations*, the *Banque de France*, etc.) designed to cover the reimbursement of any monies held by the agent on behalf of principals. The amount of this guarantee will need to at least cover the maximum amount the agent plans to hold, with a minimum of EUR 110,000 (reducible in certain circumstances).

#### 1.3 Professional civil liability insurance

Real estate agents are required to underwrite an insurance policy covering their professional civil liability. Evidence of such insurance coverage must be provided as part of the procedure to obtain the professional license.

### 1.4 Agency agreements (*mandat*)

Services provided by a real estate agent have to be defined in a formal written and regulated agreement (*mandat*). Failing which, agents will not be entitled to collect their fees.

Agents also have to comply with specific legal and accounting obligations, including the obligation to keep a chronological record of every agency agreement on a specific transaction register.

Based on their knowledge of the market, agents can provide assistance to their clients in their investment operations or to identify potential contracting parties and to introduce such parties to their clients with a view to completing the transaction for which they have been appointed.

Agents have a decisive role as intermediaries, providing advice and organising visits, meetings and negotiations to achieve the given objective.

Payment of fees may only be made once the deal has been completed.

## 2. General comments on negotiations

Negotiations may include:

- "Pourparlers" (discussion phase) including written, verbal or electronic exchanges, etc.; and
- Where applicable, the making of either a letter of intent or an offer.

The discussion phase occurs before any preliminary sale agreement or deed of sale is signed and, theoretically, during this phase, the parties are free to give or withhold their consent on to the proposed transaction.

Parties are under the obligation to negotiate in good faith and this obligation strengthens as the parties progress towards an agreement. Failure to comply with this obligation, i.e. by (i) entering into negotiations knowing that they have no chance of being successful or (ii) breaking them off suddenly and unilaterally, without reasonable grounds, may entitle the other party to claim damages for the loss incurred.

In the event of a proposed sale, once the parties have agreed on the price and the sale, a binding contract is formed, unless otherwise stipulated.

As a result, during the discussion phase, the parties must pay close attention to the scope of any obligations entered into and ensure that no document may be construed by either party as proof of the existence of a sale or an agreement to sell. Various methods may be used to postpone conclusion of the agreement:

- Making such other matters (such as terms of payment, conditions precedent, sale timeframes) a part of the negotiation; and
- Using a standard set clause such as, "This letter does not under any circumstances constitute an offer of purchase made by us to you and its acceptance may not be construed as an offer of sale."

The term "offer" should be avoided in favour of "interest in".

## 3. Non Disclosure Agreements (NDA)

During discussions in connection with a real estate transaction, it is common practice to implement a non-disclosure agreement, as the seller generally intends to ensure that any sensitive information that will be made available to potential purchasers in the course of the acquisition process remains confidential.

The main features of such agreements are as follows:

- Definition and scope of confidential information;
- Parties' obligations (prohibition/limitation of disclosure, list of persons with access to the confidential information, etc.);
- Return and destruction process;
- Term of the agreement.

## 4. LOIs and offer letters

### 4.1 Letters of intent (LOIs)

A LOI or a "protocole" (heads of terms) commonly constitutes the step following either a call for tenders issued by the seller or direct negotiations between the seller and a potential buyer. The document is generally drawn up in two original copies, signed by the potential buyer and countersigned by the seller.

The legal value of an LOI will depend on its content. The LOI may (i) simply express a desire to

enter into negotiations, which is not considered *per se* as a genuine obligation to negotiate or (ii) constitute a contract whereby the parties express their initial desire to begin the process to negotiate an agreement or pursue ongoing negotiations.

In the LOI the potential purchaser will usually express its interest in the contemplated transaction and define the main terms and conditions of any possible acquisition (price or method used to assess the price, terms of payment, required guarantees, etc.). The LOI will also:

- Set forth the methods to be used to perform due diligence (index of required documents, deadline for completion, etc.);
- Define the process relating to the drafting of contracts, together with their key features and the timeframe for drafting and completion of the transaction;
- Request an exclusivity period (i.e. an obligation for the seller to refrain from undertaking any other negotiations in connection with the same potential transaction), usually covering the period scheduled for due diligence. The exclusivity period is generally granted free of charge but consideration may be requested.

The LOI may also provide for additional obligations, e.g. confidentiality (if not already covered by an NDA) or a right of first refusal.

#### 4.2 Offer letters

An offer is an act of freewill binding the author thereof to the terms of the offer. Once accepted, an offer letter is considered to be binding.

The offer defines the key features of the contract, i.e. the building must be clearly identified and the price set unambiguously.

If no deadline for acceptance is provided, the offer may be withdrawn after a reasonable period of time has passed, unless the parties have expressly subjected consent to other formalities.

To avoid any disputes, the offer should provide that it will automatically lapse in the event of a counter-proposal or of qualified acceptance.

#### 5. Exclusivity agreements

In the absence of an LOI or if the LOI does not set forth an exclusivity period, the parties may enter into an exclusivity agreement (**see above, regarding the exclusivity period**).

#### 6. Due diligence

Due diligence (*audit*) is the process whereby a potential purchaser analyses the target property. This covers:

- Technical due diligence (the seller or notary may not agree to sign the preliminary contract on the basis of a "subject to survey" clause; Consequently, if the purchaser is willing to undertake a survey, it should perform such prior to signing the preliminary agreement);
- Environmental due diligence (pollution, asbestos, etc.);
- Valuation of the building: Market value/utility value, review of rental situation; and
- Tax and legal due diligence (property, planning, tenancy situation, etc.).

The data room may be either physical or electronic.

## B. Asset deals

### 1. Characteristics of the asset

#### 1.1 Asset to be purchased

Ownership is a right *in rem*, i.e. a right attached to a thing as opposed to a person.

Though there are various kinds of ownership and rights *in rem* – e.g. usufruct and bare title, joint ownership (*indivision*), co-ownership (*copropriété*), land tenure (*droit de superficie*) flying freehold (*division en volumes*), construction lease or long-term lease – an asset deal usually consists of the acquisition of the undivided ownership (*pleine propriété*) of a building.

As an unfettered right, undivided ownership endows its holder with the right to (i) use (*usus*), (ii) enjoy periodic returns (*fructus*, i.e. rents, interest on money due, dividends, etc.) and (iii) dispose of the asset (*abusus*).

## 1.2 Possible rights encumbering or affecting the asset

### 1.2.1 Easements

An easement (*servitude*) is a burden imposed upon a property for the use and utility of a property belonging to another owner. Easements are exercised to the detriment of the properties they encumber – servient tenements (*fonds servants*) – and to the benefit of properties they enhance – dominant tenements (*fonds dominants*). Easements constitute rights *in rem* and are inseverable from the properties they are attached to.

The owner of a dominant tenement may, at its expense, carry out any work necessary to use or preserve the easement but is not entitled to do anything to aggravate the situation of the servient tenement. Similarly, the owner of the servient tenement must allow the easement to be exercised without doing anything to restrict such.

Easements are:

- Either contractual (usually published at the land registry) or statutory/regulatory;
- Either permanent (e.g. pipes for water, sewage or rights of air, etc.) or temporary (e.g. rights of way, use of a well, etc.);
- Either apparent (e.g. a door, window, aqueduct, etc.) or non-apparent (e.g. ban on construction or ban on construction above a certain height).

#### a. Private easements (governed by private Law)

Private easements may originate either from Law or a written agreement, the latter requiring publication. Easements that are both permanent and apparent may also arise by acquisition of title by adverse possession, namely where an action is carried out for thirty years without triggering any reaction from the owner of the servient tenement.

Examples of private easements: Right to light, rights of way, right to running water, *non aedificandi*, (i.e. ban on construction) or *non altius tollendi* (i.e. the maximum level above which structures may not be built), positioning easements determining distances that buildings or plants must respect.

#### b. Administrative easements (governed by public Law)

Administrative easements are introduced by different types of Laws. Terms pertaining to their related compensation may vary considerably.

Administrative easements may be occasional, temporary or permanent and have various objectives, e.g. the protection of natural, cultural, sporting or tourist sites; use of energy or communication resources and infrastructures; national defence; public safety; public health; public works; planning.

Town planning easements are based on the French Planning Code (*Code de l'urbanisme*) or its implementing documents (**please refer to Chapter IV - Section A**). No compensation may be claimed for these easements.

### 1.2.2 Mortgages and special lenders' lien

#### a. Mortgage (*hypothèque*)

A mortgage is a non-possessory security encumbering an asset, which entitles its beneficiary to a preferential right over other creditors in the event of the forced sale of the relevant asset, to pay off the monies owed to him. It also confers a *droit de suite* (i.e. the right to follow the property into the hands of a third party purchaser to recover possession), entitling the secured creditor to take possession of the asset offered as security, even if it is possessed by a third party.

Any property may be mortgaged and there is no limit on the number of mortgages that may encumber a single property.

A mortgage may be effected either by (i) contract (incorporated in a notarised deed in order to be enforceable), (ii) Law or Regulations, or (iii) by Court Order (as security for a debt).

Notaries have a monopoly on the establishment of mortgage instruments. In order to be binding on third parties, mortgages must be registered. The registration of a mortgage for a property located in France is subject to French Law and may not be established outside France, even by a foreign notary. This rule is applicable even if the loan agreement is established outside France or is governed by a foreign Law.

Priority between mortgages applying to the same property is governed by the chronological rank of registration.

In principle, a mortgage secures the entire debt as well as the interest accruing on the debt over a period of three years.

The mortgagee has to adhere to specific enforcement proceedings to take possession of the property and sell it.

### **b. Special lender's lien (*privilège de prêteur de deniers* – PPD)**

A *privilège de prêteur de deniers*, i.e. a special lender's lien, is a right derived from the lender's claim for preference over other creditors, even mortgagees. This lien is a right over the purchased asset.

A lender's lien may be registered only when the acquisition of the property is financed by a loan, provided that the loan agreement is executed by notarised deed and that the funds borrowed are used to pay the price of the property.

As the lender's lien is specific to French Law, it may only exist if the loan agreement is subject to French Law and if the loan was granted to purchase an immovable property located in France.

The lender's lien must be registered within two months from the date of the purchase deed in order to enter retroactively into effect as at the date of the purchase.

The secured monies are: The amount of the loan, plus interest over a three-year period.

A draft bill to reform the Law of Security Interests (2017) purports to convert the lender's lien into a mortgage.

### **1.2.3 Cahier des charges de cession de terrains (CCCT)**

#### **a. CCCTs and subdivision estates (*lotissements*)**

A subdivision estate (*lotissement*) arises from the division of a piece of land into smaller lots that may then be sold separately. The land as a whole is known as a subdivision estate (*lotissement*) (please refer to Chapter II - Section A).

The CCCT (Book of conditions applicable to the assignment of land) is a document which mainly contains mutual easements creating permanent obligations *in rem* that must be recorded on the land registry to be enforceable on the successive holders of other rights *in rem* over the lots. The CCCT must be provided to the purchaser prior to the acquisition.

CCCTs contain both:

- Requirements pertaining to the use of lots; and
- Technical, architectural and urban planning requirements.

Some of the provisions of the CCCT fall under the scope of personal obligations.

The planning rules contained in CCCT used to be relied on as grounds to challenge planning permissions. The ALUR Law of 24 March 2014 provided for the lapse of planning rules set forth in CCCTs. This lapse gradually comes into effect and shall fully apply in 2019 at latest (save exceptions). It will then no longer be possible to invoke CCCTs against planning permissions. The French Supreme Court considers that CCCTs are nonetheless contractually binding and that the provisions thereof may be relied on against neighbouring owners.

#### **b. CCCTs and Concerted Development Zones (*zones d'aménagement concerté* – ZAC)**

In concerted development zones supported by local or central authorities, known as "ZAC" (please refer to Chapter II - Section A), the terms and conditions for the sale of any property by the developer must be determined according to a CCCT.

The CCCT sets forth (i) the authorised gross floor area (*surface de plancher*) for a construction on the relevant plot of land as well as (ii) technical, planning and architectural rules (together with the relevant planning documents applicable throughout the ZAC's term).

The CCCT will be appended to any future deeds of sale or rental agreements and attached to any planning permission application file.

### **1.2.4 Rights of pre-emption**

The French Authorities may, under specific circumstances, have the power to expropriate an owner or requisition a building. However, more generally in the context of the sale of real estate, they will benefit from a right of pre-emption (only applicable within defined areas) that will enable it to purchase the property *in lieu* of the proposed purchaser.

#### **a. The different pre-emption rights**

A right of pre-emption is a statutory option granted to certain public Authorities to substitute the purchaser in a real estate transfer (and - in some instances - in the transfer of moveable property) on grounds of public interest.

The right of pre-emption held by the State prevails over any private rights of pre-emption.

There are several types of pre-emption right which purport to satisfy different objectives, e.g.:

- The pre-emption right of French Land Use Planning and Rural Societies (*Société d'aménagement foncier et d'établissement rural* – SAFER) entitling it to a priority in acquiring agricultural and green belt land to prevent urban sprawl. This pre-emption aims at implementing a programme to promote agricultural use of land, forestry management, conservation and enhancement of green areas and landscapes;
- The pre-emption right regarding natural areas of the department. This pre-emption right

purports to protect the quality of sites, landscapes or natural habitats by implementing a policy of protection, management and openness to the public;

- The pre-emption right regarding ongoing business entitling municipalities to a right of pre-emption on artisanal businesses, commercial businesses or commercial leases ensure commercial diversity in certain municipalities;
- The pre-emption right or “priority” granted to municipalities and public inter-community cooperation entities (*établissement public de coopération intercommunale* or “EPCI”) to benefit from a priority over projects for the transfer of real estate assets owned by the State or of certain companies primarily owned by the State;
- The pre-emption right applicable within deferred development zones (*zones d’aménagement différé*); and
- The urban pre-emption right (*droit de préemption urbain – DPU*), which is the most commonly encountered and whose purpose is to enable development projects or operations to be implemented. It applies to sectors defined by a specific decision of the municipality or EPCI and within areas of development such as concerted development zones (*zones d’aménagement concerté – ZAC*).

### **i. Urban pre-emption right**

The urban pre-emption right was created to enable development projects or operations set forth in the French Planning Code.

Pre-empted assets must be used or transferred for one of the purposes set out in the French Planning Code and this purpose has to be mentioned in the actual decision to pre-empt.

Although it is now admissible for this purpose to differ from the one mentioned in the decision to pre-empt, if the asset is not used for one of the purposes set out in the French Planning Code, the holder of the pre-emption right must offer to transfer the asset back to the former owner. The French Planning Code therefore now contains a buy-back right held by the former owner (or the ousted buyer).

### **ii. Implementation of the urban pre-emption right (DPU)**

The DPU may only be set up where a municipality or EPCI has implemented planning Regulations (a *plan d’occupation des sols – POS* or a *plan local d’urbanisme – PLU*).

The DPU is implemented wholly or in certain areas of the municipality only and applies to all plots of to which it applies.

The Municipal Council or the deliberative body of the EPCI is solely responsible for the creation, modification or withdrawal of the DPU

### **iii. Transactions subject to urban pre-emption rights**

In theory, only transfers, whether voluntary or not, of real estate or corporate rights resulting in the allocation of title to or enjoyment of an immovable asset or part of an immovable asset, whether developed or not, are subject to the urban pre-emption right (with the exception of those included in a disposal plan decided on as part of liquidation proceedings).

Exceptions:

- Sales of one or more lots consisting in a single set of premises for residential, professional, or mixed use, or consisting in such premises plus additional premises, or consisting in one or more sets of premises that are ancillary to the main premises located in a building that is co-owned (*en copropriété*) at the time of disposal, or after the complete or partial division of a “*société d’attribution*”, or for at least ten years where the formation of a co-ownership does not ensue from such division;
- Transfers of shares in companies created for the purpose of allocating buildings or in cooperative construction companies intended for the allocation of residential, professional or mixed premises and related secondary premises;
- Sales of a buildings within a period of four years following completion of the construction.

These operations may however be subject to a pre-emption right subject to a specifically reasoned decision of the Municipal Council (i.e. a reinforced pre-emption right).

In the event the assets and liabilities of a company are made up of a single developed or undeveloped immovable property whose disposal would be subject to a pre-emption right, an urban pre-emption right will apply to disposals (i) of a majority shareholding in a *société civile immobilière* (real estate partnership), or (ii) resulting in a buyer owning a majority shareholding in said partnership.

Buildings constructed or acquired by affordable housing organisations and owned by them come within the scope of the pre-emption right, subject to the tenants’ rights set out in the French Construction and Housing Code regarding the sale of housing units belonging to HLM (affordable housing) organisations and encouraging home ownership by HLM tenants or their families.

Properties or corporate rights entitling their holders to be attributed ownership or use of a developed or undeveloped property or part thereof are also subject to a pre-emption right:

- Where they are transferred free of charge, unless the transfer is made between persons related either up to the 6<sup>th</sup> degree of kinship or by marriage or civil partnership (*pacte civil de solidarité*). The declaration of intent to dispose of property does not include the price. The holder of the pre-emption right shall mention the tax Authorities' assessment on the property's value in its decision; and
- Where they constitute a contribution in kind to a *société civile immobilière* (SCI).

Since the enactment of the aforementioned ALUR Law, the *Préfet* may now exercise the pre-emption right - in municipalities where subsidised housing objectives have not been met - over all types of buildings zoned for housing, irrespective of the type of ownership arrangement.

#### iv. Pre-emption procedure

A declaration of intent to dispose of property must be filed prior to any transfer of property subject to pre-emption, failing which the transfer agreement will be null and void.

The exercise of the pre-emption right is subject to a time limit. If the right is not exercised, the owner will be free to sell the asset at the price set in the declaration of intent to dispose of property.

##### - Declaration of intent to dispose of property (DIA)

Where a disposal is subject to a pre-emption right, a prior declaration must be filed by the owner with the town hall where the asset is located, failing which the disposal will be null and void. The DIA must indicate the assets concerned, the price (or the assessment of the payment in kind), the terms and conditions of the proposed disposal and the information required under Article L.514-20 of the French Environmental Code (i.e. information relating to the operation of a Facility Classified for the Protection of the Environment within the asset and the major hazards and inconveniences arising from such operation). There is no legal obligation to mention the name of the purchaser.

If the price or the terms and conditions of the sale change, the owner will be required to file a new DIA.

Within a period of two months following notification of the DIA, the pre-emption right holder will be entitled to send the owner a single request for documents to assess the substance and condition of the property and, if applicable, the partnership's (*société civile immobilière*) corporate and financial situation as well as its assets and liabilities. Pre-emption right holders also benefit from a right to visit and the owner accepting such a visit must inform the occupants referred to in the DIA thereof.

##### - Communication to the Public Finance Departmental Direction (DDFIP)

In certain situations, pre-emption right holders must procure an opinion from the DDFIP on the price of the property that may be acquired.

The pre-emption right holder is not bound by this opinion.

##### - Exercise of the pre-emption right

The pre-emption right holder has to notify and communicate its decision within a period of two months as from receipt of the DIA. This timeline may be suspended as from receipt of a request for additional information or request to visit the property. The period resumes once (i) the additional documents are received by the pre-emption right holder or (ii) the owner refuses to allow the visit of the property or (iii) the pre-emption right holder has visited the property. Where the period remaining is less than a month, the pre-emption right holder is given one month to make a decision. On expiry of this period, absence of response is construed as a waiver of the pre-emption right.

Where the pre-emption right holder exercises its right, it must notify the seller, the notaire, and the ousted purchaser (if any is referred to in the DIA) by registered letter with acknowledgment of receipt. Where the pre-emption right holder notifies its intent to acquire the property, the owner must inform tenants or bona fide occupants, and also inform the pre-emption right holder of their existence.

The pre-emption right holder can notify the owner of its decision to exercise the pre-emption right for a price different to that mentioned in the notification. If no mutual agreement is reached on the purchase price, the price will be determined by the court with jurisdiction for expropriation matters.

##### - Decision of the owner

As from the date of receipt of the offer to acquire issued by the pre-emption right holder, the owner has two months to notify whether it intends to:

- Accept the price or the new proposed terms;
  - Maintain the price contained in the declaration and agree that the price should be determined by the court with jurisdiction for expropriation matters; or
  - Abandon the transfer.
- That owner failing to respond within the two-month time period mentioned above will be deemed to have abandoned the transfer.

### - Setting a date for transfer of the pre-empted property

When property is acquired via pre-emption or under the right to relinquish a property (*droit de délaissement*) - whereby any property owner subject to a pre-emption right may propose that the holder of the right acquires the property for the requested price - the transfer of ownership will take place on the later to occur of the following dates: Payment of the price or execution of the notarised purchase agreement.

The purchase price shall be paid or, if there is any obstacle to payment, placed in escrow, no later than four months after (i) the decision to acquire the property for a price requested or accepted by the seller, or (ii) the final decision of the court with jurisdiction for expropriations matters, or (iii) the date of the deed of sale or auction award. Failure to respect this timeline will result in the seller's freedom to dispose of the property.

### - Publication of pre-emption decisions

Since the enactment of the ALUR Law, pre-emption decisions have to be published, the conditions of publication however have not been defined.

### - Determination of the price by Courts

If there is disagreement as to the price, the pre-emption right holder may refer the matter to the court with jurisdiction for expropriation matters. The owner and the pre-emption right holder may decide to abandon the transaction if the price determined by the Judge is not considered suitable.

### v. Penalty applicable to breach of the urban pre-emption right procedure

Any breach of the urban pre-emption right procedure entails the nullity and unenforceability of any deeds of transfer enacted.

Judicial proceedings shall be instigated before the Court of first instance (*Tribunal de grande instance*) of the place where the asset is situated. This action is subject to a five-year limitation period as from the publication date of the deed whereby ownership is transferred.

The pre-emption right holder may also instigate proceedings against the seller and, if applicable, the seller's agent (drafter of the instrument), on the grounds of fault-based liability.

### 1.2.5 Expropriation

Expropriation is a procedure enabling a public entity to compel a private entity to transfer its real estate property rights in the public interest and in consideration of just and prior compensation.

Before acquiring a real estate asset, investors should assess whether any public works – whether ongoing or planned – are liable to generate any risk of expropriation.

#### a. Prerequisite to expropriation: Public interest

The public interest criterion is deemed satisfied whenever:

- The project is entirely justified;
- The project is unavoidable;
- The infringement of the related private entity's rights is not disproportionate in relation to the pursued objective.

#### b. Expropriation procedure

##### i. Administrative phase

This phase is aimed at (i) assessing whether the project satisfies the public interest criterion and (ii) identifying the related real estate properties, via a public enquiry (*enquête publique*) and a plot survey (*enquête parcellaire*).

Where the public interest criterion is met, two administrative documents are issued:

- A declaration of public interest (*déclaration d'utilité publique*). This document is subject to appeal before an administrative Court.
- A transferability Order (*arrêté de cessibilité*) listing the affected properties.

##### ii. Judicial phase

- Unless a voluntary settlement is reached, a judicial phase will occur. The court with jurisdiction for expropriation matters first of all issues an expropriation Order for the related property and then assesses the compensation to be awarded to the private entity.

## 2. Preliminary agreements

### 2.1 General comments

A preliminary agreement is an extremely important part of the conveyancing process in France and will contain all of terms and conditions of the sale agreed by the parties. Under French Law, there are no standard form conditions of sale. Preliminary agreements grant the parties more or less wide-ranging rights, depending on the provisions included.

There are essentially two types of preliminary agreement: The *promesse unilatérale de vente* (call option agreement - entailing a unilateral covenant to sell) and the *promesse synallagmatique de vente* (sale and purchase agreement entailing a bilateral covenant to sell and purchase).

Both types of preliminary agreement may be subject to conditions precedent, e.g. waiver by the local Authorities of their pre-emption right, obtaining a loan to finance the acquisition, securing planning permission.

There are two major restrictions to such covenants:

- Any unilateral covenant entered into for the purpose of property or a right for which a payment is required or received from that party entering into the binding covenant shall be null and void.
- Any transfer for consideration of rights granted by a covenant to sell a property shall be null and void if such transfer is entered into by "real estate professionals" (*professionnels de l'immobilier*).

In the event of an off-plan sale agreement in the protected sector (residential premises or premises for mixed business and residential use), a specific contract - known as a *contrat préliminaire de réservation* - shall be drafted. The French Construction and Housing Code provides for detailed rules for such deeds and relevant deposits.

Preliminary agreements provide a description of the relevant building and must determine its price or its method of calculation.

## 2.2 Categories of preliminary agreements

### 2.2.1 Call option or unilateral covenant to sell (PUV)

A PUV is a contract whereby the seller or promisor (*promettant*) irrevocably covenants to sell the property for a specified price, whereas the buyer or beneficiary (*bénéficiaire*), has the option to purchase (or not) this property during a given time period.

In consideration for the option and the exclusivity granted, the parties may provide for the buyer to pay a deposit (*indemnité d'immobilisation*), which generally corresponds to 10% of the purchase price. If the beneficiary exercises the option, the sale will be completed (with no retroactive effect), subject to any conditions precedent that may have been set forth, and the deposit will usually be deducted from the purchase price. If the beneficiary drops out of the acquisition, the deposit will not be refundable. The deposit will be refunded to the buyer if any of the conditions precedent set forth in its favour are not fulfilled.

Sometimes, despite the irrevocable character of the covenant to sell, a promisor may notify the beneficiary of the withdrawal of its covenant, before the option is exercised. Case law considers that such a unilateral withdrawal gives rise merely to damages in favour of the beneficiary. Since 1 October 2016, Article 1124 of the French Civil Code states that in this situation, the beneficiary may request damages and/or specific enforcement of the PUV.

If not notarised, a call option must:

- Be drawn up in at least three original copies;
- Be filed with the registration Authorities within a period of ten days from signature. Failure to do so renders such agreement null and void (Article 1589-2 of the French Civil Code). Nevertheless, if the option is exercised within ten days, the covenant will still remain valid, even though it was not registered.

Registration of the covenant at the land registry is optional.

### 2.2.2 Bilateral covenant to sell (*promesse synallagmatique de vente*)

Also known as a *compromis de vente*, a bilateral undertaking to sell is a preliminary sales agreement, as there is a clear bilateral obligation.

The owner agrees to sell to the buyer and the buyer in turn agrees to buy from the owner, subject to any conditions that are stipulated in the contract.

If the agreement does not provide whether the potential buyer may be substituted by a third party, no substitution shall be enforceable against the seller. If substitution is provided, such must take place before the conditions precedent have been fulfilled, for tax considerations.

A bilateral undertaking to sell may be drawn up by notarised deed or by a deed drawn up privately (*sous seing privé*, i.e. in a private written document).

The details of the property are set forth, including a description and the cadastral references listing each plot of land, its surface area and its intended use.

Conditions may relate, in particular, to planning permission, the purchase of adjoining land and the presence of easements to the benefit of the property or to that of third parties over the property.

The agreement may also provide the terms according to which the buyer is to establish fulfilment, or not, of the conditions: e.g. an offer or refusal of a mortgage, a copy of the planning permission

or proof of its refusal.

Parties may also wish to either defer transfer of title to the date of signature of the deed of sale before the notary simply performs one of the mechanical aspects of the sale process (the covenant will then be deemed to constitute a sale), or to make the notarisation of the deed a material condition to completion and thus to the validity of the sale. The covenant not then constituting a sale.

In the latter case, it is advisable to insert the following clause: "As an exception to the provisions of Articles 1583 and 1589 of the French Civil Code, notwithstanding the parties' agreement regarding the building and the price, as well as the bilateral nature of the covenant and the fulfilment of any conditions precedent, the transfer of title to the building is conditional to the signature of the notarised deed of sale, combined with the payment of the purchase price and of the down payment to cover expenses."

The covenant constitutes a sale: This applies both to firm covenants and to those whose conditions precedent have been fulfilled. Should one party refuse to sign the notarised deed, the other party will then be entitled to seek enforcement of the covenant, plus damages.

Any tax liability pertaining to the transfer arises as soon as the covenant is concluded. Exercising a right to substitute the initial buyer after the fulfilment of the condition precedent will be treated as a second transfer.

In terms of taxation, any registration fees linked to the sale are not payable at the time the covenant is entered into and the substitution of the initial buyer before the conditions precedent are satisfied does not constitute a sale.

To secure covenants to sell between a property developer or operator and an individual, Article 116 of Law No 2009-323 of 25 March 2009 to facilitate housing and to combat social exclusion has provided (Articles L.290-1 and L.290-2 of the French Construction and Housing Code) that "any covenant to sell involving the sale of a property or right *in rem* which is valid for a period of more than eighteen months, or any extension of a covenant to sell increasing its total term to more than eighteen months is null and void if agreed by a natural person and not recorded in a notarised instrument".

### 2.2.3 Right of first refusal or pre-emption agreement (*pacte de préférence*)

Pursuant to a *pacte de préférence*, a party covenants to offer a property for sale first to the beneficiary of the *pacte de préférence*, should that party decide to sell the related property in the future.

The *Cour de cassation* (Supreme French Civil Court) takes the view that this contract constitutes "a conditional unilateral covenant". In 1994, overturning its previous ruling, the Court decided that such agreements do not constitute a restriction on the right to dispose of property and therefore do not call for compulsory registration at the land registry.

This agreement may be ancillary to another agreement, e.g. a lease. In this case, the right of first refusal grants the tenant the right to purchase the rented property should the landlord decide to sell. The relationship between the two contracts should also be dealt with in order to determine whether the right of first refusal survives lease termination or renewal, for instance.

Since 1 October 2016, Article 1123 of the French Civil Code now provides that when a deed is executed with a third party in breach of a right of first refusal, the beneficiary of such right is entitled to compensation. If the beneficiary is able to establish the third party's knowledge both of the right of first refusal and of the beneficiary's intent to use it, the beneficiary may also bring an action for the annulment of the deed or request to be substituted to the third party.

### 2.2.4 Residential properties: Protection of non-professional purchasers of residential properties (*secteur protégé*)

Specific legal measures have been enforced to protect non-professional purchasers.

#### a. Withdrawal and cooling-off periods

The Law provides in favour of non-professional buyers for a seven-day cooling-off period to withdraw after the signature of:

- An covenant to sell; or
- A notarised deed of sale that was not preceded by a preliminary agreement.

#### b. Conditions precedent related to the obtaining of a loan

The deed must include various items of information on financing, i.e. an indication as to whether the price is to be paid directly or indirectly, even partially, with or without one or more loans. If no loan is used to purchase the property, this will need to be mentioned in the deed.

Pursuant to the French Consumer Code (*Code de la consommation*), if a deed provides that a loan is being used to pay the price, it should also include a condition precedent as to the obtaining of the loan. If provision for this condition precedent is not made, and unless the agreement expressly states that the property is being purchased without a loan, the Law assumes that a loan needs to be obtained by the purchaser to complete the acquisition.

### 3. Deed of sale

#### 3.1 General comments

The deed of sale enables the transfer of title to a property from seller to buyer. It is notarised and, as constituting the completion of the preliminary agreement, is entered into by the parties on the terms and conditions provided in such preliminary agreement.

The notary is in charge of registering the deed of sale at the land registry.

The deed will mention the rental situation of the building and the apportionment of rental payments to be made between seller and buyer.

If the property is sold within a period of less than ten years from its completion, the purchaser shall benefit from automatic transfer of the two-year and ten-year warranties (**please refer to Chapter IV - Section H**).

The seller of a property is under the mandatory obligation to provide the purchaser with two warranties: The warranty covering dispossession and hidden defects.

#### 3.2 Warranty covering dispossession

This warranty covers the risk of dispossession by third parties or by the seller itself.

##### 3.2.1 Warranty covering seller's personal actions

The seller must refrain from any action towards the purchaser that would result in a deprivation of the sale proceeds, e.g. direct or indirect *de facto* disturbances (relocating of the seller's ongoing business to within the vicinity of the property sold; causing an administrative measure detrimental to the purchaser), or direct or indirect legal disturbances (claiming a right over the property sold or granting a third party a right over the property sold likely to reduce/cancel the purchaser's rights).

This warranty is mandatory and transferable to subsequent buyers.

##### 3.2.2 Warranty third party actions

This warranty differs from the preceding one as it only purports to protect the purchaser against actions to claim a right over the property sold (i.e. its scope does not cover *de facto* disturbances).

This may involve a threat of total dispossession, such as a third party claiming ownership over the property, as well as a risk of partial dispossession. It implies that there is a legal action or a threat of such action.

This warranty may extend to any encumbrances on the property which were not declared at the time of the sale, such as easements, if they interfere with buyer's enjoyment. Courts will then assess whether the purchaser was genuinely unaware of such encumbrances charge at the time of the sale.

Another material criterion is that the grounds for the dispossession existed at the time of the sale (to be proven by the buyer).

In the event of total dispossession, the seller must refund the original price paid, plus an additional sum if the value of the building has increased, as well as any profits it has produced.

In the event of partial dispossession, the buyer is entitled either to a partial refund or to opt for annulment if the right or the part of the building it has been deprived of were essential. Exemption or limitation clauses are valid under certain conditions.

#### 3.3 Warranty covering hidden defects

Following the completion of the sale, the purchaser may discover a hidden defect affecting the building, i.e. a defect either rendering the building sold unfit for the purpose intended by the purchaser, or impairing the building to such an extent that had the purchaser been aware of this defect it would not have purchased the building - or would have offered a lower price.

In this case, the purchaser will be entitled to apply for the rescission of the sale together with a refund of the price paid or for a reduction of such price.

The warranty covering hidden defects does not apply to sales entered into by judicial Order.

##### 3.3.1 Hidden defects (*vices cachés*)

Hidden defects make the building unfit for its intended purpose. To make a proper assessment whether a building is unfit for its intended purpose, it is necessary to consider the use of the building as contemplated by the purchaser; this use depending mainly on the nature of the building, but also on the seller's possible knowledge of the purchaser's intentions.

Hidden defects may, first of all, be of a material nature. Case law has indicated a number of hidden defects:

- A dilapidated roof on a renovated building;
- The poor condition of a structural beam;
- The presence of termites;
- The absence of crawl space, giving rise to dampness in the building;
- An external crack masked by vines; and
- The unsanitary condition of a building, making it unfit for human habitation.

The defect may also be of an intangible or legal nature, such as:

- Tardy disclosure of an obligation to conform to a permitted building line;
- A drainage system constructed without the necessary authorisations;
- The fact that the land cannot be constructed upon.

The defect must not be apparent. The seller is not required to grant a warranty covering any apparent defects. The extent to which a defect is deemed not to be apparent depends primarily on the extent of the purchaser's experience in detecting such defects. Thus a professional purchaser is assumed to possess the technical skills needed to detect any hidden defects. If the purchaser specialises in the same professional field as the seller, it is presumed to be aware of the defect, and will have to prove that it could not be detected. On the other hand, a non-professional purchaser is simply required to prove that he exercised due care during the acquisition process.

### 3.3.2 Implementation of the warranty

The purchaser may first of all seek rescission of the sale (*action rédhibitoire*). Article 1644 of the French Civil Code also entitles the buyer to apply to courts for a reduction of the property's price (*action estimatoire*).

The purchaser must act within a period of two years following discovery of the defect (Article 1648 of the French Civil Code amended by Ordinance No 2005-136 of 17 February 2005, Article 3).

### 3.3.3 Contractual alterations to the warranty

Provisions are often made in contracts to limit or exclude the seller's warranty. These provisions are invalid if they are initiated by a professional seller, unless the purchaser is also a professional, specialising in the same field as the seller. Where, these provisions are admissible, they are construed narrowly.

These provisions will remain inefficient if it is established that the seller was aware of the defects when the sale was executed.

In sales completed between similar real estate professionals, this provision may include a representation by the purchaser, that it has conducted a comprehensive review of the legal, tax, administrative and technical aspects of the building, and that the acquisition is therefore subject solely to the warranties negotiated under the contract.

Recent Laws have imposed requirements to append various schedules relating to various hazards attaching to property (e.g. termites, lead poisoning and asbestos), either to the preliminary agreement or the notarised deed of sale. If the seller fails to provide these schedules, it will then be unable to invoke a provision granting an exclusion of the warranty covering hidden defects, should the relevant hazards actually materialise.

## 3.4 Specific information on surface areas for sales of co-ownership units

Pursuant to the Law known as the *Loi Carrez*, when selling a co-ownership unit, the seller has to declare the habitable floor area of the property (i.e. areas with less than 1.8 metres headroom are excluded).

Failure to indicate this figure may give rise to cancellation of the sale and, in the event of a discrepancy of more than 5%, the purchase price can be reduced on a *pro rata* basis.

## 3.5 Specific terms: Purchasing buildings to be developed or renovated

### 3.5.1 Off-plan sales (VEFA)

Off-plan sales (*ventes en l'état futur d'achèvement – VEFA*) are commonly used to sell buildings to be developed.

Pursuant to an off-plan sale agreement, the seller undertakes to erect a building on a plot of land initially sold, within specified deadlines and in accordance with certain contractual technical specifications. The seller must also provide the buyer with certain warranties, in particular against construction defects affecting the property sold.

## **a. Off-plan sale procedure**

### **i. Legal framework**

The legal framework provided by the French Civil Code and the French Construction and Housing Code is solely mandatory with regards to transactions involving residential premises (either in part or as a whole), also known as the protected sector.

### **ii. Notarised deed**

To be enforceable against third parties, the deed shall be notarised and registered at the local land registry.

### **iii. Transfer of title to the land and buildings**

Title to the land is immediately transferred to the purchaser. Thereafter, the purchaser shall gradually become the owner of the building as and when construction works proceed.

A schedule of payments based on construction work progress is contained in the agreement.

### **iv. Obligation to build**

Until completion of the construction works, the seller shall act as the developer and enter into the necessary related agreements.

The seller shall obtain the purchaser's prior consent if changes to the building sold or filing of an application for an amended planning permission are necessary.

## **b. Execution of the off-plan sale**

### **i. Delivery of the building by the seller**

The seller will have to meet the deadline set forth in the agreement. In practice, delivery of the building shall only take place once the building has been accepted by the seller acting as developer.

The building delivered must comply with the provisions set forth in the agreement, i.e. mainly its intended use, fitting out, surface area and quality of the materials used.

### **ii. Completion guarantee (*garantie d'achèvement*)**

The completion guarantee is mandatory regarding the protected sector and strongly recommended regarding other off-plan sales.

Prior to the signature of the off-plan sale agreement, the seller must underwrite either a completion guarantee or a repayment guarantee.

The completion guarantee only covers costs relating to those works necessary to complete the building - i.e. works enabling the building to be used for its intended purpose - but may be extended to cover any finishing touches or purely decorative works.

Since 1 July 2016, the seller must provide the third party (bank, insurer, etc.) issuing the guarantee and the notary with a certificate of completion of works.

### **iii. Warranties covering construction defects**

Ten-year warranties and performance warranties: The seller is subject to the same warranty requirements as those applicable to contractors, with the exception of the warranty covering "final completion" (**please refer to Chapter IV - Section H**).

## **3.5.2 Sale of properties to be renovated (*vente d'immeuble à rénover*)**

The legal framework on sales of properties to be renovated is largely inspired from the legal regime applicable to off-plan sales.

The legal framework does not apply to properties used solely for professional or commercial purposes.

Both the preliminary agreement and the deed of sale must contain certain representations. A specific warranty must be provided regarding completion of works (bank/insurer's joint and several guarantee).

Any person (i) selling an existing building, (ii) undertaking to directly or indirectly carry out work on the building and (iii) receiving payments from the purchaser prior to completion of works must enter into an off-renovation plan sale agreement.

The sale of properties to be renovated applies to projects solely involving renovation works. If the project involves reconstruction or extension works, the off-plan sales legal framework will then apply.

## **3.5.3 Sales subject to completion sale (*vente à terme*)**

Pursuant to a forward sale agreement, the seller covenants to deliver the building upon completion and the buyer covenants both to take possession of the building and to pay the purchase price on the date of delivery.

The seller retains ownership of the land and of the building until completion.

A final notarised deed regarding the effective the transfer of title is signed once the building is completed.

## 4. Registration and protection of ownership

### 4.1 Registration

Any establishment or modification of a right *in rem* over a building must be registered at the local land registry. Registration ensures that these rights are enforceable against third parties.

The French Civil Code also sets out other actions to protect the owner's rights.

### 4.2 Actions to establish ownership or other rights *in rem*: Actions to protect or recover possession

#### 4.2.1 Actions to establish title

These actions (*actions pétitoires*) aim to obtain judicial recognition of the right of ownership over a building.

The applicant must prove its right, either by deed or evidence.

#### 4.2.2 Actions to protect or recover possession

These actions (*actions possessoires*) aim to protect possession against any infringements affecting or threatening it.

These actions are open to anyone who has peacefully possessed or owned a building for at least one year.

#### 4.2.3 Actions to demarcate boundaries

Actions to demarcate boundaries (*actions en bornage*) enable owners which do not know the precise limits of their land and fearing potential neighbour encroachment, to judicially request the establishment of the exact boundary of their properties in the absence of an amicable agreement.

Such boundary demarcation is performed by a quantity surveyor (*géomètre-expert*).

## 5. Tax issues

### 5.1 VAT and Stamp Duty

The acquisition of property may give rise to VAT and/or Stamp Duty.

#### 5.1.1 VAT

The VAT treatment of a property asset deal depends both on the status of the seller with regard to VAT and the type of property.

Regardless of the purchaser's status, a sale of property is never subject to VAT as far as the seller is a private individual or a non-taxable entity (for example public bodies and acting in this capacity).

The transaction falls within the scope of VAT where the seller is a taxable person and acting in this capacity (those who carry out an economic activity, either individuals or legal entities). Nevertheless, the transaction is not necessarily taxable on account of several exemptions.

#### a. General rules

##### i. Sale of property by a taxable person gives rise mandatorily to VAT when the property is either:

- A piece of building land (*terrain à bâtir*) which is defined as land upon which constructions fixed to or in the ground may be authorised under (i) local or municipal planning Regulations or (ii) the provisions of Article L.111-1-2 of the French Planning Code. A property may be considered as building land rather than building if it is unsuitable for use due to its condition (e.g., derelict building due to partial or complete demolition, building rendered unsuitable due to disuse over a long period of time); or
- A new building. A building is considered "new" during the first five years following its completion, i.e. either the completion of an entirely new building or the completion of significant works on an existing building on:
  - . The majority of the foundations;
  - . The majority of the structures outside the foundations which determine the strength and rigidity of the building;
  - . The majority of the consistency of the facades (except cleaning and painting);

. Or more than two-thirds of all defined second fixings (*second œuvre*) i.e. non-load bearing floors, external joinery, internal partitions, sanitary and plumbing installations, electrical installations and heating systems.

The taxable amount of the sale of a new building is the sale price agreed by the parties plus any charges or liabilities of the seller to be assumed by or transferred to the buyer. The tax Authorities may substitute the fair market value for the price declared if they can establish the existence of fraud or evasion. The same rules apply to building lots except where the seller was not entitled to deduct VAT charged on the previous transaction (his acquisition of the property). In that case, the taxable amount constitutes the margin calculated as the difference between all amounts and charges payable to the seller by the buyer, less VAT on the margin itself and the original purchase price paid by the seller subject to VAT.

**ii. Sales of other properties but building land or new buildings - i.e. non-building land and buildings completed for more than five years prior to the sale - are VAT exempt but may be subject to VAT if the seller exercises an option for VAT in the deed of sale.**

Where election for taxation is possible, the taxable amount is the sale price or the margin on the sale price when the seller was not entitled to deduct VAT with respect of the previous transaction (see above).

The VAT rate on property sales is the 20% standard rate except for specific transactions to the benefit of social housing for which a reduced rate (5,5% or 10%) may apply.

Finally, the sale may give rise to VAT adjustments when such occurs prior to the beginning of the nineteenth year following the year the building was completed or acquired. A portion of VAT that was initially applied to the acquisition may either give rise to deduction (if the seller was not entitled to a full deduction at the time of acquisition and the subsequent sale is subject to VAT) or to a refund (if the seller was entitled to a full deduction at the time of acquisition and the subsequent sale is VAT exempted). In the latter case, the buyer can deduct the amount of VAT that has been refunded by the seller under the condition that he allocates the property to an activity subject to VAT and the seller issues a certificate specifying the refund and its amount.

#### **b. TOGC VAT regime**

According to the French tax Authorities, an isolated property sale may be considered as a transfer of a going concern that is disregarded for the purpose of VAT (no taxation or adjustments on the transaction) if the buyer intends to continue the taxable activity that was carried out by the seller.

Our recommendation: Both parties should pay specific attention regarding this special rule. In the event of misapplication, the seller (the tax Authorities challenge the applied TOGC scheme) or the purchaser (the tax Authorities challenge the taxation of the property sale) may bear non-recoverable VAT plus interests.

#### **5.1.2 Stamp Duty**

The purchaser of immovable property is liable for the payment of Stamp Duty except where a special exemption exists (for example, for the benefit of certain acquisitions made by local authorities).

Stamp Duty is assessed on the purchase price agreed by the parties increased by any charge or liability of the seller transferred to or assumed by the buyer. The tax Authorities may however reassess Stamp Duty by substituting the market value to the purchase price if they consider the latter to be higher.

The normal global rate of Stamp Duty is 5.80% (plus an extra duty for transactions concerning professional buildings located in the Ile-de-France region).

A reduced rate of 0.715% applies to the following transactions:

- Acquisitions of new buildings (completed within the last five years) or a building lot when VAT is payable on the total price);
- Acquisitions of property by a finance leasing company in order to grant the enjoyment of the property to the seller directly under a finance lease agreement;
- Acquisitions of buildings to be developed by the seller;
- Acquisitions carried out by buyers liable for VAT (irrespective of the seller's VAT status) entering into the covenant to re-sell the property within a period of five years from the acquisition. Should the buyer fail to re-sell the property within said five years period, it will be then liable for the payment of the difference between the Stamp Duty paid at the reduced rate and the Stamp Duty calculated at the standard rate in force on the date of acquisition plus interest. Before the deadline, the buyer may replace the covenant to re-sell by a covenant to build (see below) within a period of four years from the date of this new covenant.

Finally, a property acquisition by a VAT taxable person may be exempt (except a fixed duty of EUR 125) if the buyer undertakes to carry out work on the property in order for it to qualify as a new building within a period of four years from the date of acquisition. It is possible to apply for an extension of deadline on an annual basis. Should the buyer fail to meet its commitment (new

building completed within a period of four years), it will then be liable for the payment of the difference between the Stamp Duty paid at the reduced rate and the Stamp Duty calculated at the standard rate in force on the date of acquisition plus interest.

## 5.2 Local tax issues

The change of ownership of a property entails a change of the person legally responsible for paying the local taxes due by property owners. As local taxes are assessed on the 1 January of the financial year, the identity of the taxpayer will not be changed until the year after the sale, subject to the deed registration formalities being fully carried out at the land registry.

The purpose and use of a property are assessed according to the type of activity actually engaged in by the occupier on the 1 January of the year of assessment.

The acquisition of residential, office or commercial property (but not industrial buildings) does not usually affect the parameters used to assess the various local taxes (no change in the taxable surface area or the cadastral rental value of the property).

The rules are different for industrial property. Property is considered as "industrial" if it is used for an industrial activity such as production, transformation, packaging or extraction, or a non-industrial activity that uses large-scale equipment and techniques that play a predominant role in the activity (e.g. high capacity storage plant, logistics, centres). The acquisition of such properties can have an impact on the rental value assessed on the basis of the cost price of the land, constructions and landscaping that are as one with the building, as recorded in the assets of their owner and/or tenant.

However, there are mechanisms that allow the cadastral rental value to be fixed or limited to a minimum amount (*valeur locative plancher*) following certain transactions, such as exercising a lease option, sale and lease-back transactions, or the acquisition of a property along with all the moveable items required for the business that the seller was engaged in.

NB: Prior to the purchase, the purchaser should check that the seller is up-to-date with its payments of local taxes and verify the amounts charged, as tax Authorities have consequential rights of recovery against the purchaser of any amounts left outstanding by the seller (e.g. by attachment of rental income generated from the property).

## C. Share deals

### 1. Specific aspects of acquiring a property company

In cases where a building is held by a company, the sale can be carried out either through a share deal or an asset deal.

Such a decision is motivated by legal, financial and tax driven reasons both for the share-buyer and the asset-purchaser.

In tax terms, a share deal will entail registration fees (but not notary fees like in an asset deal) and the profitability of such a share deal may depend on the situation of the company. Debt in the property company will reduce the taxable base and lower registration fees for substantial savings.

However buying the property company could be less favourable than buying a building in cases of important latent capital gains, which will be taxable.

**Please refer to Chapter II - Sections B, C and D** for a detailed analysis of transfer taxes involved in a direct or indirect acquisition of property.

### 2. Key issues when purchasing a company

- The due diligence to be conducted must cover the property, similar to the due diligence to be carried out for an asset deal, but also the structure of the company. As a consequence, the scope of due diligence (and relevant warranties) could be more extensive for companies which had former activities or activities other than merely holding a building.
- The protection afforded by Law in the case of a property acquisition do not apply to a purchase of shares to the same extent. Therefore contractual warranties should be inserted into the share purchase agreement as the acquisition of a property company is ruled by general Contract Law.
- The structuring of a share deal may also take into account trapped cash issues if the property is ultimately sold by the company.
- The price for the shares is generally calculated according to a price formula to be agreed upon in the share purchase agreement.
- The form of the company may also be taken into consideration as shareholders' liability differs depending on the corporate form.

### 3. Property company acquisition process

#### 3.1 Preliminary agreement

Usually, the parties will enter into a preliminary agreement, such as a non binding offer, in order to enter into a discussion process, organise the data room, perform due diligence and discuss the contractual documentation. Thereafter, the parties can agree on a binding offer or contract which is generally subject to conditions precedent (obtaining planning permission, conclusion of a lease or clearance of the urban pre-emption right of local Council, clearance of antitrust issues - especially where significant revenue is derived from leasing or when acquiring a share of a bank facility, etc.). A unilateral covenant is also possible. In such case, the seller may require the payment of specific indemnification where the buyer does not purchase the shares, despite the fact that the conditions precedent have been satisfied.

#### 3.2 Valuation of the company and determination of the purchase price

The first step is to agree on the valuation of the buildings.

In principle, such a valuation is performed using the same methods as those which would be used if the building was to be purchased. The main factors are the building's actual or anticipated earnings, price/earnings ratio (*taux de capitalisation*) and the internal rate of return required.

For the calculation of the price for the shares, the parties often have an asset value approach which consists of a breakdown of the company's assets and liabilities.

The traditional formula is: Value of the assets + current assets – debt.

However in negotiating the calculation, buyer should pay close attention to the definition of the different items (e.g. treatment of provisions).

The value of the assets is often agreed on by the parties on an unalterable basis (*ne varietur*).

By adopting this method of valuation, it is obvious that, for a building's given value, the greater the liabilities, the lower the value of the company. In this context, the valuation of the building is critical.

Moreover, the precise definition of terms is crucial because the accounts provided for by the vendor due diligence and reviewed by the buyer due diligence are provisional and final accounts which will be delivered after the acquisition date. Buyer and seller will need to set a provisional price with a price adjustment mechanism.

### 4. Representations and warranty agreement

When pursuing a share deal, a buyer will need to be aware that although its aim is to acquire the assets of the company (i.e. the real estate), the vehicle through which the sale is made is the property company. As such, the representations and warranties should take into account all necessary corporate aspects covering assets and liabilities other than the real estate.

Because a share deal consists in the acquisition of the property company, the applicable Law is Corporate Law and several elements that would be mandatory in an asset deal are not so in a share deal. Using the representation and warranty mechanism, the buyer should seek to obtain the same level of protection he would have in an asset deal thanks to Real Estate Law.

In any case, using the representation and warranty mechanism the buyer should seek protection from liabilities yet unknown at the date of acquisition, and in particular tax liabilities.

#### 4.1 Protection against company related risks

It is common practice in share deals for the seller to grant the buyer contractual warranties regarding:

- Title to the shares;
- The asset situation of the target at the time of transfer;
- Any event leading to a potential liability having taken place prior to the date of acquisition that could become apparent after the date of acquisition: Mainly an increase in debt or liabilities, a reduction of assets compared to the financial representations made at closing as well as tax and legal disputes;
- The fact that the representations made by the seller regarding the company and its assets are true and accurate as of the date of acquisition.

## 4.2 Key issues regarding the warranty agreement

Four issues must be addressed when drafting a warranty agreement.

### 4.2.1 Beneficiary of the warranty and type of compensation

In cases where the warranty benefits the buyer, the consequence will generally either be a reduction of the purchase price or specific indemnities as set out in the share purchase agreement.

The share purchase agreement may stipulate that the buyer may have the right to choose the beneficiary of the indemnification: The buyer itself or the target company.

Whether the benefit of the warranty comes in the form of a reduction in the purchase price or of the payment of damages to either the target company or to the buyer may have tax consequences.

### 4.2.2 Scope of the representations and warranties

Regarding the company:

- Incorporation, existence and history of the company;
- Title to the shares and the absence of any lien;
- Free transferability of the shares;
- Any collateral granted by the company or in its favour;
- The company's accounts;
- Personnel, if any;
- Current contracts;
- Loans, receivables and provisions;
- Absence of receivership proceedings;
- Compliance with tax and social security regulations;
- Operations carried out by company management during the period between signature of the preliminary agreement and the actual date of transfer; and
- Legal disputes.

Regarding the fixed asset :

- Fixed asset (co-ownership, flying freehold divisions, valid thirty-year root of title, mortgage situation, collateral or preferential claims, planning situation, rental situation, situation of works covered under the 10-year construction warranty, activity relating to classified facilities falling within the scope of environmental permit regulations, health and safety regulations, pollution, natural and technological hazards, etc.);
- Compliance with various Regulations (planning permissions, planning issues, environmental issues, etc.).

In the course of the negotiation of the representations and warranties, it would be in the seller's best interest to negotiate a cap, a *de minimis*, a maximum duration for the representation and warranties and to include that the seller will be liable only in excess of the *de minimis*.

Depending on the observations made during the due diligence phase conducted by the buyer, its best interest will be to obtain specific indemnifications on specific items.

### 4.2.3 Assessment of loss

In practice, compensation is paid for the actual net loss suffered by the company and the purchaser. The net loss calculation is generally the gross loss offset by potential provisions made by the seller, insurance payments that should cover the loss and decreases in tax due to losses.

The buyer will seek to include all direct and indirect items pertaining to the loss (for example reasonable expenses and fees, etc.).

In practice, compensation is paid:

- If and when the warrantor acknowledges the beneficiary's claim;
- If and when a Court decision upholds the beneficiary's claim.

### 4.2.4 Guarantee securing payment of compensation

Should the seller's financial situation make it apparent that its ability to pay the relevant compensation is hindered or should the seller's financial situation make it likely that it will be wound up, a guarantee securing payment of compensation will be important to the buyer.

Such a guarantee is usually issued by either a bank or the parent company of the seller with adequate resources, either through the implementation of an escrow, a first demand guarantee provided to the buyer or a joint guarantee in order to guarantee that the seller will pay the monies owed under his warranty agreements.

## 5. Tax implications

### 5.1 Acquisitions of shares in companies that invest in immovable property assets

#### 5.1.1 Registration duty due upon acquisition of a *société à prépondérance immobilière* (company whose assets mainly consist of real estate)

For the application of the rules on registration duty, are considered as a *société à prépondérance immobilière* any French or foreign corporate entity whose shares are not listed and whose total gross assets, on the day of the acquisition or during the previous period, are comprised by more than 50% of immovable properties or rights located in France, or interests in unlisted legal entities whose own assets mainly consist of real estate.

The following ratio is applied:

Actual value of the immovable properties or rights located in France, including interests in French or foreign companies whose assets mainly consist of French real estate
--

Actual value of the total assets
----------------------------------

Unlike other taxes (especially the 3% annual tax), properties used by companies as part of their business activity are taken into account in estimating the proportion of real estate in their assets.

When the ratio is above 50% the company's assets are considered to be invested mainly in real estate and a 5% registration duty is payable on transfers of its shares. The registration duty is paid on the value stated in the agreement, plus the value of any commitments that can be added to the price, or the actual value, if higher.

Although the applicable tax rate (5%) is close to the rate applicable to direct disposals of the same property (between 5.09% and 5.80%), the acquisition of shares is generally less expensive for the purchaser as the basis of the valuation usually takes the company's debts into account.

Also, in principle, share transfers do not have to be formalised at the land registry (*publicité foncière*) and there are no notary's fees (save voluntary submission).

However, since 1 November 2011, transfers of shares in (French or foreign) companies whose assets mainly consist of real estate must be registered in a notarised deed in France, within one month from the transfer.

#### 5.1.2 Registration duty due upon acquisition of other types of company

Where the company is not considered as having assets that mainly consist of real estate, the following registration duty is payable:

- At the proportional rate of 0.1% for securities in share companies, SA, SAS or partnerships limited by shares (SCA).  
For companies that are listed on the stock exchange, no tax is due unless the transfer is recorded in writing (i.e. any written document that constitutes title with regard to each of the parties, that records their agreement on the subject matter and the price of the sale, whatever its form may be). Transfers of shares in companies listed in France or abroad but that are issued by a French company whose market capitalisation exceeds EUR 1 billion on 1 December of the year preceding the year of completion of the transfer are chargeable to the tax on financial transactions at the rate of 0.2% of the acquisition price. As a consequence, no registration duty is due;
- At the proportional rate of 3% (an allowance equal to the ratio of the sum of EUR 23,000 and the total number of shares in the company is applied on the value of each share), for transfers of shares in *sociétés civiles* (partnerships – SCI), general partnerships (*sociétés en nom collectif* – SNC), limited partnerships (*sociétés en commandite simple* – SCS) limited liability companies (*société à responsabilité limitée SARL*).

However, with the exception of companies whose assets mainly consist of real estate, share transfers within consolidated tax groups within the meaning of Articles 223 A and 223 A (bis) of the French Tax Code, as well as share transfers between companies that are members of the same group described under Article L.233-3 of the French Commercial Code, are exempt from the 0.1% and/or 3% taxes referred to above.

In accordance with Article L.233-3 of the French Commercial Code, two companies are deemed to belong to the same group if:

- One company directly or indirectly owns a fraction of the capital that confers it a majority of voting rights in that company's shareholders general meetings;
- One company alone holds the majority of voting rights in the other company, by virtue of an agreement passed with other members or shareholders, that is not contrary to the interests of the company;

- One of the companies takes, *de facto*, through the voting rights that it holds, the decisions at the other company's shareholders general meetings;
- One company is a member or shareholder of the other company and has the power to appoint or dismiss a majority of the members of the administrative, management or supervisory bodies of the other company.

Disposals abroad of the shares of these French companies, agreed to in contracts signed in France, also give rise to a tax credit equal to the amount of registration duty paid abroad. This tax credit is deductible from the French tax applicable to the disposal, up to the limit of the French tax paid in this respect.

In practice, and subject to an in-depth assessment of the other potential tax consequences of this kind of restructuring, it may be better, from the registration duty point of view, to convert an SCI, SNC or SARL into an SA, SAS or SCA before disposing of the shares, to reduce the tax impact of the transaction.

However, to avoid any risk of the tax Authorities questioning the conversion of the company (on the basis of the theory of abuse of process, for example), it would be advisable not to convert the company back into its initial form at a later date, or to merge or dissolve it shortly after the transfer transaction.

## **5.2 Taxation of capital gains on disposals of shares in companies whose assets mainly consist of real estate**

### **5.2.1 Disposals of shares in companies whose assets mainly consist of real estate by shareholders that are French tax residents**

#### **a. Individual shareholders**

Under the rules governing income tax, a company is considered to have assets that mainly consist of real estate when, at the end of each of the three financial years preceding the disposal, its assets comprised, in actual value, more than 50% of buildings or land, or interests in such properties. If the company whose shares are disposed of has not yet closed its third financial year, the composition of its assets is assessed at the end of the last closed year or, failing that, on the date of the disposal.

The capital gains are calculated as the difference between the disposal price and the cost price of the shares (or, if the shares were acquired free of charge, the market value taken into consideration for assessing registration duty).

The taxation of capital gains on the disposal of the shares in a mainly real estate company by an individual depends on the tax regime of the company whose shares are disposed of:

- If the company pays personal income tax, the capital gains realized on the disposal will be taxed as for capital gains on real estate and, therefore, will be chargeable to IRPP (personal income tax) at the rate of 19%, plus social contributions at the rate of 17.2%. The capital gains are reduced by applying taper relief allowances that are different for income tax and for social contributions;
- If the company pays corporate income tax, the chargeable gains on the disposal are taxed as for capital gains on disposals of stocks and shares, with a single fixed-rate withholding tax at the all-in rate of 30% (although it is possible to opt to be taxed at the incremental personal income tax rate).

#### **b. Corporate shareholders**

The rule is that the capital losses or gains realized on disposals (and on provisions for depreciation) of securities in unlisted, mainly real estate companies still falls within the short-term regime, regardless of how long the securities have been owned, and thus contribute to the calculation of taxable profits under General Law.

Companies are deemed to be companies whose assets mainly consist of real estate if their assets comprise, in terms of actual value, over 50% of real estate, interests in real estate, interests in real estate leasing contracts or shares in other companies whose assets consist mainly of real estate. Buildings or property rights that are principally allocated by the company to its own industrial, commercial, agricultural or professional business are not taken into account in the calculation of the 50%, regardless of whether they are recorded among its own assets or owned through a company that is itself qualified as having assets that mainly consist of real estate.

However, capital gains on disposals of equity securities in listed companies whose assets mainly consist of real estate are taxable as long-term capital gains or losses. Such securities benefit from the long-term capital gains regime if (i) they qualify as equity securities and (ii) have been owned for at least two years. The net long-term capital gains are taxed at the reduced rate of 19%, plus any additional contributions that may be due. Capital gains on disposals may be offset against net long-term capital losses arising from the disposal of securities of the same type (during the financial year, or remaining to be carried down).

Capital gains or losses on the disposal of such securities owned for less than two years, or that do not qualify as equity instruments, are taxed according to the short-term regime (including the provisions for depreciation).

### 5.2.2 Disposals of shares in companies whose assets mainly consist of real estate by non-resident shareholders

For the application of the rules applicable to non-residents, and subject to the terms of international tax Treaties, a company is considered to have assets mainly consisting of real estate when its assets mainly consist of buildings and property rights; That status is assessed, with no exceptions, at the close of the three financial years that precede the year of the disposal.

Again subject to the terms of international tax treaties, capital gains from disposals of shares in companies whose assets mainly comprise real estate by taxpayers that are not domiciled in France are, regardless of the tax regime, subject to a specific withholding tax of:

- 19%, in discharge of income tax, for individuals, individual partners in partnerships and individual investors in FPIs, *pro rata* to the shares held.  
In addition to the withholding tax, capital gains earned directly or indirectly by individual non-residents are also liable for social contributions at the rate of 17.2%. Whether these social contributions comply with Community Law or not is subject to debate.  
The capital gains are reduced by applying taper relief allowances that are calculated differently for income tax and for social contributions;
- 19% (deductible from corporate income tax) for legal entities that are residents in a Member State of the European Union or of the European Economic Area on transactions that benefit from this rate, if carried out by a legal entity that is a French tax resident (e.g. disposals of interests in a SIIC;
- 33.33% in all other cases (deductible from corporate income tax);
- 75% if the disposer is domiciled or established in a NCST (non-cooperative State or territory).

### 5.3 Local tax issues

In addition to the verifications referred to in **Chapter II - Section B**, the purchaser must also check the *cotisation sur la valeur ajoutée* (CVAE) calculated and paid by the target company, to ensure that there is no underlying tax debt.

On the other hand, the acquisition of the shares of the entity that owns a property does not, in principle, have any impact on the cadastral rental value of the property, even if it is an industrial building.

It should be noted, however, that acquisitions of industrial premises made as a result of capital contributions, mergers and demergers of companies, disposals of firms or universal transfers of assets can lead to the minimum rental value (*valeur locative plancher*) being applied, the amount of which varies according to the date of the transaction and the relationship between the parties to the transaction.

## D. Tax considerations: Asset deal vs share deal

An asset deal is taxable under or exempted from VAT according to the buyer's status and the qualification of the asset (building land, new building, etc.). The right for the seller to deduct or not VAT linked to the expenses made in relation with the transaction directly depends on this regime.

Except where owning the shares of the company gives the shareholders the legal or *de facto* ownership or enjoyment of land or a building, the sale of the shares is exempted from VAT and does not entitle to deduct the input tax.

From that standpoint, it is relevant to assess the VAT potential impact of both transaction when making a choice between an asset deal and a share deal.

The difference can also be huge from the standpoint of stamp duties.

Transactions on immovable properties are generally subject to stamp duties (whose rates can differ) on the purchase price (or on the fair market value when higher).

Transactions on shares are taxed when the assets of the company are mainly real estate. In such a case, stamp duties are due at the rate of 5% on the purchase price which can be much lower than the price of the sale of the buildings to the extent such is determined taking into account the company's debts.

## E. Sale of the property purchased

### 1. Environmental property surveys and mandatory information for sales

Increased regulation of health-related and environmental issues – from a preventive and remedial point of view – has led to more stringent obligations for both sellers and landlords alike in terms of providing information to purchasers and tenants.

#### 1.1 Mandatory surveys for sales and leases

##### 1.1.1 Surveys to be conducted for property sales

A technical survey file (*dossier de diagnostic technique* – known as the “DTT”) containing various mandatory surveys, must be supplied by sellers to purchasers.

For example, Law No 2014-366 of 24 March 2014 (the ALUR Law) introduced the requirement of a new survey for the assessment of the risk pertaining to the *serpula lacrymans* (*mérule*) fungus (dry rot).

#### a. Surveys on asbestos

##### i. Scope of the obligation to provide an asbestos report (*constat amiante* or *diagnostic amiante*)

The use of asbestos has been prohibited in France since 1997.

Sellers of buildings whose planning permission was issued prior to 1 July 1997 must provide purchasers with a report identifying any building materials or products containing asbestos on the premises or, where applicable, certifying the absence of any such materials or products. If the presence of asbestos is identified, the survey must indicate the necessary measures to control and reduce exposure.

This applies to both public and private sellers.

Asbestos reports must be attached to any preliminary agreement and to any contract completing or recording the sale of certain buildings.

##### ii. Term of validity and punitive measures

Asbestos reports are not valid indefinitely. Carrying out works on the property between two successive sales or between the signature dates of the preliminary agreements and the final deed of sale could invalidate the report.

If the seller fails to provide an asbestos report, it may not be released from liability under the warranty covering hidden defects relating to asbestos. If the report is negative and the purchaser subsequently discovers materials containing asbestos on the property, it may not sue the seller under the hidden defects liability. However, it would have cause of action to bring a civil liability suit against the surveyor. The only circumstances the purchaser could bring a claim against the seller and the surveyor would be in the event of fraudulent collusion between the two parties.

The seller may not be held criminally liable under for failing to provide an asbestos report.

The enforceable provisions are provided by the French Public Health Code (*Code de la santé publique*).

##### iii. Distinction between the asbestos report and the asbestos technical file (*dossier technique amiante* - DTA)

Property owners may be required to carry out an asbestos survey in circumstances other than sales (for instance co-owners keep an asbestos technical file of common use areas).

Sellers are required to obtain an asbestos survey examining all fireproofing materials in sprayed form, insulating materials and suspended ceilings in all buildings whose planning permission was issued prior to 1 June 1997. For certain buildings, the survey must also cover other components liable to potentially contain asbestos.

Roofs, cladding, façades and pipes installed on roofs and façades must all be examined. Two Bylaws issued on 26 June 2013 specify the method to be used to identify asbestos. They apply to any operation where the survey report is provided to the property owner after 1 July 2013.

If asbestos is detected, depending on the condition of the related materials and whether the fibres have become airborne, it may be sufficient to (i) ensure that the related materials remain in a good state of repair or (ii) to confine such materials. Otherwise, they will have to be removed.

If the materials are in good condition, the owner has an obligation to check their condition within a period of three years from the survey date or in the event of any substantial changes to the building.

If the materials show signs of deterioration, the owner has an obligation to obtain an asbestos level survey performed by a qualified inspection agency.

All of the information on the above-mentioned surveys and, where relevant, any works carried

out, will be collected to compile an asbestos technical file (*dossier technique amiante* – DTA). The DTA must be accessible and reviewable by anyone occupying the building.

Asbestos technical files must be updated in keeping with the Bylaw dated 21 December 2012.

Property owners must also establish, update and retain an asbestos file for the private areas of their property (*dossier amiante – parties privatives* or DAPP), including the report on fireproofing materials in sprayed form, insulating materials and suspended ceilings, to be examined by occupants and any person carrying out works in the property.

For office buildings, workspaces, common use areas of residential buildings, high-rise buildings and establishments open to the public, the DTA must be particularly detailed and the asbestos survey must cover a wider range of materials and products in addition to fireproofing materials in sprayed form, insulating materials and suspended ceilings.

The information sheet (*fiche récapitulative*) included with this type of DTA may be scheduled in lieu of the asbestos report to the sale.

#### **b. Report on the risk of exposure to lead (*constat de risque d'exposition au plomb*)**

The purpose of this report is to identify any coatings containing lead and to review the state of repair of the property, since exposure to lead – particularly lead-based paint – can cause lead poisoning (saturnism).

The report on the risk of exposure to lead (CREP) is scheduled to any preliminary agreement and to any contract completing or recording the sale of a building assigned in all or part to a residential use, built prior to 1 January 1949. The report is valid for an unlimited period of time except where it indicates an abnormal concentration of lead, in which case it will expire after one year.

Consequently, if the report provided with the preliminary agreement has expired on the date of signature of the final deed of sale, a new report will have to be provided.

The consequences of failing to provide a report on the risk of exposure to lead are identical to those set out above for asbestos reports. If the report is not scheduled to the aforementioned instruments, no clause excluding the warranty covering hidden defects can be stipulated.

#### **c. Energy performance survey (*diagnostic de performance énergétique – DPE*)**

All sellers of buildings must provide an energy performance survey unless the sale concerns an off-plan property.

The survey states the actual or estimated energy consumption for a building or part of a building being sold and includes a standardised scale of values to help the purchaser understand the information and therefore compare and evaluate the energy performance of the property.

Since the introduction of the “Grenelle 2” Environmental Law on 12 July 2010, a DPE must be obtained for the construction or extension of a building.

It is also mandatory to obtain a DPE for all buildings which were equipped with heating or cooling systems prior to 1 January 2017, with the exception of collective residential buildings of over fifty units whose planning permission application was filed prior to 1 June 2001 as they instead have to carry out an energy performance survey within five years as from 1 January 2012.

Owners of buildings of more than 250 m<sup>2</sup> as of 1 July 2015 and classed as a public access building (*établissement recevant du public – ERP*) are under the obligation to obtain and display an energy performance survey (ERP categories 1 to 4).

Greenhouse gas emissions as well as recommendations for improving energy performance and to promote energy saving are included in the DPE.

The survey is provided for information purposes only. Under current legislation, the purchaser is not entitled to bring a claim against the seller for omissions or errors in the survey.

The failure to provide a DPE is not subject to any particular punitive measures under French Law.

However, this survey is part of the technical survey file that must be submitted to prospective purchasers and therefore constitutes a mandatory legal obligation. Sellers may therefore incur contractual liability for failing to provide a DPE. As a result, if the purchaser suffers a loss as result of the seller's failure to submit a DPE, it may bring a claim against the seller, the difficulty being the assessment of the applicable consequence in law. The Courts should apply the most appropriate solution, which could range from cancelling the sale contract to awarding damages, unless the purchaser should prefer a DPE to be provided.

Energy performance surveys are valid for 10 years.

#### **d. Termite report (*état relatif à la présence de termites*)**

The obligation on sellers to provide this report depends on the geographical location of the relevant property. Termite reports are only required for buildings located in designated areas as defined by an Order of the *Préfet* following the discovery of termite nests. Where applicable, they must then be appended to preliminary agreements or to final deeds of sale.

The termite report identifies the building concerned, indicates those areas which have been inspected and those that could not be inspected, the components infested by termites, those that have been and those that are not so infested as well as the date and place of its establishment.

The consequences of failing to provide a termite report are identical to those set out above for asbestos reports.

Termite reports are valid for six months.

#### **e. Report on hazardous easements and information on soils (*état des servitudes risques et information des sols - ESRIS*)**

Article L.125-5 of the French Environmental Code provides that sellers of buildings located in certain designated areas must inform their purchasers of the hazards that their buildings are exposed to (e.g. natural, mining, technological, seismic activity risks). Until 31 December 2017, a model form known as the *état des risques naturels, miniers et technologiques* (ERNMT) was appended either to the preliminary agreement or directly to the final deed of sale. Since 1 January 2018, the ERNMT has been profoundly modified and has now become the ESRIS. The sellers' obligations are now strengthened regarding the information to be provided regarding technological hazards and a section on soil information has been added to the model form. Please note that the Ordinance of 10 February 2016 also requires the risk of exposure to radon to be indicated (though this obligation has not been inserted in the ESRIS model form and cannot practically be fulfilled due to the absence of Order defining precise details of the information to be provided).

The ESRIS must be appended to the preliminary agreement or directly to the final deed of sale, irrespective of whether the property in question is used for commercial, industrial or residential purposes.

ESRISs are valid for six months.

Sellers must also inform potential purchasers of any events that have given rise to insurance proceeds consecutively to a natural or technological disaster.

This information has to be reiterated in the deed of sale.

Purchasers are entitled to apply either for the rescission of the sale contract or to take legal action to obtain a price reduction should the seller fail to comply with the obligations to (i) inform potential purchasers about the status of the property and (ii) to append the ESRIS to the sale contract.

#### **f. Domestic gas and electrical surveys**

A domestic gas survey (*état relatif aux installations intérieures de gaz*) must be provided in the event of sale of all or part of a residential building fitted with gas installations that are over fifteen years old. The survey allows risks to personal safety to be assessed.

The survey covers the private areas of residential premises and their outbuildings and must be provided with the preliminary agreement or appended to the deed of sale. It is valid for three years.

Since 1 January 2009, sellers of all or part of a residential building are also required to provide a domestic electrical survey, allowing risks to personal safety to be assessed.

Since 20 April 2011, this survey must include a list of all measures taken to limit the risks of an electric shock where basic safety rules cannot be applied in full for economic, technical or administrative reasons.

If the seller fails to provide a domestic gas or electrical survey, the latter will not be entitled to exclude its liability under the warranty covering hidden defects.

#### **g. Information on sanitation**

Since 1 January 2011, a sanitation report (*état relatif à l'assainissement*) must be applied for and obtained from the local Authorities to sell properties which are not connected to the public sewer system. This document must be less than three years old at the time of signature of the deed of sale.

The report must be appended to the technical survey file. Failing this, the seller may not exclude liability under the warranty covering hidden defects, i.e. the seller could be held liable in the event of a problem with the sewer system if it had not notified the purchaser of the issue prior to the sale. The French Supreme Court (*Cour de cassation*) has held that bringing a claim under the warranty covering hidden defects does not prevent purchasers from subsequently bringing an action to invalidate the sale for fraudulent withholding of information (*réticence dolosive*).

#### **h. Dry rot (*Serpula lacrymans fungus*) survey (*mérule*)**

Since 27 March 2014 and the ALUR Law, property sellers must provide a new document to inform potential purchasers where there is a risk of dry rot.

Properties within areas identified by an Order of the *Préfet* (issued on the proposal and after consultation of Municipal Councils) are concerned by this new Regulation. The document is not a

survey and merely informs purchasers of potential risks pertaining to this fungus.

Occupants and/or property owners have an obligation to promptly report signs of fungus to their local town or city hall.

Co-ownership associations bear the same obligation pertaining to the common use areas of buildings governed by the Law of 10 July 1965.

The lawmakers have yet to set any specific term of validity for this new document or to determine the penalties applicable to sellers failing to provide such at the preliminary or final contract stage.

### 1.1.2 Technical surveys to be conducted for leases

Landlords must also provide their tenants with technical surveys.

Although the obligations concerning landlords are not as stringent as those concerning property sellers, they are required to provide certain documents to their tenants upon the signature of a lease.

#### a. Report on the risk of exposure to lead

The landlord must provide the tenant with a report on the risk of exposure to lead.

This obligation applies to leases concluded on or after 12 August 2008 for premises used in full or in part for residential purposes, located in a building constructed before 1 January 1949.

Unless otherwise agreed, the expense of the report is borne by the landlord. If the lease relates to a building placed under co-ownership, the report on the risk of exposure to lead shall only concern the private use areas (and not the common use areas).

As a result, tenants in buildings leased partly under a commercial lease and partly for a residential purpose would be entitled to a report on the risk of exposure to lead.

Failure to comply with these legal requirements constitutes a breach of the specific safety and prudence obligations imposed on landlords, thereby exposing them to a criminal liability. Tenants would also be entitled to file a civil claim before the Courts.

#### b. Energy performance survey (DPE)

An energy performance survey must be appended to all residential leases. Since the Grenelle 2 Law, this obligation was extended to all types of lease covering all or part of completed buildings, save rural leases and seasonal rentals.

As from 1 January 2011, as part of the mandatory information provided to potential tenants, the energy performance ranking of the property for lease must now be mentioned in the rental advertisement.

Energy performance surveys are valid for ten years but are solely for information purpose. Under current legislation, tenants would not, therefore, have the right to bring a claim against landlords for any omissions or errors in the survey.

Nonetheless, as is the case for purchasers, tenants may bring a claim against landlords for breach of contract if they can prove they suffered a loss resulting from landlords' failure to provide the energy performance survey. Remedies to compensate for tenants' loss under general Contract Law include rescission of the lease or reductions of rent.

#### c. Report on hazardous easements and information on soils (ESRIS)

If the building is located in a high-risk area, all tenants must be provided with a report on the natural, mining and technological hazards applicable to the building in question. This applies to buildings used for residential, commercial or professional purposes.

The report must be drawn up no more than six months before the date of the lease in accordance with a pre-defined model document. Tenants may claim rescission of the lease or apply to Courts for a reduction of rent if no such report is provided.

As is the case in sales, landlords must inform tenants of any events having given rise to insurance proceeds consecutively to a natural or technological disaster (**please also see above**).

#### d. Asbestos technical file (*dossier technique amiante* – DTA)

A copy of a report on the presence of asbestos or of materials containing asbestos within the property, if any, must be appended to the lease.

#### e. Domestic gas and electrical surveys

Since 1 January 2018, all landlords must provide tenants with a survey of the indoor gas and electricity installation.

These documents purport to assess the risks relating to the property's gas and electricity installation. If the installation is in poor condition, landlords are under the obligation to notify the future tenants but is not required to undertake any works.

These surveys shall be valid for six years and cover buildings with an indoor gas and electricity installation installed more than fifteen years ago.

### 1.1.3 Surveyors: Proficiency and liability

Surveyors are now subject to more stringent rules than in the past.

A surveyor may be an individual whose proficiency is certified by an approved agency in the building industry (French Law sets forth specific conditions for the approval of such agencies) or a legal entity with employees whose proficiency is certified by an approved agency. Two criteria are taken into account for certification by the approved organisation: Technical expertise in the building industry and the ability to establish the various technical survey reports.

Surveyors have a duty to advise their clients.

Surveyors must ensure they have inspected all areas to be surveyed and cannot claim the client did not fully inform them in this respect. To discharge themselves of liability, surveyors must be able to prove that they did not breach their duty to advise their clients. This duty can be mitigated if the client is a real estate professional.

Surveyors must be independent both with regard to sellers and purchasers and with regard to landlords and tenants. They must have no relationship whatsoever with any firm responsible for carrying out works in the building. Failing this, these connections may affect their impartiality and independence.

An exception exists as it is possible for DPEs to be displayed for the attention of the general public in public access buildings to be carried out by a representative of the public Authority or legal entity occupying the building.

Surveyors must take out insurance to cover liability for any errors committed in conducting surveys.

A ministerial Order was issued on 8 February 2012 to supplement the rules for issuing these surveys, with a view to making them more reliable and more transparent. The provisions of the Order entered into force on 1 January 2013.

Surveyors may incur a criminal liability for failing to take out insurance or for breach of their obligations. Lastly, sellers of properties may also be liable to a fine for using a surveyor who has not complied with regulatory requirements.

## 1.2 Mandatory information

In addition to the above-mentioned surveys, other information must also be disclosed to purchasers to allow them to make an informed decision.

The seller is under a general obligation to disclose information and any vague or ambiguous statements in an agreement will be interpreted against it. The obligation to disclose information is more stringent for sellers who are considered as real estate professionals.

### 1.2.1 Information on classified facilities

Sellers of land on which a classified facility (subject to authorisation or registration) has been operated must inform the purchaser of this in writing. They must also inform the purchaser of any risks or inconvenience resulting from the operation of the facility, to the best of their knowledge.

If the seller is also the operator, it must inform the purchaser in writing if any chemical or radioactive substances have been handled or stored at the facility.

The obligation to provide information only applies to land on which a classified facility is no longer operated. It does not apply to sales of land on which the operation of a facility is still in progress.

Should it fail to provide this information to the purchaser or in the event of misrepresentation, the purchaser may apply - within two years from the discovery of the pollution - for rescission of the sale, the reimbursement of part of the purchase price or that the site be reinstated at the sole expense of the seller, if the cost thereof is not disproportionate in relation to the sale price.

Sellers may not claim that they were unaware of the existence – even in the past – of a classified facility on the land. Consequently, they have a responsibility to determine whether any such facility may have existed on the land and to identify any residual pollution before putting the site on the market.

### 1.2.2 Soil pollution

It can be difficult to identify a source of pollution, which may be the result of activities carried out on the property in the past. In some cases however, pollution may be closely connected with a specific, identified activity.

Prior to the Grenelle 2 Law, soil pollution surveys were not mandatory. There are now new requirements for landlords or sellers in this regard.

Where information released by the Authorities shows that there is a risk of soil pollution affecting land to be sold or leased, the seller or landlord must inform potential purchasers or tenants in writing thereof. The sale or lease agreement must state that this requirement has been satisfied.

**Please also refer above to the section on ESRISs.**

Failing this, if the pollution renders the land unfit for the purpose as contemplated in the contract - within two years of the discovery of the pollution - the purchaser or tenant has the right to rescind the contract or, depending on the circumstances, to apply for a partial refund of the sale price or for a reduction of the rent.

Purchasers may also request site rehabilitation measures at the expense of the seller, if the cost is not disproportionate in relation to the sale price.

**1.2.3 Polychlorinated biphenyls (PCBs)**

Polychlorinated biphenyls (PCBs) are industrial products that were previously used as insulating oils for transformers and in certain types of heater and that are suspected to be carcinogenic. The sale of these products, in use since the 1930s, was prohibited in France in 1987.

Depending on its size, sellers must inform purchasers of the presence of any equipment containing PCBs on the property for sale.

**1.2.4 Information on the presence of *legionella pneumophila***

*Legionella pneumophila* is a bacterium that can cause legionnaires' disease. Although they are not specifically obliged to do so, sellers should inform purchasers of the existence of any systems that may be a source of this bacterium, such as cooling towers. Failing this, their liability may be incurred.

**2. Tax issues**

For VAT related matters, **please refer to Chapter II - Section B.5.1.**

**2.1 Sales of property by non-residents**

Subject to the terms of international tax treaties, capital gains from disposals of properties by taxpayers who are not domiciled in France are chargeable to a specific withholding tax of:

- 19% for individuals, individual partners in partnerships and individual investors in FPIs, *pro rata* to the shares held;
- . In addition to the withholding tax, capital gains sourced directly or indirectly by individual non-residents are liable for social contributions at the rate of 17.2%. Whether these social contributions comply with Community Law or not is subject to debate;
- . The capital gains are reduced by applying taper relief allowances that are calculated differently for income tax and for social contributions;
- 33.33% in all other cases (deductible from corporate income tax);
- 75% if the disposer is domiciled or established in a NCST (non-cooperative State or territory).

Rules defining the basis of the chargeable gains differ according to whether the seller is an individual or a legal entity and, in the latter case, whether it is a resident of a Member State of the European Union or of a State that has signed an administrative cooperation agreement for the exchange of information and for combating tax fraud and evasion with France.

The seller has to appoint a tax representative in France who will undertake to carry out the formalities and pay the withholding tax on behalf of the non-domiciled seller. However, since 1 January 2015, this obligation only applies if the seller is domiciled, established or incorporated in a Member State of the European Union, in Iceland or in Norway.

This withholding tax is in discharge of income tax.

It is deductible from corporate income tax due in France with respect to sales of properties by corporate sellers. Any overpayment is refunded upon request to the corporate entities residing in a Member State of the European Union or in a State having signed an administrative cooperation agreement for the exchange of information and for combating tax fraud and evasion with France (unless the seller is domiciled, established or incorporated in an ETNC).

**2.2 Sales of property by French taxpayers****2.2.1 Individual sellers**

Chargeable gains earned by individuals – equal to the difference between the purchase price and the cost price of the property, less any taper relief allowances – are taxed at the proportional rate of 19%, plus social contributions at the rate of 17.2%.

**2.2.2 Corporate sellers**

Capital gains earned from the sale of a property by a corporate person domiciled in France - equal to the difference between the purchase price of the property and its net value after amortisation (or fiscal cost price) - are chargeable to corporate income tax at the rate of 33.33%, plus the additional contributions on top of corporate income tax.

### 2.2.3 Sales by private partnerships

When the French legal entity is a private partnership, the chargeable gains from the sale are taxable to the partners in proportion to their share in the partnership and depending on their status (individuals or legal entities) and their State of residence or incorporation:

- Individual partners: Tax at the rate of 19% if they are domiciled in the EEA, and 33.33% in all other cases; The capital gains are also chargeable to social contributions at the rate of 17.2%;
- . The capital gains are reduced by applying taper relief allowances that are calculated differently for income tax and for social contributions;
- Corporate partners: The chargeable gains are taxed at 33.33%;
- Partners domiciled in an ETNC: The chargeable gains are taxed at 75%.

Finally, there is another tax on capital gains above EUR 50,000 earned from real estate (other than bare land for building purposes) that are chargeable to income tax or the withholding tax due by non-residents. This is due by individuals and companies or groups that pay personal income tax, as well as taxpayers domiciled outside France that are liable for personal income tax.

Sales that are exempt from personal income tax or the withholding tax due by non-residents are not concerned (e.g. the sale of a main place of principal residence, a property owned for a certain number of years, etc.).

## III. Financing real estate acquisitions

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A real estate acquisition is usually financed by a credit institution licensed or passported in France. However, senior financing may also be provided by debt funds that have been authorised in France to engage in lending activities or to purchase lending claims from banks under a “fronting bank” structure.

Banks or investors in real estate lend money on a secured basis. They usually require from the borrower (or from its holding company), as applicable, (A) a pledge over the shares of the asset company, (B) a mortgage over the immovable property financed or the benefit of the special lender’s lien over such property, (C) where applicable, a “Daily Assignment” by way of security over the rental receivables and/or (D) a pledge over the bank accounts of the asset company and/or those of the borrower. More recently, in more distressed or complex transactions, French trusts (*fiducies*) have also been implemented (E).

Please note that real estate may also be financed by financial lease transactions (*location financière* or *crédit-bail*) whereby the property is leased and the lessee benefits from an option to acquire the property at the end of the leasing period. In France, this type of transaction is generally subject to banking monopoly and may only be offered by credit institutions (often specialised in this type of product).

## A. Security over shares

### 1. Registration of a pledge over shares

The corporate form of the company or partnership whose shares are subject to a security interest shall influence the form and the means of the security regarding perfection thereof.

- As regards SCIs, their shares are pledged (*nanties*) and such pledge shall be established in writing. The pledge is perfected by:
  - . Notification by a process server on the partnership issuing the pledged shares (such notification may be avoided if the pledge agreement is made in the form of a notarised deed); and
  - . Registration of the pledge agreement at the Commercial Court (*Tribunal de commerce*) where the company is registered. Such formalities require prior registration of the pledge agreement with the tax Authorities (involving the drafting in French of an executed version of the pledge agreement).
- As regards SNCs or SARLs, the shares are pledged (*nanties*) and such pledge shall be established in writing. This pledge is perfected by registration of the pledge agreement on a special register at the clerk’s office of the Commercial Court (*greffe du Tribunal de commerce*) where the company is registered.
- As regards SAs or SASs, the pledge over the shares (held in a dematerialised financial securities account) involves the pledge over a dedicated financial securities account (*nantissement de compte-titres*). The shares are credited to such dedicated financial securities account, opened in the name of the pledgor. When such account is held by the issuing company itself (and not by a licensed intermediary or depository), monies received under the shares will be credited to a separate bank account which forms part of the pledge. The pledge over a financial securities account (*nantissement de compte-titres*) is perfected by the execution by the pledgor of a statement of pledge (*déclaration de nantissement de compte-titres*).

Creditors may enter into an agreement on the respective ranking of security interests over shares. In the absence of an agreement between the creditors to share the benefit of the security and with respect to their respective ranks, the ranking of such security interests generally depends on the date they are made enforceable against third parties (depending on the type of shares pledged). Any subsequent security over shares is made enforceable in the same way as any existing security over such shares.

### 2. Enforcement of the pledge

The pledge may be enforced by public auction (*vente judiciaire*), judiciary foreclosure (*attribution judiciaire*) or, if provided for in the pledge agreement, by the transfer of the pledged shares to the creditor. In the latter case, the transferee may have to make a balancing payment (*soulte*) for the amount of the value of the transferred shares exceeding the amount of the secured liabilities.

## B. Mortgage and lender's lien

### 1. Mortgage over land and buildings

A mortgage (*hypothèque conventionnelle*) is a right over immovable property and hence may be granted over land, buildings and movables attached to immovable property. This security notably grants the secured creditor a preferential right over the proceeds of the sale of the secured property. A mortgage must be executed in the form of a notarised deed.

A mortgage extends to all improvements on the mortgaged immovable property. Where a party has a right to build on someone else's property, it may grant a mortgage on the buildings whose construction has already started or is planned. In the event of destruction of the buildings, the mortgage will apply to any new buildings constructed on the mortgaged land.

Please note that French Law provides for other types of security over property, such as a *gage immobilier* (formerly known as *antichrèse*), whereby the secured creditor takes and retains possession of a real estate property, pursuant to Article 2387 of the French Civil Code. In practice, this security may be more complex to structure as it often requires the execution of a leaseback agreement for the grantor to use the property.

### 2. Registration of the mortgage

Land security must take the form of a notarised deed to be valid. In order to be enforceable against third parties, they must be registered at the land registry service (*service de publicité foncière*) of the district where the property is located.

So called "silent mortgages" take the form of a notarised deed but do not involve registration. A creditor may register them at any time but such registration may occur too late for the mortgage to rank with seniority. An unregistered security remains valid between the parties but is not enforceable against third parties.

Except for legal costs (for drafting and negotiating the security documents), the cost of creation and registration of a mortgage includes the following components, to be assessed and discussed with a notary:

- Notary fees (negotiable to a certain extent);
- Fees of the land registry service;
- Land registration tax (*taxes de publicité foncière*), which are not applicable for the registration of a special lender's lien (*privilège du prêteur de deniers*).

Second ranking mortgages are registered at the land registry service and rank according to their respective registration dates.

### 3. Transfer of the mortgage or of the underlying immovable property

Mortgages may be transferred with the underlying receivables to a new creditor. They may not be transferred from one property to another. Since March 2006, a mortgage may be "reloaded" (*rechargeable*), i.e. it can secure loans other than the initial secured amount.

Pursuant to Article 2393 of the French Civil Code, a mortgage remains attached to the underlying immovable property, if its owner disposes of it.

### 4. Enforcement of the mortgage

Disputes relating to security interests over land and their enforcement may only be settled by the relevant French Court where the property is located. Foreign Courts may settle disputes concerning the loan for instance, but may not decide on the validity or rank of security over land.

Enforcement procedures generally put the property up for sale by means of public auction, and certain mandatory procedures must be adhered to. Generally, where a creditor has an enforceable title in relation to an unpaid debt (the debt is enforceable if the loan agreement or other debt instrument is created by a notary deed or the creditor has an enforceable Court decision), the creditor may have the property sold.

In practice, creditors and debtors often agree to sell the property to avoid lengthy and costly public auction sale procedures. Subject to a few specific limitations, a creditor may agree in advance with the grantor that title to the property will be transferred to the secured creditor upon enforcement of the mortgage, on the basis of a valuation of the property as assessed by an expert.

## 5. Special lender's lien

A special lender's lien is very similar to a mortgage but may only be granted to an entity financing the real estate property.

This lien gives the lender a preferential right over the other creditors: The lender holding this lien is paid in priority.

For the lien to be effective, the following three main criteria must be met:

- Deeds of sale and borrowing must be established by a notary;
- The deed of borrowing must mention that the monies borrowed are intended for the acquisition of the immovable property; and
- The deed of sale must mention that the payment was made using the funds of the loan.

Pursuant to Article 2379 of the French Civil Code, it must be registered at the land registry service within a period of two months from the signature of the notarised deed.

Its cost is lower than that of a mortgage.

## C. "Dailly Assignment"

Pursuant to Article L.313-23 of the French Monetary and Financial Code, any loan granted by a bank (or certain other banking or financial entities) to a company, in the course of its professional activity, may be secured by the transfer of the company's present or future receivables, that it may hold against a third party, to the bank (or other banking or financial entity). The Assignment is performed by the execution of a transfer deed identifying the receivables assigned to the lender.

The Dailly Assignment is enforceable against third parties as of the date specified on the transfer deed.

If all criteria required for the Dailly Assignment are not met (in particular in the case the secured creditor is not an eligible beneficiary), pursuant to the specific provisions of the Dailly Assignment, the creditor may alternatively require the debtor's rental receivables to be pledged. This pledge is very similar to that over a bank account.

## D. Pledge over a bank account

A pledge over a bank account being a type of pledge over receivables, governed by Article 2360 of the French Civil Code, it must comply with the provisions of Article 2356 of the French Civil Code relating to creation, i.e. it must be established in writing, and the pledged claims, present or future, must be identified in the pledge agreement.

Regarding pledges over a bank account, the pledged claim is made up of the credit balance, whether temporary or definitive, on the day of enforcement of the security.

To be enforceable against the debtor of the claim, the pledge over a bank account must be notified on the debtor or the latter may stand as a party to the pledge agreement. The pledge over a bank account shall enter into effect between the parties and becomes enforceable against third parties on the date of the pledge agreement.

Even if the pledged bank account may be frozen prior to enforcement, it is generally specified in the pledge agreement that the company that has pledged its bank account may continue to use the funds that are credited to the pledged account unless an acceleration event occurs.

## E. French trust (*fiducie-sûreté*)

The concept of the trust (referred to as the *fiducie*) was introduced into French Law in 2007, enabling the appointment of a security trustee in a French Law agreement.

In the French trust, the settlor transfers the ownership of an existing or future asset (e.g. the property or shares of the asset company) to a trustee on behalf of a beneficiary. The assets being transferred to the trustee, i.e. held in a trust, they are protected against potential insolvency proceedings connected to the settlor, i.e. the debtor.

The French trust is either statutory or created by a private deed. Pursuant to Article 2012 of the French Civil Code, it must be established in the form of a notarised deed in certain special cases or where the assets transferred to the *fiduciaire* are real estate properties or lands.

## G. Tax issues

### 1. Deductibility of financial charges

French Tax Law provides for no less than six sets of rules limiting the deductibility of interest, most of them applying in respect of loans and advances made by related entities.

#### 1.1 Maximum interest rate

According to Article 212, I, a of the French Tax Code, interest paid by a French company to related entities is only deductible if the interest rate applied does not exceed a rate legally defined under Article 39, 1, 3° of the French Tax Code.

This legal threshold is the annual average rate charged by financial institutions on variable interest rate loans to enterprises extended for a period exceeding two years, as determined by the Bank of France (1.67% at 31 December 2017).

If the applied rate exceeds this threshold, the interest deduction is subject to proof that the rate corresponds to arm's length, i.e. corresponds to a rate that financial establishments would have proposed under similar conditions ("market rate")<sup>1</sup>.

#### 1.2 Minimum interest taxation

Additionally, Article 212, I, b of the French Tax Code makes the interest deduction subject to a minimum taxation of the interest at the level of the lender.

The French borrowing company must be able to prove that the lender is subject, on the interest received, to taxation corresponding to at least 25% of the equivalent French tax. In practice, a minimum tax rate of 8.33% on these interests is required.

Several questions arise as to the application of the latter rule, and in particular whether refinancing costs borne by the lender may be taken into account for the minimum taxation test (relevant tax base). In our view, this should be the case, but there has not been any official statement from the French Tax Authorities (FTA) on this matter so far.

#### 1.3 Thin capitalisation test

For interest regarded as deductible under Article 212, I, a and 212 I, b of the French Tax Code, a thin capitalisation test (as defined under Article 212, II of the French Tax Code) must further be satisfied.

The thin capitalisation test applies to interest paid to related entities, but also to interest accruing on amounts provided by a third party, where reimbursement is secured by a related entity:

Interest paid to "related entities"	i.e., interest paid to:	(i) Entities which, directly or indirectly, either control or are controlled by the borrower; or (ii) Entities which, directly or indirectly, are controlled by the same entity as the one controlling the borrower.
Interest paid to third parties, when the loan is guaranteed by a related entity	Except for:	(i) Bonds issued in a public offering;
		(ii) Certain loans secured by a pledge, if: <ul style="list-style-type: none"> <li>a. The pledge is over the shares of the borrower (e.g. a parent company gives a pledge on shares of a French subsidiary to guarantee the loan granted by a bank to the subsidiary); or</li> <li>b. The pledge is over a receivable held by the parent company against the borrower; or</li> <li>c. The pledge is over securities of a direct or indirect shareholder of the borrowing entity, provided that the entity which grants the pledge and the borrower are members of the same tax consolidated group;</li> </ul>
		(iii) Refinancing resulting from the mandatory repayment of a pre-existing debt after a change of control of the borrower;
		(iv) Loans granted prior to 1 January 2011 for the financing or refinancing of a share acquisition;
		(v) Loans granted to a <i>SCI de construction-vente</i> and guaranteed by one or more of its members, provided that the portion guaranteed by each member does not exceed the proportion of its rights in the SCI and that the monies borrowed by the SCI are not again made available to the benefit of a related company.

<sup>1</sup> In case the lender is a direct shareholder of the borrower, but fails to qualify as a "related entity" (e.g. in case of a minority shareholder), the cap is strictly limited to the legally defined rate, with no possibility to rely to the market rate.

A company is deemed to be thin-capitalised when all three of the criteria are exceeded:

- Maximum debt-to-equity ratio of 1.5 to 1: The average amount of the loans and advances granted by related entities or by third parties but secured by a related entity should not be higher than (i) 1.5 x the share capital or (ii) 1.5 x the net equity of the borrowing company;
- Interest coverage ratio: The amount of interest paid to related entities and to third parties secured by related entities should not be higher than 25% of the operating profit before tax, increased by aforementioned interest, depreciations and finance lease rents;
- Interest received from related entities: The amount of interest paid to related entities or to third parties but secured by a related entity of the borrower should not be higher than the interest received from related entities.

If the company fails all three tests, the tax deductibility of interest paid to related entities (or to third parties when secured by related entities) is limited to the highest of these ratios, unless (i) the non-deductible interest is lower than EUR 150,000 or (ii) the company paying the interest provides evidence that the group to which it belongs has a higher debt-to-equity ratio ("safeguard clause").

Thin capitalisation test (stand-alone basis)	Interest deduction may be rejected if it simultaneously exceeds:	(i) A theoretical financial expense corresponding to a debt-to-equity ratio of 1.5 to 1;	Interest in excess of those three limitations is deductible only up to the highest limitation.	However, if rejected financial expenses are lower than EUR 150,000 they can be fully deducted for tax purposes.
		(ii) 25% of a before-tax adjusted operating income;		
		(iii) Interest income received from related entities.		

Interest payments considered as non-deductible as a result of the above rules are not definitely barred from deduction since they can be deducted from the taxable results of the following financial years of the borrowing company, within the limit of 25% of its adjusted current profit/loss before tax, minus deductible interest of the financial year.

After the second year however, the "deferred interest" stock is reduced by 5% each year.

With respect to tax consolidated groups, specific rules apply (Article 223 B, subparagraphs 13 to 18 of the French Tax Code): The amount of non-deductible interest determined on a stand-alone basis is transferred to the group head, and the latter may be allowed to deduct part of the aggregated non-deductible interest:

Thin capitalisation test (specific rules for tax consolidated groups)	The head of the tax group must submit the financial expenses to the "tax group test" to determine whether all or part of the rejected financial expenses, which was not deducted when computing the stand-alone tax profit of the relevant subsidiaries, may be deducted when computing the consolidated group's French taxable income.			
	Tax group test	Difference between:	a. The total amount of interest paid by the members of the tax consolidated group to related entities which are not included in that group (e.g., foreign group entities); and	b. 25% of the aggregated net taxable income of the members of the tax consolidated group, increased by depreciation allowances, certain lease payments and interest paid to related entities outside the tax group and reduced by dividends received from members of the tax group.
			This difference (when it is positive or equal to zero) represents the maximum theoretical amount of interest rejected at the level of the group members which may not be deducted from the group's consolidated tax result.	
	Amount which may be deducted from the group's consolidated tax result	=	$\sum$ of individual rejected interest – (a – b).	

In practice, this means that if the interest paid to related entities outside the tax group does not exceed 25% of the tax group's adjusted operating profits, the non-deductible interest determined at the level of each member company may be fully deductible at the level of the group.

#### 1.4 General cap on financial expenses

In addition to the previous rules, Article 212 bis of the French Tax Code provides for a general limitation on the deductibility of net financial expenses for financial years ending on or after 31 December 2012; When net financial charges owed by a French company exceed EUR 3 million, their tax deductibility is capped at 75% of their amount.

The notion of "net finance expenses" is defined by Law as "the total of financial charges borne in relation to the sums left or made available to the company, minus the total of financial income earned in relation to the sums left or made available by the company" and also includes rents (net of amortisation, depreciation and costs charged to the tenant) paid in relation to leasing agreements, rental agreements with purchase options and rental agreements entered into with related companies which concern moveable assets.

With respect to tax consolidated groups (cf. Article 223 B bis of the French Tax Code), the EUR 3 million cap is assessed at group level and thus more easily attainable. On the other hand, financial expenses and income resulting from loans and leases entered into with parties belonging to the group are not taken into account, and it is possible off set net financial expenses of a member company against the net financial profits of another member company of the group.

#### 1.5 Interest on the financing of certain share deals

##### - "Charasse Amendment"

Article 223 B, al. 6 of the French Tax Code provides that, within tax consolidated groups, the deduction of interest incurred to finance the purchase of a new company is limited over a nine-year period, if the latter was purchased from a shareholder that controls the group and, further to the transfer, the purchased company becomes a member of the tax group.

The objective of this rule is to prevent a share deal, which is considered as a "sale to self", from artificially eroding the consolidated tax base of the group.

The amount of non-deductible interest is computed as follows:

$$\text{Financial expenses of the tax group during the FY} \times \frac{\text{Acquisition price of the shares}}{\text{Average amount of debt of the tax group for the FY}}$$

##### - "Carrez Amendment"

Article 209, IX of the French Tax Code provides for another limitation on the deduction of financial expenses related to the acquisition of shares with effect from 1 January 2012, when the acquisition price exceeds EUR 1 million and the buying company cannot demonstrate that it effectively makes the decisions concerning the target company and that it effectively exercises an influence over the target.

In this case, a fraction of the financial expenses borne by the buyer is not deductible, up until the 8<sup>th</sup> year following the acquisition of shares.

The amount of non-deductible interest is computed as follows:

$$\text{Financial expenses of the buyer during the FY} \times \frac{\text{Acquisition price of the shares}}{\text{Average amount of debt of the buyer for the FY}}$$

However, this rule is not applicable to companies whose debt ratio does not exceed the debt ratio of the group it belongs to ("safeguard clause").

The Finance Bill for 2018 limited the scope of this mechanism to equity investments for which the decision-making power or influence over the target company is exercised by a related entity established outside the European Union or the EEA.

## 1.6 Interest paid in a non-cooperative State or territory (NCST)

Finally, interest paid in a NCST is not deductible from the borrower's taxable income, unless the borrower can prove that these expenses correspond to actual transactions that are not excessive and that the transaction does not have the consequence or purpose of allowing these expenses to be domiciled in a NCST (Article 238 A, subparagraphs 3 and 4 of the French Tax Code).

The list of NCSTs is set out in an Order which is in principle updated every year. As at 1 January 2016, NCSTs were Botswana, Brunei, Guatemala, the Marshall Islands, Nauru, Niue and Panama.

## 1.7 Coordination of the various limitations

According to the statement issued by practice of the French Tax Authorities (BOI-IS-BASE-35-10 Nos 70 and 80) the different regimes that may result in the denial or postponement of deductibility of financial expenses should be applied in the following order (standalone basis):

- Maximum rate of interest paid to related entities (Article 212, I, a of the French Tax Code) or direct shareholders (Article 39, 1, 3° of the French Tax Code) and minimum taxation of interest paid to related entities (Article 212, I, b of the French Tax Code);
- Thin capitalisation test (Article 212, II of the French Tax Code);
- When applicable: Carrez Amendment rules (Article 209, IX of the French Tax Code);
- General cap on financial expenses (Article 212 bis of the French Tax Code).

In practice, this means that each of those rules should be applied "net" of the financial expenses to be reinstated under the previous rule(s) in the list.

For tax consolidated groups, the different regimes should be applied in the following order (cf. Statement of practice BOI-IS-GPE-20-20-110 Nos 180 to 200):

- At the level of each member of the tax group: Maximum rate of interest paid to related entities (Article 212, I, a of the French Tax Code) or direct shareholders (Article 39, 1, 3° of the French Tax Code) and minimum taxation of interest paid to related entities (Article 212, I, b of the French Tax Code);
- At the level of each member of the tax group: Thin capitalisation test (Article 212, II of the French Tax Code); Then at the level of the group: Limitation of the members non-deductible interests due to said test (Article 223 B, subparagraphs 13 to 18 of the French Tax Code);
- When applicable: Charasse Amendment rules (Article 223 B, subparagraph 6 of the French Tax Code);
- At the level of the tax group: General cap for financial expenses (Article 223 B bis of the French Tax Code).

## 2. Tax rules applicable to a property finance lease (lessee perspective)

### 2.1 Corporate income tax issues

#### 2.1.1 Rents paid during the lease

According to Article 39, 10 of the French Tax Code, rents taken into account to determine the price for the call option on the property at the end of the lease, and relating to non-depreciable items (land), is not deductible from the lessee's taxable income.

In practice, the lessee cannot deduct the portion of the lease payments corresponding to the difference between (i) the cost price of the land for the lessor and (ii) the option strike price.

However, the option strike price is deemed to correspond in priority to the price of the land; And the rents paid during the lease are deemed to correspond first to the acquisition costs incurred by the lessor, then to the price of the constructions, and finally to the price of the land.

On account of these two favourable assumptions:

- When the option strike price corresponds precisely to the acquisition price of the land by the lessor, all rents paid during the duration of the lease agreement are deductible;
- Otherwise, the obligation to recapture a fraction of the rents is in practice postponed to the very last year(s) of the leasing agreement, depending on the option strike price and the respective value of the land compared with the value of the real estate complex.

The lessee is subject to several filing requirements, in order to document the deductible vs. non-deductible portion of the lease payments for each rent instalment.

#### 2.1.2 Acquisition of the lease agreement from the former lessee

According to Article 39 duodécies A, 6 of the French Tax Code, the acquisition cost of the rights purchased from the former lessee of a lease agreement must be broken down into the portion that relates to the land (non-depreciable) and the portion relating to the constructions (depreciable).

This price allocation must follow the following rules:

- The portion representing the land is deemed to correspond to the FMV of the land at the date of sale of the lease contract minus its FMV value at the date of conclusion of the lease agreement, increased by the rents not deducted during the lease;
- The portion representing constructions is determined by difference between the price paid to the former lessee and the portion representing the land as determined above.

The portion of the acquisition price representing constructions is depreciated over a period corresponding to the normal useful life of the constructions, assessed at the date of the transaction (irrespective of the remaining term of the leasing agreement at that date, or of the residual depreciation period of the asset for the lessor).

### 2.1.3 Exercise of the call option

Upon exercise of the call option, Articles 239 sexies to 239 sexies C of the French Tax Code provide that the lessee must add-back a portion of the rents previously paid, into the taxable income of the year during which the call option is exercised.

This mechanism purports to place the lessee in the same situation as he would have been in, had he acquired the building instead of resorting to a lease agreement. In practice, this add-back is triggered when the option strike price is lower than the theoretical net book value of the property.

The amount to be added-back is calculated as follows:

Value of the property at the time the leasing agreement is signed

- option strike price
- + portion of the rent not deducted during the course of the lease agreement
- total amount of depreciation that the lessee would have been able to account for, if he had directly acquired the property instead of resorting to a lease agreement.

In the case where the leasing agreement has been acquired from a previous lessee, this amount must be calculated *pro rata temporis* ("period during which the new lessee has held its rights to the lease/total duration of the lease").

### 2.1.4 Amortisation of the property acquired at the end of the lease

In principle, the tax cost price of the property acquired at the end of a leasing agreement is equal to the option strike price, increased by the amount of non-deductible rents during the lease (**see 2.1.1**), and the amount added-back upon the exercise of the option (**see 2.1.3**).

Once again, this price must be broken down into the portion that relates to the land (non-depreciable) and the portion that relates to the constructions (depreciable), as follows:

- The option strike price, as well as the amount added-back upon the exercise of the option, is deemed first and foremost to be an element of the cost price of the land for the lessee, up to the amount of the acquisition price of the land by the lessor;
- The excess of the total cost price of the property is deemed to correspond to the cost price of the constructions.

As a result, the cost price of the land acquired at the end of a leasing agreement is always equal to its acquisition price by the lessor, regardless of the duration of the contract.

Constructions acquired at the end of a property finance lease are depreciated over their normal useful life, determined at the option exercise date.

To comply with the obligation to record any depreciation in their accounts (cf. Article 39, 1, 2° of the French Tax Code), companies must resort to the technique of derogatory depreciation, since the add-back to be made upon the exercise of the call option is a purely fiscal one and therefore creates a tax-accounting distortion as regards the cost price of the property.

In the case where the leasing agreement has been acquired from a previous lessee, the cost price of the property must additionally include the purchase price of the rights acquired from the previous lessee; And the breakdown of the total cost price between land and constructions follows slightly different rules.

## 2.2 VAT and Stamp Duty

For the purpose of a VAT, a financial lease with an option to purchase the property is treated as a rental of premises (see below) followed by a sale of property (**please refer to Chapter V - Section E.3.**) if and when the lessee exercises the option to purchase.

Stamp Duty of 0,715% on the amount of rents financial expenses excluded is assessed on finance leases of twelve years or more.



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## A. Planning regulations

### 1. Overview of planning regulations

#### 1.1 General planning restrictions

The right to build on a plot of land may be limited or even denied under the applicable planning regulations.

These rules are defined by the national planning regulations and local planning regulations, when these have been established.

##### 1.1.1 National Planning Regulations (*règlement national d'urbanisme* – RNU)

The National Planning Regulations (RNU) govern the right to build in France and are, in principle, only applicable in areas which are not subject to a *plan local d'urbanisme* (PLU) or other comparable planning regulations. As an exception to this rule, some provisions of the RNU may apply even in such cases to seamlessly regulate the right to build.

The RNU contains general rules pertaining to location, layout, access, volume, environmental and energy efficiency and architecture of constructions.

Some of its provisions also refer to constructions that may represent a risk for public health, for the safety of the general public or for building occupants, natural areas, archaeological remains or the environment.

The RNU is part of the French Planning Code.

##### 1.1.2 Local rules

Planning documents may be adopted by the local planning Authorities, generally the Municipal Council or a public entity for cooperation between municipalities (*établissement public de coopération intercommunale* – EPCI).

Local rules override the application of the RNU, except for certain rules which are mandatory rules of public policy. This means that some RNU rules may be enforceable, even if local rules apply.

#### a. POS and PLU

##### i. Content of the PLU (Local Zoning Plan): Zoning and Regulations

A PLU (called a *plan d'occupation des sols* or POS before the "SRU" Law of 13 December 2000) is the planning Regulation applicable within the territory controlled by one or more towns or cities. If several towns or cities are involved, the PLU is called an inter-city PLU, or PLUi (*PLU intercommunale*). The aim of such documents is to define the specific planning requirements applicable to construction projects and *inter alia* to define the type of buildings (authorised and unauthorised uses, access to roadway and public networks, floor space, positioning in relation to adjacent plots, to boundary lines or to other constructions on the same land, density, height, external appearance, parking, green and free spaces) that may be constructed within said territory.

The requirements are set out in regulations (*règlements*) and zoning plans (*plan de zonage*).

The PLU or the POS defines zones (e.g. "U" for urban area, "AU" for areas designed for future urban development, "A" for agricultural, and "N" for natural areas) where the planning requirements differ depending on the objectives set for a given zone (urban development, green belt, etc.).

In addition to the Regulation enforceable on specified land, various public easements (*servitudes d'utilité publique*) may be applicable (e.g. technological hazard prevention plan, natural hazard prevention plan such as flooding or earthquakes, etc.).

##### ii. PLU amendments

Planning regulations and zoning may be changed pursuant to various procedures, such as a revision or amendment. The choice of the procedure depends on the scope of the alterations to be made and, more importantly, on their consequences for the original planning and sustainable development objectives.

Planning documents may be amended to comply with public or private projects in the general interest.

#### b. Municipal plans (*carte communale*)

Municipalities with no PLU or POS may create a municipal plan (*carte communale*) specifying how to apply the National Planning Regulations.

Municipal plans define the areas in which new constructions are authorised and the areas where they are prohibited or limited to specific cases.

They may not set specific rules designating buildable land, or the location, appearance or density of the buildings.

Most of the time, a municipal plan is used in rural areas, where very specific rules for construction are not necessary.

### c. Compatibility with other rules

Municipal plans, POSs and PLUs must be compatible with the planning regulations and documents that outrank them according to the hierarchy of norms. These regulations include the following.

#### i. The *schéma directeur*, the *schéma de cohérence territoriale (SCOT)* and the *schéma de secteur*.

- A *schéma directeur*, or master outline plan, defines the main criteria for the organisation of space within a certain area (a number of municipalities grouped within a common cooperation structure, such as an EPCI) and may define general land use.

Since the introduction of the SRU Law of 13 December 2000, *schémas de secteur*, or sector plans, have been replaced by *schémas de cohérence territoriale (SCOT)*, or territorial coherence plans.

- SCOTs, like master outline plans, define the main criteria for the organisation of space. They also specify how urban space should be restructured and set the objectives of various public policies such as housing, economic development, transport, etc.

Sector plans are intended to provide further detail on the contents of SCOTs.

With the enactment of Law No 2014-366 of 24 March 2014, referred to as the ALUR Law, the SCOT is now the only planning document that is directly enforceable and prevailing over PLUs and municipal plans. The PLU must therefore be compatible with the SCOT, which must in turn conform to higher-ranking documents.

Ratifications of or changes to any of these documents entails that the SCOT must be made compatible with such within a period of 3 years.

#### ii. In the absence of a SCOT, PLUs must be compatible with various planning standards such as the specific provisions applicable to mountain and coastal areas, the master outline plan applicable to the Ile-de-France region, regional development rules pertaining to the environment, or sustainable climate/energy plans (*plan climat-énergie territoriale*).

## 1.2 Special zones

### 1.2.1 Protected areas

#### a. Protection against hazards

Hazard prevention plans (against fire, flooding, etc.) are documents designed and issued by State Authorities, imposing public easements on private property, in the event of a particular level of hazard. These easements may involve carrying out or refraining from carrying out specific works.

#### b. Environmental protection

Special planning regulations are applicable in coastal and mountainous areas and aim to reconcile the protection of these areas with urban development requirements.

These rules prevail over any other local planning rules.

For example, the French Law called "*loi littoral*" provides that outside built-up areas, constructions are prohibited along the coastline within a one hundred meter strip from the shore.

#### c. Heritage and landscape conservation

##### i. *Sites patrimoniaux remarquables (SPR)* are cities, towns, villages or neighbourhoods whose conservation, restoration, rehabilitation or enhancement is of public interest from a historical, architectural, archaeological, artistic or landscaping point of view. This designation is a public utility easement affecting land use.

Any works undertaken in these areas is subject to particular requirements: Construction, demolition, conversion or alteration works on a plot of land or building located in a *site patrimonial remarquable* may only be carried out under the supervision of a State appointed architect (*architecte des bâtiments de France* - ABF).

##### ii. PSMVs (*plan de sauvegarde et mise en valeur*) are plans for safeguarding or developing an area of particular historical or aesthetic value that Government wants to protect.

PSMV contains planning requirements that are applicable in those areas defined by the PSMV, in replacement of the planning regulations applicable within the municipality (such as a PLU). They are soon to be incorporated into the SPR category.

### 1.2.2 Development project zones

The purpose of a “development project” (*opération d'aménagement*) is to implement an urban project, such as a local housing policy, create or expand economic activities, develop leisure activities and tourism, or to improve health and safety.

These projects are planned and carried out by the local Authority in charge of urban development, which is not necessarily the same Authority which has jurisdiction for planning matters.

There are different forms of development projects, the most common being the ZAC or state-coordinated concerted development zone (**please also refer to Chapter II**).

A ZAC is an area identified by the relevant local Authority where a development project is to be carried out.

In this respect, the local Authority defines the boundaries of the development project and its main characteristics (act creating the ZAC).

Expropriation proceedings may be instigated to take over any plots of land required to undertake the development project.

The competent public entity may:

- Conduct the operation itself; or
- Entrust the project to a third party chosen after a public contract notice and a call for tenders, via the conclusion of a development agreement (*concession d'aménagement*).

The development agreement allows the territorial community to avoid financial risks related to the land (expropriation or voluntary land acquisition and subsequent sale of the land or buildings) and the construction of certain public facilities (to be built and delivered by the *concessionnaire*, i.e., the concession holding company having been awarded the benefit of the development agreement).

Most often the developer builds the public facilities at its own risk and generally generates a profit:

- By selling the ZAC land it has developed; or
- By collecting, in the stead of the Authority and with its approval, a financial contribution at the time of the issuance of each planning permission requested by a property developer that did not purchase its plot of land from the project developer.

## 2. Planning certificates

### 2.1 Informative planning certificates

This type of certificate provides information regarding the planning regulations applicable to one or more specific plots, the administrative limits on the right of ownership (such as public easements) and the list of applicable taxes and planning contributions.

It does not grant any right to carry out any works but provides information in terms of development capacity.

### 2.2 Project-specific planning certificates

This type of certificate provides the same information as above and states whether a particular project is feasible on the given lot(s).

The certificate applicant must specify what kind of construction is being planned, together with its approximate location and intended use, and enclose a plan of the existing buildings.

The certificate indicates whether the land may be used for this project and provides details on existing or planned public facilities.

It may specify that the project is subject to approval from another administrative department or requires filing an application for a prior declaration or planning permission.

The certificate may also state that the project is subject to certain requirements or that it may not be carried out. In this case, it must also give the reasons substantiating this decision.

Once more this certificate does not grant any right to carry out works but provides information about the possibility to develop a defined project.

### 2.3 Provisions applicable to both certificates

The beneficiary of the certificate may rely upon the regulations referred to in the certificate when applying for planning permission or filing for a prior declaration within 18 months from the certificate's issuance date. The Authorities may not apply any new regulations in this respect when examining the application (except with respect to the preservation of public safety and public health). Informative planning certificates must be issued within one month and project-specific planning certificates within two months.

## B. Planning authorisations

### 1. Types of planning authorisations

Four types of planning authorisation are defined by the French Planning Code: Planning permission (*permis de construire*), development permits (*permis d'aménager*), demolition permits (*permis de démolir*) and prior declarations (*déclaration préalable*), a simplified form of planning permission.

The type of planning permission to be obtained depends on the nature and size of the project and, in certain cases, its geographical location.

In some cases, certain projects are exempted under the French Planning Code from any planning formalities prior to carrying out works.

There are four categories of construction works defined under the French Planning Code:

- New construction projects;
- Works to existing buildings;
- Works, installations and alterations affecting land use; and
- Demolition works.

#### 1.1 New construction projects

##### 1.1.1 Principle: Planning permission is required

According to the French Planning Code, planning permission is required, in principle, for the construction of any new building. This means planning permission is required for new constructions which are not specified by the French Planning Code to be subject to a prior declaration or to no permission.

A new building means any new solid and durable assembly of materials durably attached to the ground. This definition covers an extremely wide range of constructions such as buildings, wind farms, walls, framework, swimming pools, etc.

For certain major projects (whose thresholds are set by Law), the planning permission application file must include an environmental impact assessment (*étude d'impact environnementale*) that assesses the impact of the project on its surrounding environment, as well as the proposed measures, to reduce, offset or eliminate such impact.

Various public participations, e.g. a public enquiry (*enquête publique*), may also be required to provide information to the public regarding the characteristics of the project and, if necessary, to propose changes to this project.

##### 1.1.2 A prior declaration may be sufficient

However, as an exception to the rules applicable to planning permission, the French Planning Code provides an exhaustive list of projects that are merely subject to a prior declaration.

If not located in a protected sector, these may concern minor works:

- Walls with a height above ground superior or equal to two metres;
- Constructions meeting all of the following criteria:
  - . Above-ground height of over twelve metres;
  - . Site coverage (*emprise au sol*) inferior or equal to five square metres;
  - . Gross floor area (*surface de plancher*) inferior or equal to five square metres.

### 1.1.3 Exception: No permission is required

The French Planning Code provides an exhaustive list of works that are exempted from any formality regarding Planning Rules.

For example, new construction projects are thus exempted from any formality:

- If they are temporary: For example, temporary buildings directly necessary for carrying out the works are exempted from formalities throughout the duration of the works;
- If they are covered by national defence secrecy or constructions located within prisons; or
- Due to their nature: in particular, retaining walls and any land, maritime or river infrastructures such as roads, bridges, ports or airport infrastructures, when they are not located in a protected area whose boundaries have been determined.

## 1.2 Works or changes of use to an existing building

Though no formalities should apply to this category of work, numerous exceptions exist.

This means in practice, that it will often be necessary to apply for planning permission.

### 1.2.1 A prior declaration is most often required

An application for a prior declaration must be filed in particular for:

- Modifications to façades;
- Changes of use that do not involve works requiring planning permission; or
- Works within an existing building resulting in additional floor space or gross floor area of over five square metres and meeting both of the following criteria:
  - . An additional floor space inferior or equal to twenty square metres;
  - . An additional gross floor area inferior or equal to twenty square metres.

Under certain conditions, more favourable thresholds are applicable to projects located in the urban area of a PLU.

### 1.2.2 Planning permission is required in certain cases

The following works in particular are subject to planning permission:

- Work on load bearing structures or on façades with the purpose of changing the use of the building;
- Works creating a gross floor area or floor space of more than twenty square metres;

Under certain conditions, more favourable thresholds are applicable to projects located in the urban area of a PLU.

- All works on buildings or parts of a building listed as a historical monument, except for maintenance work or routine repairs and works covered by secrecy (e.g. national defence secrecy).

## 1.3 Construction, installations and alterations affecting land use

This third category groups together works or developments which do not concern a construction. This broad category includes *inter alia* subdivisions, scouring or raising of ground, installation of parkings, etc.

Though no formalities should apply to this category of works, numerous exceptions do exist. This means, in practice, that yet again it will often be necessary to apply for planning permission.

### 1.3.1 Prior declarations or development permits

#### a. Prior declarations (*déclaration préalable*)

The following, in particular, are subject to a prior declaration:

- Raising or lowering the level of ground under certain conditions;
- Trimming and felling of trees in certain areas; or
- Creating car parks.

Certain development projects that would normally only require a prior declaration are subject to a development permit where they are carried out in conservation-worthy areas, protected areas with identified borders, listed sites, nature reserves or coastal areas identified on local plans as conservation areas.

For example, any works to raise or lower the level of the ground by more than two metres in either direction and covering a surface area superior or equal to one hundred square metres on a listed site, where such work is not required to implement planning permission, is subject to a development permit rather than a prior declaration.

## **b. Development permits (*permis d'aménager*)**

The following, in particular, require a development permit:

- Subdivisions, which are the most commonly encountered type of project (see below);
- Land consolidation by a Collective Property Management Association (*association foncière urbaine libre* – AFUL) where it is planned to build roads or common areas, since the purpose of the AFUL is to manage buildings and common areas shared by several building owners and/or owners' associations (car parks, slabs, elevators, residential areas, etc.);
- The creation or enlargement of campsites with space for more than twenty people or six tents, caravans or mobile homes; or
- The installation of play and sports grounds.

### **1.3.2 The specific case of subdivisions**

#### **a. Definition of a subdivision estate (*lotissement*)**

A subdivision is the division of a plot of land or multiple adjoining plots of land into one or more lots for construction purposes. The land can be divided in terms of its full ownership or in terms of right of use.

Three criteria must therefore be satisfied for a subdivision to exist:

- The division of immovable property at the initiative of a sole holder;
- For ownership or enjoyment;
- With the intention to develop buildings.

Once these three criteria are satisfied, the project comes within the scope of a subdivision as soon as the first lot is divided.

Certain divisions of land for the purpose of building are excluded from the scope of subdivisions due to their specificity, namely:

- Divisions carried out by the developer within a ZAC;
- So-called "primary" divisions, i.e. divisions (full ownership or enjoyment rights) carried out by a land owner for the benefit of persons who have obtained planning permission or a development permit to create a group of buildings or a building other than a single-family dwelling unit.

#### **b. Subdivision documents**

Applications for authorisation to subdivide usually contain:

- A subdivision plan;
- The internal rules and regulations applicable to the subdivision estate (*règlement du lotissement*), if applicable: This document of a purely administrative nature sets out the particular planning rules applicable within subdivision estates in addition to the rules contained in the local planning regulations (POS or PLU) applicable to the land.

The French Planning Code provides the terms of expiry of these documents.

#### **c. Required planning permission**

##### **i. Subdivisions subject to a development permit**

Subdivisions are subject to a development permit where:

- They provide for the construction or development of roads, common spaces or facilities inside a subdivision; or
- They are located in a listed or protected area (mainly *sites patrimoniaux remarquables*) or within the vicinity of historical monuments.

For example, a subdivision involving the creation of three lots located in a listed area may be subject to a development permit.

##### **ii. Subdivisions subject to prior declaration**

Subdivisions which do not require a development permit are subject to a prior declaration.

Consequently, a subdivision creating five lots, not involving the construction of roads or common areas and not located in a listed or protected area, is merely subject to a prior declaration.

#### **d. Constraints applicable to lots located in a subdivision estate**

The purpose of the regulations is to protect lot owners by ensuring that the works contemplated in the application file are actually carried out and that the purchased lot is buildable.

To this effect, the French Planning Code provides for many constraints at various stages.

**i. At the leasing and sale process stage:**

- For subdivisions subject to a development permit, the French Planning Code provides that no preliminary agreements or leases may be granted on a lot located in the subdivision and no instalment may be accepted prior to the issuance of a development permit;
- In principle, lots cannot be sold or leased prior to the completion of works creating common areas and utility services unless the relevant Authority expressly authorises this by issuing an Order and the developer has a completion warranty for the development of the roads, common spaces or facilities within the subdivision estate.

**ii. At the planning permission procurement stage**

Planning permissions on the various lots of a subdivision estate authorised by a development permit can be issued:

- Either after the completion of development works in the subdivision; or
- After the issuance of permission to sell or lease the plots prior to carrying out the works, provided that the amenities to the relevant lot have been completed; or
- Immediately after the issuance of the development permit, provided that the planning permission is not implemented until the amenities to the relevant lot have been completed. This is not possible where the building permit is for a single-family dwelling unit.

**iii. At the stage of amendments to the subdivision documents**

There are two procedures to amend the subdivision documents:

- A procedure based on the consent of lot owners. Such consent must then be approved by the relevant administrative Authority; or
- A procedure to amend the subdivision documents at the initiative of the administrative Authorities, in order to bring them into compliance with the PLU or other planning documents, when they have been approved after the issuance of the development permit or prior declaration approval.

Save in exceptional circumstances, the division of the lots of a subdivision estate is subject to a development permit and can only be carried out by a modification to the subdivision documents by the lot owners or as part of the harmonisation process with respect to the local plan.

**e. Consequences in law**

Failure to comply with the rules governing subdivisions has severe consequences both in terms of civil and criminal liabilities.

The regulations do not only sanction failure to obtain the necessary planning permission but also failure to comply with the rules provided by the French Planning Code or the administrative authorisation issued for the project.

**i. Criminal liability**

The sale or rental of built or buildable lots contained in a subdivision estate without obtaining a development permit or without a prior declaration is sanctioned by a fine of EUR 15,000.

If works do not comply with the authorisation granted, remedial works may be ordered by the criminal court subject to a penalty payment and with the possibility of automatic enforcement by the competent relevant Authorities if the lot owner fails to carry out such works.

**ii. Civil liability**

In addition, the French Planning Code provides for a civil liability granting the harmed party the right to cancel the sale agreement documents entered into which conflict with the subdivision regulations, save where planning permission has been obtained.

**1.4 Demolition works**

Demolition permits are a means of protecting architectural heritage and no longer to protect the housing sector in France.

A demolition permit may be required for any total or partial demolition of a building, as well as for projects causing this building to become partly or wholly unusable (removal of the doorframes and window frames, stairways, etc.).

It is not always mandatory to obtain a demolition permit. A demolition permit is required:

- Either as a result of the building's location, more precisely due to its inclusion in protected areas such as a *site patrimonial remarquable*, or within the vicinity of a historical monument, etc.;
- Or as a result of a decision of the Municipal Council which has expressly decided to enforce this procedure over all or part of the territory of the municipality.

Where a development requires demolition works, the planning permission or development permit application can include both a request for the demolition and the construction aspects. Planning permission will be valid as a demolition permit.

## 2. Procedure for the issuance of planning authorisations

### 2.1 The relevant Authority

The following authorities are competent to issue planning permission:

- The Mayor, on behalf of the municipality; or
- The State. The State is represented in certain cases by the *Préfet* (e.g. for work subject to permission from the Minister of Defence), or more often by the Mayor.

### 2.2 Planning permission application or declaration file

Planning permission may be applied for by the owner of the building site or by any person authorised by the latter. An application may be submitted jointly by several persons and cover several lots belonging to different owners.

The French Planning Code provides an exhaustive list of documents to be attached to planning permission applications.

Applications consist of:

- Standard documents to be attached to all application files such as a site location plan, plans of the façades, etc.;
- Specific documents to be attached depending on the characteristics and nature of the project such as certificates, environmental impact assessments, permissions issued by other administrative Authorities (for example, for classified facilities – ICPE), specific justification of ownership or enjoyment for the land, a safety review for high-rise buildings (IGH), etc. **(please refer to Chapter IV - Sections E and F on these aspects for further details).**

Theoretically, the administrative Authorities are not entitled to request documents other than those listed in the French Planning Code.

### 2.3 Application review process and review period

#### 2.3.1 Application review process

##### a. Filing and registration receipt

Applications for planning permission are submitted to the town hall of the municipality where the construction work is to be carried out.

The Mayor allocates a registration number to the application or the declaration and issues a receipt. The receipt states the application number, the date when a tacit permit – if this possibility is contemplated - is to be granted, or in the case of a prior declaration, the date works may be undertaken.

The Mayor has fifteen days to display public notice in the town hall that an application or prior declaration has been submitted (the file is still not communicable to third parties as long as a decision has not been issued).

##### b. Notification of review

The Authority that is competent to issue the authorisation shall notify, within one month from the application for planning permission:

- A request, if any, for additional supporting documents;
- The application review period, as determined by the nature of the project;
- That it will not be possible, as the case may be, to rely on tacit planning permission; and
- Any additional documents to be submitted within three months from the Authority's request. Failing this, the application will be deemed denied.

#### 2.3.2 Timeframes

##### a. Review period according to General Law

The French Planning Code provides for a standard review period of:

- One month for prior declarations;
- Two months for demolition permits or planning permissions for single-family dwelling units; or
- Three months for other constructions and development permits.

These are basic time periods applying in the absence of any cause for extension or where the

administrative Authorities have not notified an alternative review period.

#### **b. Extensions of the review period**

The basic review periods are increased depending on the nature or location of the project and, in particular, whether it is necessary to:

- Consult or obtain the consent of other administrative Authorities;
- Provide evidence of permission with respect to other legislation; and/or
- Conduct a prior public enquiry (*enquête publique*) or consultation (*concertation du public*).

For example, the French Planning Code provides for a two-month extension of the review period for projects where the consultation of a county (*département*) or regional commission is required.

The review period for a planning permission application is, however, extended to five months where such concerns an IGH or a public access building (*établissement recevant du public* – ERP) (**please refer to Chapter IV - Section E** on these aspects for further details).

The review period may even be increased to ten months in certain exceptional cases, in particular where the French Defence Minister or another relevant Minister has been called upon to grant permission.

#### **c. Exceptional extensions of the review period**

In addition to the cases of extension referred to above, the French Planning Code provides, in exceptional cases, for an extension of the review period.

These extensions are necessary where permission or approval must be obtained prior to the issuance of administrative permission and during the review period.

This is the case, in particular, where permission to operate a retail activity has been issued in respect of a construction project but an appeal has been lodged against it before a National Commission.

An extended five-month review period is therefore provided for to grant the National Commission (*Commission nationale d'équipement commercial* - CNAC) sufficient time to reach a decision.

## **2.4 Decisions**

### **2.4.1 The various forms of decisions**

#### **a. Tacit decisions**

##### **i. The principle**

If the administrative Authority has not reacted to the application by the expiry of the review period, approval will be deemed tacit. The beneficiary of the authorisation may request a certificate stating the existence of this tacit approval (for example, in order to display this certificate on the site).

The administrative Authority has two months as from the existence of the tacit authorisation or the approval of declaration, to issue an Order determining the payable contributions.

##### **ii. Exception to the granting of a tacit decision**

There are a certain number of cases where the applicant cannot claim tacit approval.

This is notably the case for projects subject to a prior public environmental enquiry or those concerning listed buildings or buildings adjoined to a building listed as a historical monument.

#### **b. Express decisions**

An express decision is notified on the beneficiary.

The administrative Authority must provide grounds for its decision:

- In the case of denial of an application;
- Where it is subject to conditions;
- In case of suspension of the review period; or
- Where a derogation or minor adaptation is granted.

The decision determines the amount of the contribution(s) payable by the beneficiary of the authorisation.

The administrative Authority also states the date at which the decision becomes enforceable.

It will also provide information about its validity period and the deadline for appeal.

### **2.4.2 Enforceability of the decision**

Planning permission may be implemented as soon as it has become enforceable, i.e. as soon as certain registration or transmission formalities have been carried out.

Permits issued by representatives of local Authorities are subject to verification of their compliance

with the Law by the State (more precisely, by the *Préfet*), after they have been issued (this legal review is referred to as "*contrôle de légalité*").

They must therefore be transferred to the *Préfet* with the complete application and may only be implemented after the expiry of a time period provided by the French Planning Code.

Dispatch to the *Préfet* must normally take place within fifteen days from the signature of the authorisation.

For example, express planning permissions are enforceable after the later of the following two dates to occur: Either the date of notification of the authorisation to the applicant or the date of transmission of the authorisation to the *Préfecture*.

### 2.4.3 Effects of the decision

As soon as an authorisation has been granted and has become enforceable, its beneficiary may in principle implement this authorisation and begin the works, even if in practice, its beneficiary often waits for the litigation risk period to expire to start building.

The beneficiary must inform the administrative Authorities that a building site has been commenced.

In certain exceptional cases, the commencement of works must be postponed and is subject to the procurement of another type of permission or procedure under other legislation (such as the completion of archaeological excavations). The authorisation should, in principle, state this obligation to postpone the work.

Lastly, constraints, in particular arising under Civil Law (easements, rights to light, etc.) may prevent effective implementation of the planning permission issued "subject to third party rights" (*sous réserve du droit des tiers*).

## 3. Modifications to the project

### 3.1 Amended planning permission

It is possible to make changes to the initial project during the performance of the works by applying for amended planning permission (*permis de construire modificatif*).

In such cases, the provisions of the initial planning permission which are not modified will continue to apply and the provisions of the amended planning permission shall be incorporated into the initial project.

The beneficiary of the planning permission will then be under an obligation to implement the planning permission as amended (unless it formally waives the benefit of the amended planning permission).

If the amendments requested are too significant and affect what the courts refer to as the "overall economy of the project" a new planning permission will have to be applied for.

### 3.2 Transfer of planning permission

It is possible to ask the administrative Authorities to transfer the benefit of planning permission to another beneficiary.

The transfer of planning permission is only possible if the initial beneficiary of the planning permission has consented and if the transferred planning permission is still valid.

## 4. Period of validity of planning authorisations

Planning permission must be implemented within a set time beyond which it will expire.

The period of validity of planning permission begins from notification of the express decision or the procurement of tacit approval.

### 4.1 Validity of authorisations not involving works

This case relates to divisions of land without works or changes of use without works.

These projects must be completed within three years following the issuance of the administrative authorisation.

### 4.2 Validity of authorisations involving works

Where planning permission involves works to be carried out, the beneficiary of the planning permission has three years to start works.

In order to avoid expiry, the works undertaken must be significant and demonstrate effective intent to implement the planning permission.

After the three-year period, the beneficiary must not suspend work for more than one year (though, several periods of suspension are possible).

### 4.3 Suspension of the validity period of planning authorisations

The period of validity may be suspended on various grounds such as:

- A Court case against the authorisation granted; The period of validity will be suspended until an irrevocable court ruling has been issued; or
- Commencement of works being subject to another type of planning authorisation or procedure under other legislation; The time period will start to run as from the date the works can be commenced in application of that legislation.

### 4.4 Extension of the validity period

The period of validity of planning authorisation may be extended twice for an extra year, at the request of the planning permission holder sent to the administrative Authorities at least two months prior to the deadline of the validity period.

Such extension is not automatic and is only possible if the planning requirements and administrative easements of any kind affecting the project have not changed to the disadvantage of the project.

## 5. Completion and compliance

### 5.1 Declaration of completion and compliance of the works

The declaration of completion and compliance of the works (*déclaration attestant l'achèvement et la conformité des travaux – DAACT*) is a document sent to the town hall informing it that works, subdivisions, or changes of use have been completed and certifying their compliance with the planning permission or prior declaration that authorised them.

Such declaration must be signed by the beneficiary of the planning permission or the declaration approval and, as the case may be, by the architect who supervised the works.

The declaration must enclose certain additional documents, as applicable, including:

- A certificate - issued by either a technical inspector or architect - that the works carried out comply with the rules of accessibility for persons with disabilities; and/or
- A certificate from a technical inspector certifying that the project manager took into account its opinion on compliance with Para seismic and cyclone resistant construction rules.

### 5.2 Timeframe for challenging compliance

The administrative Authorities have a set time to perform the post completion inspection visit (*visite de récolement*) and to notify the beneficiary of the planning permission or declaration approval that it intends to challenge compliance of the works.

This time period is:

- Three months from the receipt of the DAACT; or
- Five months in the case of a mandatory inspection.

If the administrative Authorities considers that the works do not comply with the planning permission granted, the relevant Authorities shall formally notify the beneficiary of the planning permission to apply for an amended planning permission or to carry out compliance works pursuant to that planning permission.

After this time period of three or five months, the administrative Authorities shall no longer be able to challenge the building's compliance.

### 5.3 Inspection visits

In certain cases, the administrative Authorities are under an obligation to visit the construction, particularly concerning works relating to:

- ERPs and IGHs;
- Protected buildings such as buildings listed as historical monuments;
- Works carried out in protected areas; or
- Areas covered by a hazard prevention plan if specific construction constraints are provided in such plan.

#### 5.4 Certificates of no objections to compliance

If the administrative Authorities do not challenge compliance by remaining silent during the three or five-month period, the beneficiary of the planning permission may, on expiry of such period, request a certificate confirming that no objections to compliance were raised.

#### 5.5 Right to information and to inspect

During the works, the administrative Authorities are entitled to visit the building site, to carry out reasonable inspections and to be provided with any technical documents related to the erection of the buildings, in particular those relating to accessibility for persons with disabilities.

This right to inspect and to request information may also be exercised after the completion of work during a three-year period.

### 6. Works on existing constructions and reconstruction

#### 6.1 Works on existing constructions

##### 6.1.1 Works on constructions that initially complied with planning rules but have since become non-compliant

If a building that initially complied with the applicable planning rules (i.e. the appropriate planning authorisation was obtained) is no longer compliant due to changes in the rules, it is only possible to obtain a new planning authorisation for that building if this does not aggravate the existing state of non-compliance with the rules.

##### 6.1.2 Works on constructions that are non-compliant

It is not possible to obtain a new planning authorisation for a non-compliant building (i.e. that was constructed without the necessary authorisation or in violation of the authorisation issued) without first obtaining an authorisation to resolve the non-compliance. It may be possible in certain exceptional cases to obtain an authorisation to bring the building up to standard (e.g. if the building is dangerous).

The French Planning Code specifies a ten-year limitation period with regard to non-compliant buildings. The fact that a building is non-compliant cannot constitute grounds for denying planning authorisation if the non-compliant work on the building has been completed for more than ten years.

There are many exceptions to this exception:

- Buildings located in a listed or natural area;
- Buildings developed without planning permission;
- Buildings developed on public property;
- Buildings located in a hazard zone identified within a natural hazard prevention plan;
- Buildings whose nature or location causes their users or third parties to be exposed to the risk of death or injury leading to permanent impairment or disability;
- Where an action to demolish the building has been brought.

In the latter cases, the Authorities must ensure that no planning authorisation is issued for works involving a building or part of a building constructed without the necessary authorisations or not complying with the authorisations issued for it.

Non-compliant works must therefore be made compliant either before or at the time of application for the planning authorisation required for the new works to be carried out on the building.

This condition of prior compliance (which, in fact, is not always possible in view of the development of planning rules) is binding with no time condition.

#### 6.2 Reconstruction

Property owners intending to reconstruct a building (after demolition or destruction, etc.) must first obtain a planning authorisation, to be issued based on the planning rules then in force.

Identical reconstruction of a building demolished or destroyed within the last ten years is authorised notwithstanding any planning provision to the contrary, unless the municipal plan or the local planning document provides otherwise, and as long as the original building complies with the original planning permission.

This right does not apply to buildings unlawfully constructed, i.e. buildings constructed without planning permission or on the basis of a planning permission which has been withdrawn.

## C. Planning taxes

### 1. The principles

Construction and development works are subject to specific taxes aimed at collecting contributions from those who carry out works in order to finance public facilities.

These taxes and contributions are exhaustively listed by Law. Consequently, administrative Authorities cannot request any other taxes. Failing this, they may be subject to a claim for a refund of any taxes and contributions unlawfully paid.

Contrarily to “property and residential” tax paid by the owner or the tenant of a premise, planning taxes are paid by the beneficiary of a permit authorising construction or development works.

### 2. Planning taxes and construction works

Planning taxes, contributions or other charges are potentially payable further to the issuance of a planning authorisation.

The *taxe d'aménagement* and other contributions listed below are not always cumulative.

#### 2.1 Development tax (*taxe d'aménagement*)

In 2012, the French Government rationalised the system of taxation, when several taxes (TLE, TDENS, TDCAUE, TC-TLE) were replaced by a single tax entitled *taxe d'aménagement* (development tax). This tax was introduced and came into force on 1 March 2012.

*Taxe d'aménagement* is due for all development, construction, reconstruction and extension works on buildings authorised by a planning authorisation.

There are three tax rates: (i) One decided on by a decision of the Municipal Council (from 1 to 5%), (ii) one decided on by a decision of the County Council (from 0 to 2,5%) and (iii) one in the Ile-de-France region, that cannot exceed 1%.

The calculation of this tax is based on three main criteria:

- The surface area of the property;
- An annual fixed rate per square metre (m<sup>2</sup>) depending on the use of the construction;
- The three above mentioned rates.

In practice, the *taxe d'aménagement* must be calculated as follows:

Surface Area x Value x Rate (Municipal rate / County rate and, only for the Ile-de-France region, Regional rate)

By way of exception, certain types of works are taxed on a fixed charge basis per m<sup>2</sup>, such as swimming pools or solar panels.

#### 2.2 Tax on the creation of office, commercial, and storage premises in the Ile-de-France region

A reform of the former system which governed the taxation of the creation of office, commercial or storage premises in the Ile-de-France region (RCB) was introduced by the 2015 Amended Finance Bill. This new tax regime is now applicable for projects initiated as of 1 January 2016.

In the Ile-de-France region, a tax (TCBCE) is now collected for the benefit of the region on the construction, reconstruction or expansion of premises used for office, commercial or storage purposes. This tax may also be paid in the event of changes of use.

The rate is published yearly and depends on the type of use and the geographical area of the premises.

#### 2.3 Specific contributions

The beneficiary of a permit may also be required to pay other planning contributions. Such contributions are determined on a case-by-case basis in accordance, for instance, with the specificity of the public facilities required for the project, or the sector where it is located.

Among the main specific contributions are:

- One-off contributions with the purpose of financing the creation of exceptional/specific public equipment;
- Sector-specific contributions with the purpose of financing public equipment in a ZAC or a PUP (see below).

## 2.4 Partnership for Urban Projects (*projet urbain partenarial* (PUP))

Developers, builders or owners of property located in an urban area (or an area earmarked through the PLU for future urban development program) are allowed to conclude an agreement with the local Authority.

Such agreements are referred to as a *projet urbain partenarial* (PUP) (i.e. partnership for urban projects) whose aim is to provide financial support for all or part of public facilities to be erected in the area.

Under this agreement, the developer, builder or property owner may only be required to finance public facilities to be developed to meet the needs of the future users of buildings to be developed within the area defined in the PUP.

The schedule of payments is laid down in the agreement. In practice, funding may take the form of a financial contribution or, of provision of land.

## 2.5 Charges (*redevances*)

Various others charges may also be due, including, in particular the *redevance d'archéologie préventive* and *participation pour le financement de l'assainissement collectif*.

### 2.5.1 *Redevance d'archéologie préventive* (RAP)

The tax for preventive archaeology (*redevance d'archéologie préventive*) is only payable by any public or private person when the projected works authorised, are likely to have impact on the subsoil.

The Law provides for a certain number of exemptions.

### 2.5.2 *Participation pour le financement de l'assainissement collectif*

The tax for the collective sanitation system (*participation pour le financement de l'assainissement collectif*) is due if the new building implies the production of additional waste water for the public network.

This fee will be due for the benefit of network operators, after the date of connection of the building to the waste water networks.

The amount of this fee is calculated based on a decision adopted by the public entity in charge of wastewater.

## 3. Planning taxes and development projects

Specific taxes may also give rise to specific planning and development taxes such as in ZAC development projects.

## D. Planning and legal certainty

The decisions of public Authorities to draft planning rules (such as PLU, *plan de prévention du risque inondation* - PPRi) or the decision of the Mayor/*Préfet* to deliver planning authorisations may be challenged through various actions.

These proceedings constitute a major risk factor insofar as:

- The annulment of general planning regulations may have a direct effect on individual planning authorisations issued on their legal basis;
- The annulment of individual planning permissions may imply, under exceptional circumstances, an obligation to demolish or to reinstate the premises.

### 1. Challenging planning documents and planning authorisations

These decisions as mentioned above may be challenged by:

- The Authority which issued the decision through a withdrawal decision;
- A third party or the *Préfet* through an appeal brought before the Authority which issued the decision or directly before Administrative Courts.

#### 1.1 Withdrawal

A withdrawal decision shall have retroactive effect on overturning the challenged decision.

Such withdrawal decisions mainly concern individual planning decisions. They may be withdrawn:

- At the initiative of the Authority (Mayor/*Préfet*) which issued the authorisation;
- At the request of the beneficiary of the planning permission.

### 1.1.1 Withdrawal on the initiative of administrative Authorities

The Authority that issued the planning permission may voluntarily elect to withdraw its decision when it appears that this planning permission is vitiated by unlawfulness.

A withdrawal decision may be issued within three months from the date of issuance of the planning permission. This procedural rule overrides public procedural rules and does not apply in the event of fraud, i.e. on the basis of misrepresentation. In such cases, the authorisation may be withdrawn at any time.

### 1.1.2 Withdrawal at the request of the beneficiary of planning permission

Planning authorisations may also be withdrawn at the request of their beneficiaries at any time, e.g. where the authorised project is abandoned.

The beneficiary of the authorisation will then have to send a formal request to the Authority that issued the relevant authorisation.

A withdrawal decision implies the possibility, for the beneficiary of the authorisation withdrawn, to request a refund of the planning taxes and contributions which have already been paid.

## 1.2 Appeals

Appeals may be brought against different types of decisions:

- Decisions approving the planning rules at the national level (Bylaw or Order);
- Decisions approving planning regulations at local level such as decisions of municipal Councils or EPCs approving planning documents (such as a PLU);
- The planning authorisations themselves.

These appeals must be based on failure to comply with applicable regulations.

Appeals may be directly brought before the administrative Courts (*recours contentieux* - contentious appeal) or, on the contrary, before the Authority having issued the challenged decision (*recours gracieux* - non-contentious appeal).

Parties bringing a non-contentious appeal may then bring the case before the administrative Courts.

### 1.2.1 Appeal by the *Préfet*

In accordance with public procedural rules, all planning documents and authorisations must be sent to the *Préfet* of the county. The *Préfet* must assess whether these decisions have been issued in accordance with all applicable regulations.

If it considers that these decisions fail to comply with applicable regulations, the *Préfet* may request the Authority that issued the decision to withdraw this decision within a period of two months from the date of notification of such decision. The *Préfet* may also bring an appeal before Court. This is known as a *déféré préfectoral*.

To avoid the challenged decision entering into force, the *Préfet* may also file a request for postponing the enforcement of the decision until a court decision has been issued.

### 1.2.2 Third party appeals

#### a. Criteria for admissibility of an appeal

To be allowed to bring an appeal against a planning permission or planning documents, third parties have to establish their personal interest in the annulment of the challenged decision.

Third parties are entitled to bring an appeal if the project is liable to directly affect the terms of occupancy, use, or enjoyment of the premises they own or occupy. The burden of proof regarding these disturbances lies on the third party.

For instance, the neighbours of the beneficiary of a planning permission are entitled to bring an appeal against the planning permission if they can establish that the authorised works may have a direct impact on their premises.

A claim can also be brought by authorised associations for the protection of the environment or other associations, where their articles of association expressly provide that their corporate purpose is related to planning or environmental issues.

A fine may be inflicted for unreasonable/unjustified appeals, i.e. for appeals brought solely with the intent to harm the interests of the beneficiary of the challenged authorisation.

#### b. Legal timeframe for non-contentious and contentious appeals

Appeals must be filed within two months from the completion of the registration and publication formalities required under the French Planning Code.

As regards planning authorisations, these requirements imply display of the planning permission (setting out all mandatory information) on the building site, for a continuous period of two months.

No appeal may be lodged after the expiry of a one-year period following completion of the construction.

### **c. Emergency proceedings: suspension of the decision (*référé-suspension*)**

Third parties may also apply for the immediate suspension of enforcement of the challenged planning permission (or the challenged planning document).

In the case of suspension of enforcement of planning permission ordered by an administrative Court, the beneficiary of the authorisation shall no longer be able to start the works or will have to immediately stop the works.

If no suspension is requested, the beneficiary of the planning permission may carry out the authorised works, despite the existence of an appeal.

## **2. Challenging constructions**

Construction works carried out without any planning authorisation or carried out in application of an illegal planning permission may give rise to the following actions:

- Criminal proceedings to sanction the breach of obligations set out in the French Planning Code;
- Proceedings for tortious liability or for fault-based liability, which may be brought by any person claiming to have suffered loss as a result of works it considers wrongful;
- Civil proceedings open to certain public Authorities to enable them to sanction illegal work; or
- An "administrative" objection for illegal works. Although this type of objection does not directly affect those works which have already been completed, the illegal works may later provide cause for denying planning authorisation, thereby preventing any subsequent illegal works from being carried out;
- Civil proceedings based on contractual liability as a result of the construction breaching one of the owner's contractual obligations, such as easements; or
- An action based on unaccustomed disturbance to neighbours should the construction cause excessive disturbance to adjacent residents. This implies an "objective" action based on the excessive character of the disturbance caused, and does not require evidence of any misconduct whatsoever.

### **2.1 Criminal liabilities**

#### **2.1.1 Works carried out without a planning authorisation or in breach of the planning permission issued**

Carrying out works without planning authorisation required by the French Planning Code (in most cases, construction without planning permission) is an offence.

Any person who assumes a role in the execution of such works (including the beneficiary of these works) shall be held liable for this offence.

A criminal action may be initiated within a period of six years as from the completion of works.

This offence may result in a fine but also in the obligation to demolish/reinstate the premises.

#### **2.1.2 Non-compliance with planning regulations**

Developers, builders, or owners of land may also be held liable for criminal infringement.

This offence may be cumulative with the infringement of carrying out works without any prior permission.

This liability is also subject to a limitation period of six years.

This liability may also give rise to a fine and various remedial measures.

In both cases, the works may be suspended by decision of the Authorities pending judgment.

### **2.2 Civil exposure: Proceedings for fault-based liability by affected third parties**

#### **2.2.1 Illegal works**

A civil action may also be brought where the relevant works have been carried out illegally.

The applicant must be able to provide proof of misconduct (i.e. a breach of planning rules), a loss (loss of view or light) and a causal link between such misconduct and the alleged loss.

Third parties (such as neighbours) can request demolition, reinstatement or damages.

The limitation period for this civil action is five years.

### 2.2.2 Works carried out in compliance with the planning permission issued

An action for liability regarding works carried out in compliance with a planning permission which fails to comply with planning regulations is subject to extremely strict rules.

Insofar as such action implies a breach of planning regulations, it is often subject to a prior legal action designed to challenge the planning permission on the basis of which the works were carried out.

This also requires that the third party is in a position to prove the existence of a loss in connection with this misconduct.

#### a. Demolition proceedings against the owner

Such demolition proceedings may be initiated against the owner of the building, even if the works challenged were carried out by a previous owner.

These proceedings may only be brought if the planning authorisation has been directly challenged within the two-month statutory time limit before an administrative Court. In addition, the annulment of the planning permission must be final.

The request for demolition should be filed before civil Courts within a period of two years from the annulment of the permit.

#### b. Proceedings for damages against the builder

As opposed to proceedings for demolition, these proceedings are available only against the builder. This legal action is admissible only if the planning permission has been held to be unlawful by an administrative Court.

Two case scenarios may arise: Either a claim for the annulment of the planning permission is made directly before an administrative Court or the claim is indirectly brought before an administrative Court upon referral from the civil Court.

Claims for damages should be filed before the civil Court within a period of two years from completion of the works.

## 2.3 Exposure to civil proceedings: Civil proceedings by public Authorities

### 2.3.1 Demolition proceedings by the *Préfet* (*action en démolition*)

Where the matter is referred to an administrative Court by the *Préfet* and the Court annuls the challenged planning authorisation, the *Préfet* may also initiate civil proceedings for the demolition or reinstatement of the premises.

This action may be brought within a period of two years from the date at which the decision to annul the permit has become final.

### 2.3.2 Demolition proceedings by the Authority that issued the planning permission

Where works were carried out without any planning authorisation, or where the final result of the works does not fully comply with the authorisation issued or the applicable planning rules (if no permit or authorisation was required), the relevant Authority is entitled to bring demolition proceedings before the civil Courts.

This action may be brought within a period of ten years as from completion of the works.

## 2.4 Administrative exposure

Non-compliant buildings are also subject to specific rules regarding the type of construction works which may subsequently be carried out therein (**please refer to Chapter IV - Section A**).

## E. Other administrative permits

Projects sometimes require one or more administrative permits that are independent from those listed in the French Planning Code and are, for example, provided for in the French Commercial Code (*Code de commerce*), the French Heritage Code (*Code du patrimoine*), the French Environment Code, the French Construction and Housing Code, the French Forestry Code (*Code forestier*), etc.

The French Planning Code sets out the procedures for coordination between planning permission and other various administrative permits.

- In certain cases, planning permission can substitute those permits required under other legislations.

This is the case for planning permissions relating to ERPs, which are in principle governed by the French Construction and Housing Code, provided that a detailed interior floor plan of the building

is included in the planning permission application.

- In some other cases, the planning authorisation under the French Planning Code (planning permission or prior declaration) is subject to approval provided under other legislation.

This notably concerns projects relating to a building listed as a historical monument or to a building adjoined to a building listed as a historical monument, which are subject to the consent of the administrative Authority in charge of historical monuments under the French Heritage Code.

- In a third case, the authorisation provided for by other legislations is an exemption from planning permission or prior declaration.

This concerns:

- . Works carried out on a building listed as a historical monument. Such work is only authorised by the administrative Authority in charge of historical monuments subject to the decision being approved by the Authority competent to issue planning permission; or
- . Undermining and raising of the ground subject to prior declaration or a permit under the French Mining Code (*Code minier*).
- In some other cases, works will be postponed pending permission provided under other legislations.
- Lastly, in certain cases, authorisations under other legislations and planning authorisations must be obtained together and completely independently of each other. This concerns, in particular, the consultation of the competent Authority in matters of preventive archaeology (the Préfet of the region), since the planning decision may not be issued before the Préfet has decided on the matter.

## 1. Permission to operate a retail activity

### 1.1 Scope of application

Prior permission may be required to create cinematographic or commercial facilities.

The criteria used to assess applications are based on spatial planning, sustainable development, or consumer protection factors.

Spatial planning factors include:

- The project location and urban integration;
- The impact of the project on urban or rural life;
- The impact of the project on transportation flows and its accessibility via public transportation and alternative modes of travel (i.e. excluding by car);
- The efficient use of space, especially in terms of parking.

Sustainable development factors are:

- The environmental quality of the project, especially from the Perspective of energy performance and Environmental preservation;
- The integration of the project into the surrounding architecture and landscape;
- Disturbance of any kind that the project may generate, to the detriment of its immediate surroundings.

Consumer protection factors include:

- Accessibility, especially in terms of proximity to living areas;
- The project's contribution to the revitalisation of the trade mix, especially by modernising existing commercial facilities and preserving urban centres;
- The commercial variety on offer through the project, especially through the development of innovative concepts and the promotion of forms of local production;
- The natural, mining and other hazards that the project site may be exposed to, as well as measures to secure consumer safety.

As a secondary consideration, the contribution to employment may also be taken into account.

#### a. Projects subject to consent (*agrément*)

The Mayor may propose that the municipal Council requests an opinion from the Local Authority for Commercial Development (*commission départementale d'aménagement commercial - CDAC*), when seized with a planning permission application for commercial facilities including a sales area between 300 m<sup>2</sup> and 1,000 m<sup>2</sup> and located in municipalities with less than 20,000 inhabitants.

## **b. Projects subject to permission**

Projects requiring a permission from the CDAC are as follows, without limitation:

- Creation of a retail store with a sales area of more than 1,000 m<sup>2</sup>, arising from a new construction or the conversion of an existing building;
- Extension of the sales area of a retail store that already meets the threshold of 1,000 m<sup>2</sup> or that will exceed this threshold as a result of the project;
- Change in business line of a retail facility including a surface area of more than 2,000 m<sup>2</sup>. This threshold is reduced down to 1,000 m<sup>2</sup> where the new retail facility is essentially a grocery based activity;
- Creation of a commercial complex with a sales area of over 1,000 m<sup>2</sup>;
- Extension of the sales area of a commercial complex that already meets the threshold of 1,000 m<sup>2</sup> or that will exceed this threshold as a result of the project;
- Reopening of a retail store to the public on premises where operations have been discontinued for three years (this requirement was previously two years);
- Creation or extension of a "drive-thru".

As of 1 January 2018 and for a three-year period, these thresholds of 1,000 m<sup>2</sup> are reduced down to 400 m<sup>2</sup> in Paris, pursuant to Law No 2017-257 of 28 February 2017.

## **1.2 Retail licenses**

### **1.2.1 Single authorisation**

Since the implementation of Law No 2014-626 of 18 June 2014 (the Pinel Law), planning permission also counts as a business license for projects that require planning permission, provided the planning permission application received a favourable opinion from the CDAC or, as applicable, the National Authority for Commercial Development (*Commission nationale d'aménagement commercial* - CNAC).

A single planning permission application is submitted to the Mayor's office.

The department that processes the application must refer the application to the CDAC for an opinion. If the CDAC opinion is negative, the applicant may appeal to the CNAC, whose opinion will replace that of the CDAC. If the CNAC finds against the applicant, the planning permission is denied.

The CNAC may act on an ex officio basis regarding any project subject to permission to operate a retail activity where the sales area is over 20,000 m<sup>2</sup>.

The timeframe required to process a planning permission/retail license is five months as from the date of receipt of a complete application file.

Where the CDAC's opinion is appealed against before the CNAC, this deadline will be extended for an additional five months.

### **1.2.2 Permission not included in a planning permission**

If the project does not require a planning permission, a request for a retail license must be sent to the CDAC which will decide whether to approve or to reject the project within a period of two months from receipt of the request.

## **1.3 Procedure for the issue of an opinion**

### **1.3.1 Opinion procedure**

Once it has been consulted, the CDAC has a period of two months to issue an opinion.

The planning permission applicant may provide the CDAC with any and all documents to support its application.

The CDAC is chaired by the *Préfet* and comprises eleven members (eight members in Paris): seven locally elected officials and four persons with expertise in consumer issues, planning, sustainable development and spatial planning.

In the event of unfavourable opinion, the planning permission may not be issued (planning permission denied). If the CDAC fails to issue an opinion within a period of one month, it will be deemed to have issued a favourable opinion.

### **1.3.2 Permission procedure**

The owner of the property or any person authorised by the owner to build on the land or operate the building must submit an application to obtain permission.

The application will be sent to the *Préfet* of the relevant county. The CDAC will make the decision to grant or deny permission.

The CDAC is chaired by the *Préfet* and comprises eleven members (or proxies) if the catchment area (*zone de chalandise*) for the project does not extend beyond the county: Seven locally elected officials and four persons with expertise in consumer issues, planning, sustainable development and land development.

The CDAC must reach a decision within a period of two months. Failing which the application will be deemed approved.

If the project requires planning permission, the period for review of the planning permission, will be increased from three to five months. Where the relevant Authority remains silent regarding the issue of planning permission this will result in the rejection of the application if the opinion of the CDAC is unfavourable.

#### **1.4 Impact and implementation of the permission**

Permission must be implemented within very strict time limits:

##### **1.4.1 Planning permission in lieu of CDAC**

If the project requires planning permission, the opinion will expire for sales areas that have not been opened to the public or opened for business within a period of three years from the date of notification or receipt of the opinion.

This deadline is extended for a further two years if the project concerns a sales area of between 2,500 m<sup>2</sup> and 6,000 m<sup>2</sup>, and for a further four years if the project concerns a sales area of over 6,000 m<sup>2</sup>.

##### **1.4.2 Other permissions (not including planning permissions)**

If the project does not require planning permission, the permission will expire for the sales areas that have not been opened to the public within a period of three years following the date of notification or date at which a tacit decision is deemed to have been granted.

If substantial modifications are made to the type of business or sales areas prior to opening the premises to the public, a new application must be filed for specifying any modifications.

Excerpts from all contracts for the project entered into for an amount of over EUR 10,000 must be provided to the Authorities for a period of two years following the completion of the works.

In addition, prior to opening, a certain number of documents and plans must be sent to the relevant local Authorities for verification to ensure compliance with the permission obtained.

#### **1.5 Withdrawal and third party appeals**

##### **1.5.1 Withdrawal**

A permit for a retail activity may be withdrawn at the initiative of the issuing Authority if it does not comply with Law. This will occur:

- Within a period of four months following the decision if it is an express decision;
- Within a period of two months from completion of the public notice formalities or throughout the duration of the dispute where tacit approval has been granted.

In practice, permission is rarely withdrawn.

##### **1.5.2 Appeal**

###### **a. CDAC opinions**

The applicant alone is entitled to appeal against an unfavourable opinion from the CDAC before the CNAC. Decisions must be announced within one month. Failing which, the initial opinion will be deemed confirmed by the CNAC.

###### **b. CDAC permission**

All appeals against CDAC decisions must be brought before the CNAC within a period of one month. Failing which, an application on the same issue to an administrative Court may be considered inadmissible insofar as a prior appeal to the CNAC is mandatory.

Any party may appeal provided they have cause of action to do so. Various other parties are also authorised by Law to appeal (the *Préfet*, the Mayor of the relevant municipality, the chairman of the EPIC (*établissement public de coopération intercommunale*, i.e. a public entity managing cooperation between municipalities) in charge of public development, the Chairman of the EPIC or joint union in charge of developing the SCOT.

The CNAC will then issue a new decision on the project within a period of four months.

If an appeal is brought before the CNAC but no decision is made within the four-month timeframe, it will be deemed denied and the decision of the CDAC confirmed.

The period for review of the planning permission, extended to five months when a commercial operation is required, is extended by five months when the CNAC is seized (or acting ex officio), to examine an appeal against the decision of the CDAC.

The CNAC may also review any project with a sales area of at least 20,000 m<sup>2</sup> of its own motion within one month after the opinion or CDAC decision is issued.

An appeal to have the CNAC decision cancelled can then be submitted to an administrative Court by any third party with an interest within two months from the date of completion of the formalities concerning the publication of the CNAC decision.

Administrative Courts of appeal have initial and final jurisdiction to hear appeals against planning permissions that include retail licenses.

These cases may only be referred to the *Conseil d'Etat* acting in its capacity as Supreme Court.

## 1.6 Penalties

### 1.6.1 Criminal penalties

Criminal penalties will apply where a party carries out works, either directly or indirectly, on cinema facilities or operates, directly or indirectly, a cinema without the necessary permit or without observing the requirements set out in a permit. The applicable penalty corresponds to a category 5 minor offence (*contravention*): A fine of EUR 1,500 for individuals or EUR 7,500 for legal entities.

### 1.6.2 Civil or commercial penalties

The *Préfet* has broad discretionary powers to sanction offences under commercial development Regulations. For example, he or she may:

- Issue formal notice to the related operator to reduce the sales area of its premises to the surface area stated in the retail permit granted by the relevant commercial development committee within a period of one month;
- Issue an Order for the closure of unlawfully operated sales areas within a fortnight until the necessary adjustments are made. The Order may be coupled to a daily penalty of EUR 150 per square meter operated unlawfully.

Failure to comply with the *Préfet's* Orders is punishable by a fine of EUR 15,000.

In addition, competitors have the option of filing a suit before a civil or commercial court to put an end to the damage caused to them by the unlawful operation of the commercial activity.

## 2. Approval for the creation of business premises and offices in the Ile-de-France region

As part of the decentralisation and land use planning policy, a special permission regime called "decentralisation approval" is provided for to enable the administrative Authorities to monitor the establishment of business premises and offices in the Ile-de-France region.

### 2.1 Scope of application

In the Ile-de-France region, any operation undertaken by any individual or legal entity under private Law or any public entity mainly active in the competitive sector is subject to approval. The operation has to entail the construction, reconstruction, extension, and change of user or use of premises, installations or their annexes used for industrial, commercial, professional, administrative, technical, scientific or educational activities.

Some operations are exempted from this approval (e.g. gratuitous transfers or operations undertaken by local authorities for the purpose of their public services). The French Planning Code provides for some exemptions relating to location or nature of the operation (Article R.510-6).

### 2.2 Issue procedure

#### 2.2.1 Competent Authority

The competent Authority to decide on the approval is:

- Either the regional *Préfet*;
- Or the county *Préfet* for all construction, reconstruction or extension operations. This *Préfet* is competent to decide on the approval where a valid agreement has been concluded, for a term between three and five years, between this *Préfet* and either the Mayor, or the President of the competent EPCI. These agreements include the covenant to perform the necessary measures to ensure the balance between constructions intended for housing and those intended for the activities covered by the scope of application of the approval.

### 2.2.2 Procedure

Approval applications under the purview of the county *Préfet* are sent either to the territorial unit for Paris and some counties of the Ile-de-France region (*petite couronne*) or to the county directorate of territories for the counties of the *grande couronne*.

Approval applications under the purview of the regional *Préfet* have to be sent to the Local State Administration (DRIEA).

### 2.2.3 Decision

The *Préfet* has three months to issue a decision from the receipt of the application. He or she may grant, deny or adjourn for further examination, the approval. He or she has to argue his or her decision if the application is denied or adjourned.

If the *Préfet* has not replied within a period of three months, the approval shall be deemed granted in the terms it was requested.

The approval is strictly personal.

The *Préfet* has to consider the guidelines defined by national development and land use planning policy and town planning policy related to the development of the social housing sector as well as the balance between constructions intended for housing and those intended for professional activities.

## 2.3 Effects and implementation

The decision granting approval determines:

- The gross floor area;
- The conditions and reservations the operation is subject to;
- The deadline, as the case may be, for the planning permission application to be submitted, or for legal instruments enabling the use of the premises and the facility to be created, or the premises and facilities to be effectively commissioned.

Once this time period has lapsed, and unless the competent Authority has granted an extension in which to issue the approval, the approval decision shall expire.

Permission must be obtained prior to the planning permission.

## 2.4 Withdrawal and third party appeals

### 2.4.1 Withdrawal

Approval may be withdrawn at the initiative of the issuing Authority if it does not comply with Law. In practice, approval is rarely withdrawn.

### 2.4.2 Appeals

Third parties with cause of action may refer the matter to an administrative Court for the annulment of the permit issued by the *Préfet* of the county or the region.

There again, however, such appeals are exceptional in practice.

## 2.5 Penalties

The construction of any areas without approval or the breach of the conditions specified by the *Préfet's* decision entails a criminal liability in the form of a fine of between EUR 1,200 and either EUR 6,000 per square meter built in the case of a floor area construction, or EUR 300,000 in other cases.

In the event of repeat offence, a six-month prison sentence may be passed.

Additionally, the evacuation of the unlawfully occupied premises, demolition and rehabilitation may be ordered.

## 3. Permission for changes of use

Since 1948, changes of use affecting residential premises has been strictly regulated in Paris and its surrounding areas and in certain large cities in order to counterbalance the housing shortage.

### 3.1 Scope of application

Municipalities with more than 200,000 inhabitants and the municipalities located within the counties of the Hauts-de-Seine, the Seine-Saint-Denis and the Val-de-Marne regions are subject to the regulations regarding the change of use of residential premises.

All categories of housing and their annexes, including shelter housing (*logements-foyers*), caretaker's lodges (*logement de gardien*), service rooms (*chambres de service*), company housing (*logement de fonction*), housing included in a commercial lease, leased furnished premises (*locaux meublés donnés en location*), are considered as residential premises.

Premises are deemed to be used for a residential use if they were assigned to such use as on 1 January 1970. This use may be established by any means such as general records prepared in 1970 during the land tax review.

Premises which have been or which underwent works as from 1 January 1970 are deemed to be assigned to the use for which the construction or work was authorised.

When the project requires the issue of a planning authorisation (planning permission or prior declaration), the planning authorisation application will replace the application for a change of use.

### 3.2 Issue procedure

Since 1 April 2009, in the above-mentioned municipalities, a municipal Council's decision has been enacted to determine the terms of (i) issuance of the authorisations and (ii) assessment of compensation.

The competent Authority issuing permission for a change of use is the Mayor. In Paris, Marseille and Lyon, the borough Mayor is required to give an opinion on the application.

The granting of the permission does not need to be reasoned, unlike the refusal of such permission.

### 3.3 Effects

Temporary authorisations to change use are granted on a strictly personal basis. They terminate definitively when the beneficiary ceases to conduct the relevant professional activity.

Where the authorisation is granted in exchange for compensation, the permission to change use is attached to the premises and not to the beneficiary. The permission then has to be registered.

Certain authorisations are subject to compensation consisting of the concomitant conversion into housing of premises with another use. Financial compensation is strictly banned.

Where the change of use includes works, the planning permission will operate as a change of use.

### 3.4 Penalties

Agreements concluded in violation of this regulation will be null and void.

Furthermore, illegal changes of use are subject to a fine of up to EUR 50,000 per premises. The relevant Court will set a deadline to comply. Failure to meet the deadline will result in a penalty of up to EUR 1,000 per day and per square meter of premises unlawfully converted.

Finally, a Court may order that premises unlawfully converted be returned to their residential use.

This legal action must be brought within a period of thirty years as from the date at which the use of the premises was unlawfully changed.

## 4. Permission to carry out works and to open an ERP/Monitoring ERPs

### 4.1 Definition of ERPs

A public access building (ERP) is any building, premise and enclosure where individuals are admitted (with the exception of employees), either freely or through remuneration or any participation, or where meetings are held and open to everyone or by invitation, whether free of charge or not. ERPs are classified according to the number of people they can accommodate.

### 4.2 Construction work permits

All construction, development and modification works in an ERP have to be authorised by the competent Authority that will check compliance with the regulations on accessibility for persons with disabilities and fire safety.

The competent Authority is either the *Préfet* where he or she is competent to issue planning permission or where the project concerns a high-rise building, or the Mayor in all other cases.

The Mayor or the *Préfet* has to issue a decision within a period of five years from receipt of a complete application file. In the absence of response within this deadline, the authorisation will be deemed granted.

Planning permission will be subject to the authorisation if the works have been accepted by the competent Authority with regard to the regulations on accessibility for persons with disabilities.

### 4.3 Permission to open to the public

The opening of a public access building is subordinated to an authorisation granted by the competent Authority that will check compliance with the regulations on accessibility for persons with disabilities.

Permission to open shall be issued:

- In view of the certificate of compliance. In fact, when a project is subject to regulations on accessibility for persons with disabilities and to planning permission, this certificate has to be established by an approved technical inspector who shall attest that the works comply with the accessibility regulations;
- After the consultation of the accessibility commission if no works have been carried out on the building or if such works have not been subject to the issue of planning permission;
- After the competent safety commission has issued its opinion.

The *Préfet* may grant exceptions to those regulations which cannot be adhered to due to the characteristics of the building, or in the event of constraints linked to the preservation of architectural heritage.

### 4.4 Monitoring and periodical inspection visits

Public access buildings are subject to periodical inspection visits by the relevant safety commission.

These unannounced monitoring and inspection visits will enable the administrative Authorities to check compliance with fire safety regulations and accessibility standards. As part of these verifications, the administrative Authorities may suggest improvements or modifications to the building.

A report is drafted after each visit.

In addition, the Mayor may decide to close down a building that is considered dangerous if it does not comply with applicable safety regulations.

## 5. High-rise buildings (*immeubles de grande hauteur – IGH*)

### 5.1 Definition of an IGH

IGHs or high-rise buildings are buildings whose height:

- Exceeds 50 metres for residential use buildings; or
- Exceeds 28 metres for all other buildings.

The height is measured from the road access level (used for emergency and fire department requirements) to the highest floor.

All supporting elements and underground floors of the building are considered as part of the IGH.

### 5.2 IGH construction work permits

Works conducive to the creation, alteration or modification or change of an IGH are subject to an authorisation issued by the *Préfet*.

Such authorisation may only be granted if the relevant works comply with:

- Accessibility regulations; and
- Fire safety regulations.

The *Préfet* has four months as from submission of a complete application file to issue a decision.

If there is no express decision during this four-month period, the authorisation will be deemed granted.

If planning permission has been issued in respect of the project, this planning permission will substitute the IGH work permit provided that the *Préfet* has granted approval regarding compliance with accessibility and fire safety rules before issuing the planning permission.

### 5.3 IGH operating permit

A permit to open the building is required after completion of the works and prior to the public opening.

### 5.4 Monitoring and periodical inspection visits

IGHs are subject to periodical monitoring visits by the relevant safety commission.

These visits may take place both during the construction phase of the building and after its completion.

These unannounced monitoring and inspection visits will enable the administrative Authority to assess compliance with fire safety regulations.

The owner will then have fifteen days to notify its comments. After this time period has lapsed, the mayor will notify a decision and will propose measures, as the case may be.

## 6. Heritage conservation

The French Environmental Code and the French Heritage Code provide for various regimes for heritage conservation.

The conservation of architectural heritage will be examined separately from the conservation of sites.

### 6.1 Protection of monuments

#### 6.1.1 Buildings listed as historical monuments

The administrative Authorities may list as a historical monument, buildings which are of public interest for their historical or artistic features, in whole or in part. Such protection may concern private property as well as public property.

A listed building (*immeuble classé*) cannot be destroyed or moved, even in part. Prior authorisation is required before any restoration, repair or modification works to the building.

Such permission is also required for works on buildings which lean on a listed building.

Such permission must be issued by the regional *Préfet* or the Minister of Cultural Affairs, and the relevant works must be undertaken within a period of three years and interruptions of the works should not exceed one year.

The works authorised are carried out under the scientific and technical supervision of Government services.

#### 6.1.2 Buildings registered on the supplementary inventory of historical monuments

The administrative Authority may register on the supplementary inventory of historical monuments:

- Buildings or parts of buildings of sufficient interest from an art history perspective to deserve conservation without an immediate request for listed status being justified; or
- Bare land or buildings located within sight of a building which is already listed (*classé*) or registered (*inscrit*); or
- Some types of archaeological remains.

A prior declaration is requested before any works. The application file must be submitted four months before execution of the works.

The administrative Authorities cannot prohibit work save classifying the building as a historical monument. However, if the projected changes are subject to planning permission, the permission cannot be delivered without administrative consent.

The works authorised are carried out under the scientific and technical supervision of Government services.

#### 6.1.3 Surroundings of historic monuments

Inside the perimeter of a historical monument, works are subject to a prior authorisation and to the approval of the State appointed architect ("ABF").

If the ABF disagrees, the authorisation shall not be issued.

### 6.2 Protection of sites

This procedure governed by the French Environmental Code affords protection for high quality natural or urban sites.

Listed sites can be neither destroyed nor modified having regard to their condition or appearance unless special permission has been obtained.

#### 6.2.1 Listed sites

The relevant Authority to issue such permission varies in accordance with the nature of the works (i.e. the Ministry is responsible for works subject to planning permission; The *Préfet* is responsible for works subject to a prior declaration).

The express consent of the relevant administrative Authority for listed sites is required for projects requiring planning permission.

It may be necessary to consult certain consultative Authorities, such as:

- The ABF;
- The local county commission for sites, views and landscapes (*commission départementale des sites, perspectives et paysages*);
- The local county commission for nature, landscapes and sites (*commission départementale de la nature, des paysages et des sites*).

### 6.2.2 Registered sites

Regarding works carried out within a registered site, a prior declaration must be submitted to the *Préfet*.

The *Préfet* must obtain the opinion of the ABF on the project.

Regarding works subject to planning permission, the application will substitute such prior declaration. Works may not be carried out before the expiry of a four-month period.

### 6.3 Preventive archaeology

Preventive archaeology purports to ensure the detection, conservation or safeguarding of elements of archaeological heritage that may be affected by development works (excavations for instance).

The State is responsible for supervising preventive archaeology projects.

The State has established a national archaeological map defining those areas where development works affecting the subsoil automatically trigger archaeological prescriptions.

Two types of projects are subject to preventive archaeology:

- Operations subject to a prior authorisation (e.g. planning permission) within these areas;
- Operations located outside these specific areas but whose impact is significant (i.e. a subdivision affecting an area of three hectares or more)

During the planning permission review period, the State representative (*Préfet de région*) will be consulted. He or she may prescribe a prior diagnosis, detection or conservation measures, provide scientific and technical supervision and collect data. Depending on the conclusion of these measures, he or she may also require the project to be modified.

Developers may refer to the *Préfet* upstream, before applying for planning permission in order to anticipate constraints in terms of archaeology.

The operations are financed by the tax on preventive archaeology, and shall take place either prior to the issuance of the planning authorisations, or after.

## 7. Protection of forests

Pursuant to the French Forestry Code (*Code forestier*), land clearing covers all deliberate actions resulting in the destruction of wooded areas and in the change of their intended woodland use (i.e. creating a golf course on a wooded area).

A prior administrative authorisation is required, with the exception of (but not limited to):

- Wooded areas inferior to a threshold determined by each county (between 0.5 and four hectares);
- Enclosed parks and gardens adjoined to a principal residence for less than ten hectares.

An environmental impact assessment may be required. Prior authorisation is issued by the *Préfet* within two months from the receipt of a complete application file.

Issuance of clearing permits may be denied in particular if preservation of the wooded area is necessary for water quality or public sanitation purposes.

Infringements to these rules is subject to a criminal liability and may entail a reforestation obligation.

## 8. Occupancy agreements for publicly owned property

The property belonging to public entities falls into either of two categories: The private or the public domain. The private domain is governed by General Law. The public domain is governed by specific rules and in particular the French general Code on the Property of Public Entities (*Code général de la propriété des personnes publiques*).

Occupancy of the public domain must be authorised either by a unilateral instrument or a contract.

## 8.1 Local Authorities

The signature of an authorisation or a contract by the Mayor has to be authorised by a prior decision of the local executive Council.

### 8.1.1 Administrative long-term lease (*bail emphytéotique administratif* – BEA) granted by local Authorities

The administrative long-term lease allows local Authorities to grant a right *in rem* over its property, for a term ranging from 18 to 99 years for the purpose of carrying out a public interest operation or of assigning the relevant building to a place of worship open to the public.

Such a contract may be granted over the public domain and also over the private domain of the local Authority (except over public roads and their appurtenances).

The rights arising under these leases may only be transferred with the approval of the local Authority.

The right *in rem* granted to the leaseholder, together with the buildings it owns, may be mortgaged subject to certain conditions:

- The mortgage may only be granted to guarantee loans taken out by the tenant to finance the construction or the improvement of constructions on the leased property;
- The mortgage agreement must, under pain of cancellation, be approved by the local Authority.

The local Authority may substitute the tenant for the repayment of the loan and, in this case, will terminate or amend the lease, as well as any related agreements, as applicable.

Buildings developed under the terms of such leases may also be financed by finance lease agreements (*contrats de crédit-bail*).

### 8.1.2 Temporary authorisations to occupy the public domain of local Authorities

The scope of this type of authorisation is more restricted than the authorisation granted by the State as they should be concluded with a view to undertaking a general interest project.

If such a lease requires the execution of a public contract (such as a procurement contract or a concession agreement), the public contract will contain the terms of occupancy of the domain.

Buildings developed under this authorisation may also be financed by a finance lease agreement.

## 8.2 State

### 8.2.1 Administrative long-term lease (BEA) granted by national Government

The national Government can grant administrative long-term leases in even more limited circumstances than local Authorities:

- For the purpose of restoring, repairing or enhancing an immovable property (referred to as a BEA enhancement).

### 8.2.2 Temporary authorisations to occupy the public domain of the State (*autorisation d'occupation temporaire* – AOT)

The AOT allows a private legal entity to occupy the public domain of the State. Unless otherwise stated, the authorisation will grant the private legal entity a right *in rem*.

The occupancy or the use of the public domain for a business purpose is subject to a prior tender process.

Such occupancy cannot constitute a provision of service or works carried out on behalf of the public entity, or the discharge of public service obligations.

A mortgage may be granted only to guarantee loans taken out by the private legal entity to finance the construction.

On the expiry of the authorisation, the tenant may demolish the building or work at its expense, except where otherwise provided by the authorisation. The State will freely become the owner of the works and buildings if they are not demolished after the expiry of the authorisation.

## F. Environmental issues

### 1. Facilities classified for the protection of the environment (*installations classées pour la protection de l'environnement*)

#### 1.1 Definition and scope of application

The purpose of environmental permit regulations is to protect the environment and human beings from harm caused by activities having an impact on the environment.

These regulations apply to factories, workshops, depots, construction sites and, in general, to all facilities operated or owned by any public or private person or entity, which could be a hazard to or have a negative impact on the surrounding area, public health and safety, agriculture, the protection of nature and the environment or the conservation of sites, monuments and archaeological heritage. These facilities are known as “classified facilities” (*installations classées pour la protection de l’environnement* - ICPE). A definition of classified facilities is provided by Article L.511-1 of the French Environmental Code.

Created by a Law of 19 July 1976, classified facilities are subject to a list established by an Order (the *nomenclature des installations classées*) setting out the types of facilities that are regulated and stating whether they are subject to an authorisation, registration or declaration requirement.

## 1.2 Procedure for opening classified facilities

Classified facilities can be divided into four categories, based on severity of the risks and on the negative consequences they entail.

Facilities that represent a significant hazard or risk for the environment are subject to a prior authorisation before they can be operated. This authorisation is named the “environmental authorisation” (*autorisation* – A). The authorisation is issued based on an application file that contains certain technical documents (environmental impact assessment, risk assessment), and after public hearings and consultations with various Authorities have been held. The authorisation sets out the rules that apply to the facility. Additional rules established by the Environmental Ministry at the national level and concerning specific categories of facilities may also apply. Pursuant to the “Seveso” directives, certain facilities requiring an authorisation are also subject to additional rules intended to prevent major accidents.

An intermediate category of facilities is subject to a registration requirement (*enregistrement* – E). A registration Order (*arrêté*) is granted based on a simplified application file, after consulting with municipal Councils and the public. The facility must be operated under the terms stated in the ministerial Order (*arrêté ministériel*), whose terms may be adjusted by the *Préfet* in each case, under certain conditions.

Other facilities involving less serious risks or negative consequences are subject to a prior declaration requirement, subject or not to a periodical inspection requirement (*déclaration* – D or *déclaration avec contrôle périodique* – DC). Based on the declaration, the *Préfet* issues a receipt and includes, if needs be, standard operating prescriptions that will apply to the facility.

In all four cases, the *Préfet* can enforce additional operating instructions at any time, which is referred to as the *police continue des installations classées* (meaning that the *Préfet* keeps tight control over classified facilities during their operation).

Since 1 March 2017, the various environmental procedures and decisions required for projects subject to a classified facility permit (ICPE) or the Water Act (IOTA) have been merged into the environmental permit (*autorisation environnementale unique*).

## 1.3 Operation of classified facilities

The facility must be operated in compliance with the conditions imposed on the operator, or there is a risk of administrative and criminal liability.

In addition, the *Préfet* must be informed of any changes that may entail noteworthy modifications to the data included in the relevant file. The *Préfet* may set out additional requirements or, if the change is substantial, require that a new authorisation or registration request or declaration be filed.

Any and all changes of the operator must be reported to the *Préfet*. For certain types of facilities, prior authorisation to change the operator may be required.

## 1.4 Discontinuance of the facility

Where the operator of a classified facility is planning to shut down the operation, the *Préfet* must be informed at least three months prior to the intended date (*notification de la cessation d’activité*). The “safety procedures” the operator will be following to prevent any immediate risks and negative consequences must be communicated to the *Préfet* at the same time. The operator must then leave the site in a condition such that it cannot have a negative impact on the environment. The discontinuance process is linked to each registered classified facility. If the operator changes but the classified facility continues to be operated, no discontinuance needs to be notified. Other example, if several classified facilities are operated on a site, the process will need to be followed for each one if the facility is to be shut down.

A site may also need to be rehabilitated (*remise en état*).

The purpose of rehabilitation is for the land to comply with a specific type of use. If the use was not originally described in the authorisation order, it will be defined as follows: If the facility is

subject to authorisation or registration, the use is defined in consultation with the operator, the owner and the Mayor of the municipality where the site is located. If they do not reach an agreement, the use will be the one recorded for the last period of operation (e.g. "industrial use") unless the *Préfet* decides otherwise due to the fact that the use is clearly incompatible with the general future use of the area (in this last case, a higher sensitivity use may be chosen).

If the facility is subject to a declaration requirement, the choice of use does not require any consultation, and will be the use recorded for the most recent period of operation ("industrial use"). The operator has to advise the owner of the land of the discontinuance.

The last operator of the facility is the party primarily responsible for rehabilitation (in some cases, if the last operator is unable to carry out the rehabilitation, responsibility for rehabilitation could be passed on to the owner or another party). It is possible for a third party to make a commitment to the Authorities to carry out the necessary works. Should that third party then fail to fulfil its commitment, the liability will still fall by default to the last operator. Third party contractors must possess the necessary technical capabilities (*capacités techniques*) and hold sufficient financial guarantees (*garanties financières*) to carry out the rehabilitation works.

The operator will prepare a rehabilitation memorandum and submit this to the *Préfet*. The *Préfet* can issue an Order with additional rehabilitation requirements if necessary. Once the works required by the Order have been completed, the operator will inform the *Préfet* and the classified facilities inspector will establish a report (*procès-verbal de récolement des travaux*).

Even if completion of the works has been duly recorded, the *Préfet* may impose any measures that seem necessary to protect the environment by issuing an Order with additional requirements. However, the *Préfet's* involvement is limited in three ways:

- Measures can only be required of the operator (or its assigns) of the activity that caused the pollution;
- If the use of the site has changed with regards to the use defined upon closure, the operator cannot be required to carry out any additional measures needed for such new use, unless this operator initiated the change;
- The *Préfet* cannot place the financial burden of rehabilitation measures on the operator (or its assigns) if more than thirty years have gone by since the date the Authorities were informed of the end of operations (unless the risks or negative consequences of the site were concealed).

## 1.5 Which party bears the obligation to rehabilitate?

### 1.5.1 Substitution of a third party to carry out the rehabilitation works

If several operators have conducted operations on the same site, the issue arises as to which of them is under the obligation to restore the site.

If there has been a series of operators conducting separate activities on the same site, administrative Courts tend to consider that each individual operator is required to take the measures directly related to the activity it engaged in.

If a series of operators have conducted the same activity on the same site, then in principle, the last operator will be bound by such obligation.

According to Case law, the *Préfet* cannot in principle require rehabilitation measures from the "mere owner" of a plot of land or a shareholder of the operating company on the basis of the regulations on classified facilities. If the operator no longer exists or is in default, the public Authorities may take on responsibility for safety procedures with respect to the site.

## 1.6 Administrative and criminal liabilities

Failure to comply with the environmental permit regulations is subject to several types of administrative and criminal liabilities.

A person or entity operating a business that comes within the scope of these Laws but does not have the appropriate title (authorisation, registration or receipt of declaration) may receive formal notice from the *Préfet* to ensure compliance with the required standards. In the meantime, the *Préfet* can suspend operations for a one year period. At the same time, operating without the proper title to do so is a criminal offence if the operations require an authorisation, registration or declaration.

An operator that conducts its business without complying with applicable requirements is at a risk of incurring an administrative and criminal liability. Regulatory penalties may be ordered after formal notice has been served and consist of depositing an amount that matches the cost of the works to be carried out, with automatic enforcement at the operator's expense, or of being obliged to suspend operations. Failure to comply with the requirements imposed on the activity counts as a category 5 minor offence, which may count as a criminal offence if operations are continued unlawfully once the deadline set in the formal notice has expired.

## 2. Waste

### 2.1 Definition and scope

Waste is defined by the provisions of Article L.541-1-1 of the French Environmental Code. Any residue of a production or conversion process or the use any substance, material, product or generally any object that has been abandoned or that the holder intends to abandon is considered as waste (*déchets*).

Six major categories are set out in the French Environmental Code (Article R.541-8): Hazardous waste (*déchets dangereux*), non hazardous waste (*déchets non dangereux*), inert waste (*déchets inertes*), household and related waste (*déchets ménagers*), economical activities waste (*déchets d'activités économiques*), and bio-waste (*biodéchets*).

The provisions of the French Environmental Code are intended to prevent and reduce the production and harmful effects of waste, to organise guidelines for the carriage, re-use, or removal (collection, carriage, storage, sorting, treatment, etc.) of waste, and to inform the public.

In general, anyone who produces or holds waste under conditions that may harm human health or the environment is required to remove such or have it removed under the conditions set out in the French Environmental Code.

The Mayor is the Authority having jurisdiction for ensuring that the legal provisions on waste are adhered to. The *Préfet* can also intervene either if the Mayor does not or, independently, where the waste derives from the operation of a classified facility (because of the *Préfet's* specific authority in this area).

### 2.2 Penalties

Failure to comply with the legal provisions on waste can lead to administrative and criminal liability.

In the event of soil pollution or a risk of soil pollution, or where waste has been abandoned, deposited, or processed in breach of the provisions of the French Environmental Code, the Mayor (or, as applicable the *Préfet*) can automatically have the necessary works carried out, after serving formal notice, at the expense of the liable party.

There are also several types of criminal liability under the legal provisions on waste; For example, abandoning or depositing hazardous waste or having it deposited under conditions that are in breach of the French Environmental Code constitutes a criminal offence.

Similarly, industrial firms may incur civil liability if the surrounding area has suffered unusual damage due to the production of waste. In such cases, those responsible for the risks may be ordered to pay an indemnity and specific performance may be ordered.

## 3. Pollution

The French Environmental Code sets specific rules on soil contamination.

### 3.1 Measures of public information

#### 3.1.1 Establishment of soil information sectors (*secteurs d'information sur les sols*)

Based on the information available and prior to 1 January 2019, the Authorities are under the obligation to establish soil information sectors cataloguing land that is known to be contaminated and therefore potentially in need of soil surveys and pollution management measures in the interests of public safety, health and sanitation and the environment, particularly where there has been a change of use.

Soil information sector documents are appended to local planning documents.

##### a. Consequences for future construction projects inside a soil information sector

Project owners (or developers) now have to undertake soil surveys to seek out pollution and determine what management measures are necessary to make the land suitable for their proposed project.

##### b. Consequences and penalties for property sales and leases

If the buyer or tenant is not informed and if contamination subsequently renders the property in question unsuitable for the use specified in the contract, the buyer or tenant will have a two year period as from discovery of the contamination to apply to rescind the contract or, as applicable, to obtain a partial refund of the sale price or a reduction in rent. Purchasers can also apply for the rehabilitation of the property at the seller's expense where the cost of the rehabilitation is not disproportionate in relation to the sale price.

Since the ALUR Law, sellers have a specific written obligation in the deed of sale to provide environmental information (Article L.514-20 of the French Environmental Code).

### 3.1.2 Establishment of maps of former industrial and tertiary sector sites

Based on the information available, the Authorities will publish a map of former industrial and tertiary sector sites. The planning certificate (*certificat d'urbanisme*) for a given property will indicate whether it is located on a site catalogued on the map or directly on a former industrial or tertiary sector site known to the Authority issuing that document.

### 3.2 Establishment of a hierarchy of liability for soil contamination

In the event of potential or established soil contamination representing a risk to public safety, health and sanitation or the environment due to the use of the land in question, Article L.556-3 of the French Environmental Code grants the competent local Authority the power to formally notify the liable party to take the necessary remedial action or, failing a response from that party, to take such action itself at the expense of the liable party and to compel that party to deposit funds to cover the cost of the actions with a public accounting official (*comptable public*).

The hierarchy of liability for soil contamination is as follows:

- Where the contamination is caused by an activity listed in Article L.165-2 of the French Environmental Code (e.g. collecting, transporting, recycling and disposing of waste) or a classified facility, the last operator of the facility, a person substituting for the operator or the project owner that changed the use of the land, each in accordance with their own obligations;
- Where the cause lies elsewhere, the producer of the waste that caused the contamination or that party in possession of the waste which bears liability therefore due to negligence;
- Alternatively, where there is no liable party in the above two categories, the owner of the property whose soil is contaminated by the above-mentioned activities or waste is located, if it can be demonstrated that the owner was negligent or was involved in the contamination.

## 4. Water Regulations

The French Environmental Code protects water resources and aquatic ecosystems.

Facilities, structures, works and activities carried out for non-domestic purposes and involving withdrawals of surface or ground water, whether or not such are returned, change in the level or dynamics of water flow, destruction of certain areas, or overflows, run-off, waste or deposits are subject to a specific set of rules (referred to as the "IOTA" rules, for *installations, ouvrages, travaux, activités*).

Either an authorisation must be obtained or a declaration submitted for any facilities, etc. that correspond to the above description, depending on the risks and severity of their effects on water resources and aquatic ecosystems (*listed in the "nomenclature eau"*).

For example, work for the purpose of creating a drainage network (3.3.2.0 item of the nomenclature of the Law on Water):

- Over an area superior or equal to 100 hectares (ha) are subject to authorisation; and
- Over an area superior to 20 ha and inferior to 100 ha are subject to declaration.

### 4.1 Authorisation

If the works require an authorisation, the applicant must prepare an application file to be sent to the *Préfet* of the place where the works or the operations are situated. The application must include the location where the facility or works are to be set up and monitoring procedures for any dangers that may arise. A public enquiry is then held, whose procedure may vary depending on the type of works at issue.

Within three months from receipt of the application file sent by the investigating commissioner (*commissaire enquêteur*), the *Préfet* must decide whether or not to grant the authorisation.

The *Préfet* will then notify the applicant of any requirements to be adhered to in building and operating the facility.

### 4.2 Declaration

The applicant must file a declaration with the *Préfet* of the county where the work will be carried out. The declaration must include a statement regarding the impact of the operation on water resources. A receipt for the declaration is provided to the applicant together with any general requirements that apply to the relevant facility.

If necessary, the *Préfet* may also notify the applicant of any requirements that are specific to the operation of the facility.

### 4.3 Effects of an authorisation or declaration

No works may be undertaken before the declaration or authorisation process is complete, or if the *Préfet* denies authorisation or otherwise objects to the works.

If the *Préfet* has issued a declaration receipt or authorisation, the works should be carried out in compliance with the conditions set out in the application file.

### 4.4 Penalties

Any failure to comply with the provisions of the water Regulations may give rise to an administrative or criminal liability.

This is true in particular for facilities or structures that are operated without the required authorisation or the required declaration being submitted. Such cases may result in closure of the facility after formal notice to comply has been served. The offender also risks a prison sentence and a fine.

At the same time, operators may be liable under Civil Law if they have engaged in any act that has resulted in water pollution.

## G. Construction contracts

French Construction Law is highly specific, especially in terms of the different types of contracts that may or must, at times, be used.

The growth of the construction industry has required the creation of special instruments drawn from traditional contracts such as sales agreements, agency agreements or company formation documents.

Four special contracts were successively created in 1967, 1971, 1972 and 1984. These were contracts for the sale of buildings to be developed (the most common type being the off-plan sales agreement discussed in Chapter II - Investing: The real estate acquisition process – Property Law), property development contracts, construction contracts for single-family dwelling units and rent-to-buy agreements (*contrat de location-accession*).

Since construction contracts for single-family dwelling units are used exclusively for housing and rent-to-buy contracts are relatively rare in practice, this chapter does not include a discussion of these two types of agreement.

The basic construction contract under General Law is the services agreement. This contract serves as the basis for the relationships between project owners and the various stakeholders involved in the construction work.

French Construction Law also imposes various obligations on such stakeholders, both in terms of liability and insurance.

The main stakeholders in construction works that we will be referring to in this chapter are as follows:

- The project owner (*maître d'ouvrage*): The person or entity the construction is being performed for;
- The project designer (*maître d'œuvre de conception*): The architect who designs the project and draws the plans;
- The project manager (*maître d'œuvre d'exécution*): The person or entity (usually an architect) that monitors performance of the works, coordinates the various builders/contractors and checks the invoices presented to the project owner. The lead designer and the project manager are sometimes one and the same, in which case the assignment will be referred to as comprehensive project management (*maîtrise d'œuvre complète*);
- Builders/contractors (*locateurs d'ouvrage*): These are the companies in charge of actual performance of works. Only contractors that entertain a contractual relationship with the project owner are liable to that owner, as we will explain later in this chapter.

Other parties may also be involved in the construction process:

- The project owner assistant (*assistant à maître d'ouvrage - AMO*): Owners of large-scale or technically complex projects are often unable to coordinate all of the necessary actions for the technical, administrative and financial organisation of the project. The solution is to call in a specialist to assist them from the early stages of the operation through to completion of the buildings. The main role of the AMO is therefore advisory for the benefit of the project owner;
- The project owner delegate (*maître d'ouvrage délégué - MOD*): In addition to advising the project owner, the MOD may also manage all or part of the project owner's obligations.

## 1. Property development contracts

Under a property development contract, the developer will enter into the covenant to carry out a construction project involving one or more buildings on the project owner's property for an agreed price. The property developer will be in charge of negotiating and entering into all contracts for services with contractors and of handling all or part of the legal, administrative and financial procedures involved in the project.

The developer may also purchase the land in order to complete the project itself. However, this approach requires an off-plan sales agreement (*vente en état futur d'achèvement – VEFA*) rather than a property development contract.

Property development contracts are not widely used in practice due to the rather substantial obligations that these types of contracts entail for the developer.

### 1.1 Features of property development contracts

#### 1.1.1 Distinctive features

In order to qualify as a property development contract, a contract must include certain features.

##### a. Mutually beneficial agency agreement (*mandat d'intérêt commun*)

Under property development contracts, the developer acts on behalf of the project owner. The developer is therefore the project owner's agent, although it bears more extensive obligations than an ordinary agent.

The developer is responsible for having the building constructed using contracts for services and shall be answerable to the project owner for those contractors' obligations.

The developer can also perform the construction works itself, in which case it will bear builders' liability.

Lastly, the project owner cannot terminate the *mandat d'intérêt commun* unilaterally – both parties have to consent.

##### b. Construction projects involving one or more buildings

The developer is responsible for the construction project and acts in the name of and on behalf of the project owner. Property development contracts may also be used for the renovation of existing buildings. In any event, for the contract to qualify as a property development contract, the developer must carry out construction on behalf of the project owner.

The above-mentioned construction obligation is multifaceted and includes the installation of any and all equipment necessary.

##### c. Contract amount

The parties must agree on the price (the cost) for the construction project and the remuneration that the developer is entitled to.

##### d. Differences with other contracts

An agreement where the builder provides house plans qualifies as a construction contract for a single-family dwelling unit, rather than a property development contract, even if the builder acts as the client's agent.

Practice has given rise to delegated project ownership agreements (*contrat de maîtrise d'ouvrage déléguée*) which is a type of agreement governed by the Law applicable to agreements involving public project owners. The project owner delegate is an ordinary agent acting for the client.

The delegate's contractual liability is therefore limited since liability only applies where there is a documented breach.

#### 1.1.2 Mandatory property development contracts

The "protected sector" is a general concept in Construction Law, which refers to the protection of residential and mixed use (residential and professional) buildings.

The "protected sector" should be distinguished from the "open sector" which is composed of buildings used exclusively for business and office purposes.

In principle, the use of a property development contract is mandatory if at least 10% of the building's surface area is intended for a residential or mixed use (residential and professional).

However, there are certain exceptions to this rule, particularly when the developer provides directly or indirectly the land. In this case, an off-plan sales agreement (VEFA) can be used.

Where a property development contract concerns the protected sector, Law strictly regulates the contract and the obligations borne by both the project owner (who must provide a payment guarantee) and the developer (who must provide a completion guarantee).

### 1.1.3 Recordation and form of property development contracts

In the open sector, property development contracts do not need to be signed in accordance with any specific rules and may therefore be drawn up privately. However, if the signatories intend to make the contract enforceable against third parties, this must be enacted in a deed, either drawn up or registered by a notary, in accordance with the mandatory rules governing recordation at the French land registry.

In the protected sector, lawmakers have safeguarded the interests of project owners by regulating the form and content of property development contracts. Moreover, although a notarised deed is not required, the contract will only be enforceable against third parties once it has been recorded at the French land registry.

## 1.2 Rights and obligations of the parties

### 1.2.1 Rights and obligations of the developer

#### a. Rights of the developer

The developer is entitled to take any action required to complete the project (entering into contracting agreements, acceptance of the works, etc.). However loans and disposals entered into by the developer are only binding on the project owner to the extent it has given the developer a specific power of attorney for that purpose – in which case the project owner will be held to the covenants entered into in its name.

#### b. Obligations of the developer

##### i. Obligation to complete construction

The property developer has an obligation to complete the building. In other words, it is under the obligation to produce a specific result (*obligation de résultat*). If the developer fails, it is presumed to be in default and only a *force majeure* event (an unforeseeable, irresistible and extraneous event) may reverse this presumption, provided that the developer has not committed any breach of contract or negligence.

##### ii. Responsibility for cost overruns

Once the contract has come to an end, the parties must agree on the final accounts for the project.

If construction costs do not overrun the agreed amount, the owner should accept the expense amounts. However, the project owner can seek to incur the developer's liability if it is able to prove that the developer incurred unreasonable costs.

The agreed amount for the construction of the building should not be considered as remuneration for the property developer, but merely as the maximum cost authorised by the project owner. Savings are not supposed to benefit the developer, although the parties may decide otherwise.

The developer is presumed to be liable for any extra cost, i.e. beyond the agreed price, incurred through its own actions or those of the people acting under its responsibility. The developer may only claim a refund for extra costs incurred due to misconduct on the part of the owner.

In practice, the parties may agree to include a line item in the accounts for "unforeseen expenses" giving the developer some leeway. In this case, the content and conditions for using this line item must be clearly defined.

##### iii. Warranties and guarantees provided by the developer

The developer guarantees the satisfactory performance of the construction project to the project owner, whether the construction is carried out by the developer itself or by independent contractors as agreed with the developer. The developer will therefore bear the two-year (*biennale*) and ten-year (*décennale*) builders' liability stipulated by Law, as well as the General Law liability. These specific warranties will be defined and described in further detail below.

The developer guarantees the fulfilment of any obligations incumbent upon the persons – including contractors – with whom it has dealt on the owner's behalf. Since the developer acts as guarantor, there is no reason for the project owner to first take action against the relevant contractor.

If the developer itself has carried out the building works, then like any builder it will be liable towards the owner under the warranty covering final completion (*garantie de parfait achèvement*) for any construction defects for a period of one year following acceptance of the works.

The developer will therefore always be liable under the ten-year and two-year construction warranties, but will only be liable under the warranty covering final completion when it also acts as the builder. This is because only the contractor carrying out the works is bound, for one year starting from acceptance, to remedy any and all snagging items recorded upon acceptance or during the one-year warranty period. This one-year time period is known as the final completion period (*parfait achèvement*).

Accordingly, when seeking to incur the liability of other contractors, the developer must establish that they are in default. This will put the developer in a rather complicated situation since, in contrast, the project owner can seek to incur the developer's liability without having to prove any misconduct on the part of the latter.

Aside from these cases, developers are liable towards project owners for any proven breach of contract. Lastly, developers may be liable in tort and quasi-tort with regard to third parties. In such cases, General Law governing liability applies.

#### **iv. Transferability of property development contracts**

The property developer cannot assign the property development contract or substitute a third party without the owner's prior consent.

### **1.2.2 Rights and obligations of the project owner**

#### **a. Right to assign the contract**

The project owner enjoys the right to assign the property development contract, which is essentially an option to assign the entire project. Owners may do this without the developer's permission. However, the assignor of the property development contract remains jointly liable with the assignee for all obligations arising from the contract.

#### **b. Obligations towards the developer**

The owner must pay the agreed contract amount to the property developer, including construction costs and the sum agreed as consideration for the developer's work.

The owner should also agree with the developer on the final accounts. Acceptance of final accounts for the construction project should be differentiated from acceptance of the work (see below).

#### **c. Obligations towards third parties**

The project owner, as principal, is bound by any deeds signed by the developer as part of its role.

The owner must perform the covenants the developer has entered into on its behalf pursuant to the authority the developer holds by Law or by virtue of a property development contract. However, the French Civil Code provides that loans contracted or acts of disposal entered into by the developer are only binding on the building owner if the contract or a subsequent instrument contains a special agency agreement.

### **1.3 End of the contract**

The developer's assignment will end with delivery of the works, on the condition that the accounts have been settled finally between the project owner and the developer, without prejudice to any actions for damages the owner may be entitled to bring against the developer.

Property development contracts may also be terminated by mutual consent or through legal proceedings.

Court-ordered reorganisation or liquidation does not automatically entail the termination of a property development contract. Any provision to the contrary in the contract will be considered null and void.

### **1.4 Insurance**

The developer is required to underwrite insurance policies covering both its own liability as a builder (insurance covering the ten-year warranty) and its liability as the owner's agent.

The developer can also underwrite insurance covering civil liability, for example, to cover cost overruns.

## **2. Contracts for services**

### **2.1 Definition of a contract for services**

Under a contract for services, the service provider – generally referred to as the “contractor” – covenants along with the project owner to plan, make, process, transform, start up or repair something or to achieve a particular result, in exchange for consideration.

The contractor may be entrusted with completing the construction works (including the supply of building materials) or it may simply make use of the materials supplied by the project owner. Whether or not the contractor supplies building materials has legal and financial effects on the risk of loss or damage to materials prior to acceptance of the works.

Contracts for services can include construction or civil engineering. Only private works will be discussed below.

## 2.2 Entering into a contract for services

The contract for services may be negotiated directly between the project owner and the contractors, or the project owner may issue a call for tenders and award the contract to the lowest bidder.

Although in principle contracts entered into between traders do not have to be written and can be demonstrated using any type of evidence, in practice, contracts for service are generally written, especially when they involve large sums of money.

Parties may also include references to various standards in their contracts, the most common being the AFNOR P03-001 standard. This standard is not mandatory and is only binding on the parties if they have expressly agreed to apply it. If this is the case, the standard will be used as the general framework of the technical and legal terms and conditions applicable to the contract.

Parties can always conclude special agreements to exclude the application of certain provisions of the standard.

## 2.3 Contract amount

Contracts for services are valid even if no price is stipulated, although in practice, parties will set out a clear contract amount.

### 2.3.1 Lump sum contract (*marché à forfait*)

A lump sum contract cannot be used for subcontracting, since the project owner must be a party to it. This type of contract can only involve building construction or rehabilitation, ruling out civil engineering works. Lump sum contracts are frequently used in practice.

A lump sum contract provides that the contractor will be paid a negotiated fee which is fixed at inception of the contract. It normally requires the contractor to complete and deliver the works within the estimated cost.

Lump sum contracts are fixed maximum price contracts for the work defined therein. Therefore, the lump sum cannot apply to each work package separately, but must apply to the work as a whole. The maximum price can be adjusted under certain circumstances.

Work specifications must be clearly set out and cannot be modified. A contract containing a clause that allows the project owner to alter the plans or outline of the works would not qualify as a lump sum contract. The project owner cannot change the construction project that was initially defined in the contract and any additional works should be agreed on by the parties for a specified price.

Payment for additional work is, however, possible, even without the project owner's consent, in cases where there has been a *disruption of the contract structure*. The disruption must arise on the initiative or following the wishes of the project owner.

### 2.3.2 Unit price contract (*marché sur prix unitaire ou au mètre*)

In unit price contracts, the total price is calculated by applying unit prices to the amount of work actually completed (e.g., a price per square metre). Prices may either be based on pre-existing lists or specifically prepared for the project in question.

### 2.3.3 Other types of contract

- Contracts based on estimates: This type of contract is based on an overall price estimate;
- Contracts based on justified expenses: Under this type of contract, works are paid for on the basis of supporting documents submitted by the contractor.

## 2.4 Obligations of the contractor

### 2.4.1 Duty to advise

Contractors have a duty to advise that arises from Case law. When contractors (including architects or engineers) are instructed to conduct preliminary technical studies, they have a duty to offer up advice regarding all risks involving both the structure to be built and existing structures such as neighbouring buildings or parts of the building that are undergoing renovation.

The duty to advise is part of the contractor's relationship with the project owner and the other contractors.

Contractors cannot be held liable for a breach of their duty to advise if the project owner has deliberately concealed certain items of information or if it uses the work for any other purpose than originally intended.

Under contracts for services, contractors also have an obligation to only take on work they are actually qualified to perform.

### 2.4.2 Performance

Contractors should perform works with due care, in a good and workmanlike manner, in accordance with the contract provisions and with best practices as codified in the “unified technical documents” (*documents techniques unifiés* – DTU). DTUs, however, are only applicable if expressly referenced in the contract.

Recent Case law has held that a contractor’s liability is limited to the obligations provided in the contract.

Contractors are also liable for any defective materials they supply.

### 2.4.3 Compliance with timeframes

The contractor is required to comply with all timeframes set forth in the contract. If work is behind schedule, the project owner will be entitled to seek compensation from the contractor or to enforce the liquidated damages clause if there is one.

As a reminder, French Courts have the power to assess liquidated damages clauses and can reduce or increase their amount if they find them to be manifestly excessive or derisory.

### 2.4.4 Holdback (*retenue de garantie*)

If the contract includes a holdback provision, the project owner can withhold up to 5% of the contract amount from each payment made to contractors. The amount withheld must be entrusted to a third party.

Holdback can be avoided if the contractor provides a bank guarantee.

The purpose of the holdback is to compel the contractor to remedy any and all snagging items. Case law has held that the holdback amount can also be used in cases where the contractor does not perform the work, and especially in cases of abandonment of the construction site. On the other hand, it cannot be used to cover penalties for late performance.

In principle, the holdback amount will be released by the project owner at the end of the final completion period (*parfait achèvement*), once all of the snagging items have been remedied by the contractor.

The project owner may prefer to rely on a non-performance exception (*exception d’inexécution*) rather than a holdback or bank guarantee. In this case the contractor will be paid in full each time payments are due.

### 2.4.5 Subcontracting

Contractors may decide to subcontract part of the construction work to another company, referred to as a “subcontractor”. Subcontracting is governed by a Law adopted in France on 31 December 1975. Most of its provisions are rules of public policy.

#### a. Relationship between the general contractor and subcontractors

The general contractor has a direct contractual relationship with the subcontractor.

The Law requires the general contractor to provide subcontractors with a guarantee for all amounts owed to them. The guarantee may be provided through a joint and several guarantee or by direct payment from the project owner to the subcontractor.

The subcontractor is under an obligation to provide a specific result to the general contractor, but does not owe the mandatory two-year and ten-year warranties to the project owner. Only the general contractor owes these legal warranties to the project owner.

#### b. Relationship between the project owner and subcontractors

Subcontractors and their terms of payment require the project owner’s express or implied acceptance. Without such acceptance, the general contractor will not be able to rely on the subcontract with regard to the project owner. The general contractor must, however, respect its contract with the subcontractor even if the project owner’s acceptance has not been obtained.

Where the subcontractor has not been approved and the project owner learns of the subcontractor’s existence, the project owner must formally demand that the general contractor obtain its approval of the subcontractor. If the project owner does not make this formal demand, it could be required to pay a sum of money to the subcontractor through a “direct action”.

A direct action brought by a subcontractor against a project owner is restricted to (i) work performed by the subcontractor and (ii) the amounts the project owner still owes to the general contractor at the time the subcontractor brings the direct action. The subcontractor must observe specific rules for serving formal notice, in order to be entitled to bring a direct action.

## 2.5 Obligations of the project owner

Project owners are prohibited from interfering with construction work or running the construction site. If they do interfere, they may incur third-party liability.

### 2.5.1 Payment of the works

Payments are made periodically as the work progresses and the materials are supplied. If an architect is involved, it must verify the invoices submitted by the contractor.

### 2.5.2 Payment guarantee in favour of contractors

Project owners that have executed work for more than EUR 12,000 are required to issue a payment guarantee, minus any down payments and advances paid when the contract was signed. The payment guarantee is required by Law regardless of whether any outstanding monies are due.

A guarantee by direct payment (*garantie par paiement direct*) is used when the contract is financed by a specific loan granted entirely and exclusively for the construction works. In this case, if the contractor has not received full payment for the debt owed on the contract, the bank must pay the loan amount directly to the contractor or its designated agent. The bank has specific obligations including the obligation to release the funds only after receiving written instructions from the project owner.

A guarantee by contractual stipulation, or joint guarantee, is used when the construction works are not entirely and exclusively financed through a bank loan and when the contractor has been given no other guarantee (e.g. an escrow account, cash with order, etc.).

If the contractor has not been provided with any of the above types of guarantee and monies are due for payment under the contract, the contractor may suspend work if the project owner has not paid within a period of two weeks from receiving notice to pay from the contractor.

## 2.6 End of the contract

### 2.6.1 Acceptance of completed construction works (*réception de l'ouvrage*)

According to the French Civil Code, acceptance (*réception*) is the act whereby the building owner declares that it approves the works either with or without any snagging items (*réserves*). Snagging items are issues involving defects, disturbances or non-compliance with specifications that are raised at the time of acceptance. These issues must be resolved in order for the snagging items to be remedied within the one-year final completion period following acceptance (*parfait achèvement*).

Acceptance occurs at the behest of the first requesting party acting voluntarily or, if not, through Court. Acceptance is an act involving the participation of all parties, although the project owner is the only party that actually decides whether or not to accept the work.

#### a. Features of acceptance

Acceptance is a unilateral action taken by the project owner. The project owner deems that the work is complete and decides to accept such. At the same time, acceptance occurs with due participation of the parties. The contractor must be duly invited to attend the acceptance meeting in accordance with contractual stipulations. If a contractor has been duly invited but decides not to attend, acceptance recorded by the project owner alone is fully valid.

Acceptance is given once and for all and may be given with snagging items. In light of the practical issues that this may raise in cases involving extremely large or complex works, in practice both pre-acceptance (*pré-réception*) and partial acceptance is possible. Partial acceptance for works as per work package (plumbing, electricity, etc.) or as per contractor has the disadvantage of spreading out the commencement dates for full completion deadlines and for the legal warranties that contractors must provide. By contrast, pre-acceptance has the advantage of allowing any problems to be remedied before the acceptance visit, thereby getting rid of many snagging items. The pre-acceptance process is generally described in the contracts.

Acceptance usually takes place voluntarily. In certain cases, acceptance may be established through Court, especially where the project owner has unreasonably refused to accept the construction works. Refusal can only be justified due to a failure to complete the works or where there are very serious defects tantamount to a failure to complete the works.

In addition, Case law has held that there is such a thing as implied acceptance under certain circumstances. This requires evidence of the project owner's unambiguous intent to accept the works. In principle, the fact that the project owner has settled into the premises does not suffice to qualify implied acceptance. The Courts will assess the project owner's intent on a case-by-case basis.

Acceptance may be given with snagging items that the contractor must have remedied within a certain timeframe. In order to do so, the contractor must remedy defects or problems that are noted on the minutes of acceptance (*procès-verbal de réception*).

#### b. Effects of acceptance

Acceptance signals the end of the contractual relationship with the project owner except with regard to any remaining snagging items yet to be remedied. Acceptance also transfers custody of the work from the contractor to the owner.

Obvious defects that are not the subject of any snagging items noted in the minutes of acceptance are deemed to have been accepted by the project owner, who cannot thereafter seek to incur the contractors' liability (except for the project manager, who may still be liable for any breach of its duty to advise).

In particular, acceptance marks the start of the various warranties borne by the contractors (mandatory two-year and ten-year warranties, as well as General Law liability), as will be explained below.

### **c. Recording acceptance and snagging items**

In principle, the project owner must sign a set of minutes, i.e. a document stating that it agrees to accept the work.

Acceptance may be implied where the project owner's intent is unambiguous. Case law has held that acceptance is implied where the project owner has taken possession of the work, paid the contractor for the project, and where the declaration of completion of works has been signed. If the project owner merely takes possession of the work or pays the contractor, this alone is not sufficient to qualify implied acceptance.

The project owner must have the minutes of acceptance served on the contractors and communicated to any other stakeholders such as engineers or technical inspectors, where applicable. The project manager is in charge of drawing up the minutes of acceptance, which it must also sign together with the project owner.

Project owners must provide reasons for any refusal to accept the works; failure to do so qualifies as unreasonable.

All defects noted at the time of acceptance and any problems that emerge thereafter and that the project owner notifies in writing within a period of one year from acceptance will fall within scope of the warranty covering final completion (*garantie de parfait achèvement*) owed by the contractor (**please refer to Chapter IV - Section H**). The contractor must resolve these issues, and the project owner must define and notify the contractor of any repair works to be carried out. In general, the parties agree on a deadline for repairs.

Once the defects and issues giving rise to snagging items have been resolved, a report will be drawn up to record the "remedial of snagging items" (*procès-verbal de levée des réserves*), which must also be signed by the project owner.

However, if the contractor does not carry out the necessary works to remedy the snagging items within the deadline, those works can be carried out at the defaulting contractor's expense and risk. The project owner then being entitled to object to paying the 5% holdback amount. If the project owner does not object, the holdback amount is automatically paid one year after acceptance.

### **2.6.2 Termination of the contract for failure to perform**

If the contractor does not perform the works in accordance with the terms of the contract or becomes bankrupt, it is not entitled to any further payment under the contract. Upon completion of the works, accounts will be drawn up between the project owner and the contractor. If the unpaid balance on the contract price exceeds the cost of works remaining, the project owner will pay the contractor for those portions of the works that were payable or completed at the time of default. However, if the cost of the works remaining exceeds the unpaid balance, the contractor will be required to pay the difference to the project owner.

### **2.6.3 Court-supervised insolvency proceedings**

If the project owner goes into court-supervised insolvency, any automatic termination clauses that may have been provided for this purpose in the contract are null and void. The contractor must continue the construction works as long as it is paid. However, in the event of payment default, the contract will be automatically terminated.

## **2.7 Final settlement of accounts**

The final settlement of accounts is separate from acceptance of the works. A statement of the remaining balance owed to the contractor will be established by the contractor and sent to the project owner and the project manager, who is responsible for verifying this. Once accepted by the project owner, the final settlement of accounts shall become final and may no longer be challenged.

The only way the project owner can subsequently challenge the statement is to prove some fraud (e.g. demonstrate that the contractor and the project manager engaged in fraudulent collusion) or an error in calculation. The AFNOR P 03-001 standard sets out a specific process for drawing up a final settlement of accounts.

### 3. Ancillary contracts

#### 3.1 Design contract

Before any work is performed, the project manager is usually responsible for conducting preliminary studies relating to the project owner's proposed programme and to the land where the construction operation is planned, drafting the technical specifications once the final design draft is established, and choosing the materials to be used for the construction project.

The project manager will also assist the project owner in preparing and submitting the planning permission application and awarding works contracts.

#### 3.2 Project manager contract

During performance of the works, the project manager may be responsible for two main tasks. The first is managing performance of the works by drafting service orders, providing information and instructions to the contractor, leading study meetings and worksite meetings, and coordinating the various contractors working on the site. The second is monitoring work progress and performance.

In addition, the project manager must comply with the committed financial budget and verify work details and pay requests prepared by contractors.

Lastly, the project manager will be responsible for assisting the project owner during the work acceptance process.

#### 3.3 Assistant project owner contract

In order to carry out its construction operation, the project owner may call on a project owner assistant for advice and assistance in the performance of all or some of its obligations. This project owner assistant may be entrusted with general as well as limited and specific tasks in particular areas or at different stages of the construction process.

The project owner assistant is a service provider with a best endeavours obligation (*obligation de moyen*) towards the project owner. The project owner assistant has no power to represent the project owner, who continues ultimately to have control over the project and serves as a single point of contact for the various building trade contractors.

#### 3.4 Project owner delegate contract

When it does not have the necessary skills to carry out a real estate construction operation or major works, the project owner may delegate its powers to a third party. Delegated project ownership was standardised by the Law of 12 July 1985 regarding public project ownership but is not the subject of any particular regulation within the framework of private-sector contracts. Practitioners have therefore developed a substitute for the real estate development contract subject to the rules of the General Law agency agreement.

The project owner's representative performs legal acts usually intended for the project owner. As a representative, the acts that it carries out during the term of the agency agreement and within the limits of the powers conferred are binding on the project owner with regard to third parties. However, this delegation of authority does not imply any delegation of liability, since the project owner's representative is held only to a best endeavours obligation and is liable only for errors committed in the course of fulfilling the agency agreement. The contract may entrust the project owner's representative with the performance of material and/or intellectual acts, as long as such acts are ancillary to the task of representation. Otherwise, it risks being reclassified as a works contract or a property development contract.

## H. Liability and insurance

### 1. Contractors' liability

In carrying out their works, builders incur the following types of professional liability.

#### 1.1 Specific builders' liability

The ten-year warranty (*décennale*), the two-year warranty (*biennale*) and the warranty covering final completion (*garantie de parfait achèvement*) described below derive from public policy provisions. They therefore cannot be limited or otherwise amended by contract. Any clause to the contrary would be deemed invalid.

### 1.1.1 Ten-year builders liability (*responsabilité décennale des constructeurs*)

Contractual liability under French Law requires proof of misconduct, loss or damage suffered and a causal relationship between the two.

The provisions on the liability of builders contain set up specific rules for certain types of construction problems.

#### a. Ten-year warranty

The ten-year warranty places a presumption of liability on the builder (Article 1792 of the French Civil Code).

The project owner need only establish the existence of a problem and is not required to prove that the contractor has committed any misconduct.

The presumption of liability means that:

- There is no need to prove the contractor has committed any misconduct;
- Contractors cannot escape their liability by proving that they have not committed any misconduct, but only by proving that the problem arises from a *force majeure* event or misconduct committed by the owner or a third party; and
- Any limitation or exclusion of liability clause is legally void.

This warranty may give rise to the payment of damages or to a duty to repair the defective works.

#### b. Damages covered by the ten-year warranty

The presumption of liability borne by the contractor does not cover all problems that may affect the construction work.

It covers two types of damage, which cannot have been apparent upon acceptance:

- Damage that causes the construction to be unsafe; and
- Damage that makes the building unfit for its intended use. In this case, it is irrelevant whether the problem affects a constituent part of the building, or equipment that forms an integral or non-integral part of the building – the ten-year warranty applies if the problem in question makes the entire work unfit for its intended use.

The ten-year warranty is applicable for ten years as from acceptance.

Although the Law of 17 June 2008 reforming limitation periods allows the period for contractual liability to be adjusted (the ordinary five-year limitation period for contractual liability can be reduced to a minimum of one year or increased to a maximum of ten years), it is not possible to amend the warranty period applicable to building contractors, particularly the ten-year warranty period.

French Law makes a distinction between integral and non-integral parts: Whether or not equipment is an integral part of the building is an essential condition defining the scope of the two and ten-year warranties. The ten-year warranty applies to equipment which forms an integral part of the building. Equipment is considered an integral part where it cannot be removed, dismantled or replaced without damaging or taking away part of the building. This would include tiled flooring, paving covering external façades, plumbing embedded in a concrete slab, etc.

The ten-year warranty does not cover aesthetic damage.

#### c. Persons concerned

##### i. Persons liable for the builders' warranty

Persons deemed "builders" for the purpose of the ten-year warranty include the following:

- Architects, contractors, technicians or anyone else with a contract for services with the owner;
- The seller of the building, whether the building is sold subject to completion or off-plan;
- The developer; and
- Builders of single-family dwelling units.

Subcontractors are not liable towards the project owner under the ten-year warranty. They can only be directly targeted through legal actions brought on the grounds of liability under general Law. The project owner must show that they committed misconduct which caused the damage in question. However, the general contractor shall bear a ten-year liability for works it has subcontracted.

##### ii. Persons covered by the warranty

The persons covered by the ten-year warranty are the following:

- The project owner, namely the owner of the land or building, as well as the holder of the right to build and for whom the construction is being developed; and
- The buyer and any subsequent buyers of the work, as long as the acquisition takes place within a period of ten years as from acceptance of the works.

Tenants, finance lessees and generally anyone that does not have a genuine ownership right over the building is not entitled to coverage under the ten-year builder warranty.

### **1.1.2 Two-year warranty covering for the proper working order of equipment (*responsabilité biennale des constructeurs*)**

This warranty covers problems affecting equipment that do not form an integral part of the building and that do not make the construction unsafe or unfit for its intended use. This warranty lasts for two years as from acceptance of the works.

Liability parties and beneficiaries of this warranty are the same as for the ten-year warranty.

If a problem affecting a non-integral part of the building causes the entire construction to be unfit for its intended use, the ten-year warranty, and not the two-year warranty, should apply.

### **1.1.3 Warranty covering final completion (*garantie de parfait achèvement*)**

The warranty covering final completion applies to all obvious defects identified by the project owner on the day the work is accepted or within a period of one year as from acceptance.

Defects caused by non-compliance come under the warranty covering final completion, which therefore has a broader scope than the two and ten-year warranties.

Only the contractor concerned by the problems the project owner has noted is liable under this warranty.

## **1.2 Liability under General Law**

The fact that builders owe specific warranties does not preclude any liability that applies under General Law.

### **1.2.1 Contractual liability**

#### **a. General Law liability prior to acceptance**

Prior to acceptance, builders are subject to general provisions on contractual liability for all losses sustained by their clients. General Law liability also covers problems recorded as snagging items in the minutes of acceptance. The project owner has the choice between relying on the warranty covering final completion (as explained above) or seeking to incur the liability of the contractor under General Law. However the latter option is fairly theoretical and rarely used in practice.

#### **b. General Law liability subsequently to acceptance**

The French Supreme Court has ruled that damage likely to be covered by the two-year or ten-year warranties should be remedied under these specific liability rules. Close attention must therefore be paid to the grounds that the project owner has cited in support of its action for damages.

Liability under General Law is therefore of interest for those damages which are not covered by those warranties, such as "intermediate" problems (i.e. problems that do not meet the criteria for ten-year or two-year liability). Works that fail to comply with the contract specifications but that do not make the building unsafe or unfit for its intended use is covered under general liability, and not the two or ten-year warranty.

#### **c. Rules for liability under General Law**

The project owner or qualified subsequent owner of the building must prove that the contractor is responsible for:

- Delayed completion;
- Failure to comply with the budget; and
- Defects which do not make the building unsafe or unfit for its purpose, referred to as "intermediate damage".

Contractors' liability can be of two types, depending on what type of obligation is specified in the contract. They may have a best endeavours obligation (*obligation de moyen*) or a performance obligation to produce a specific result (*obligation de résultat*). Requirements to fulfil material obligations are considered to be performance obligations, whereas obligations involving intellectual work (architects, engineers, etc.) are considered to be best endeavours obligations. Under a performance obligation, the builder is presumed liable and can only escape liability by proving it has committed no misconduct. Conversely, under a best endeavours obligation, the project owner must specifically show that misconduct has been committed in order to hold the contractor liable.

In either case, the project owner must prove that it is seeking compensation for damage that actually exists.

### **1.2.2 Liability in tort towards third parties**

This type of liability generally involves actions brought by tenants and neighbours.

For such action to succeed, the standard usual criteria must be satisfied: misconduct committed by the contractor (this may be in combination with misconduct of the project owner), loss or damage sustained by a third party and a causal relationship between the two.

Case law has mainly developed the concept of unaccustomed disturbance to neighbours (*trouble anormal de voisinage*) which includes:

- Disturbances resulting from the construction site (noise, dust, etc.);
- Damage to the structures of neighbouring buildings owing to the construction works. It is worth initiating preventive proceedings for a pre-works schedule of condition (*référé préventif*) before beginning any construction works to document the pre-construction condition of the neighbouring buildings; and
- Problems involving the amenities of a neighbouring building (loss of an unimpeded view, loss of light/sunlight, etc.) due to construction of the new building.

Actions based on unaccustomed disturbance to neighbours can target project owners and contractors alike. Claimants do not need to establish that misconduct has been committed to obtain compensation; they need only demonstrate that they have sustained a loss.

## 2. Insurance

Construction sites that cause no damage are rare. In fact, construction of a building can entail substantial financial claims. Given these conditions, insurance is central part of French Construction Law. It is interesting to note that the current Regulations for builders' liability, established under the "Law of 1978", are derived from a reform whose initial purpose was limited to construction insurance.

### 2.1 Required insurance under French Construction Law

#### 2.1.1 General features of the required insurance

There are two types of mandatory insurance for the ten-year warranty: One covering the building and the other covering the builder.

Before works even begin, the project owner (the owner or seller of the future building) is required to underwrite an insurance policy for construction work damage (*assurance dommages-ouvrage*) covering the building for the owner and subsequent owners of the building. This is a type of property insurance intended to fund repair works that fall within the scope of the ten-year warranty, regardless of who is liable. This policy therefore provides advance financing for any works necessary to repair problems covered under the ten-year warranty.

National and local Authorities are exempt from taking out the required insurance when acting as project owners.

Contractors (including architects and generally any parties that may incur ten-year builders' liability), in their capacity as builders, must also underwrite liability insurance for the ten-year builders' warranty. As explained above, the insurer for construction work damage provides advance financing for repairs that come under the ten-year warranty without any need for the project owner to establish liability. That insurer may then bring a subrogated claim (exercising the project owner's rights) against any parties responsible for the problems in question and who are liable under the ten-year warranty.

These legal insurance requirements mean that stakeholders involved in the construction process must successfully find an insurer. Insurance companies therefore bear an obligation to provide insurance. If a contractor cannot find an insurer, it can apply to the Central Pricing Bureau (*Bureau central de tarification*), which will order an insurer to agree to cover the risk for a given premium.

The French Insurance Code (*Code des assurances*) sets out various criminal penalties for parties who fail to observe these two insurance requirements; These include a maximum prison sentence of six months, a fine of EUR 75,000, or a combination thereof. These penalties do not apply to persons who are building housing as their residence or a residence for their spouse, children or parents.

#### 2.1.2 Construction work damage insurance (*assurance dommages-ouvrage*)

Construction works damage insurance includes optional and mandatory coverage.

Its purpose is to cover repair works for all damage resulting from the construction works and affecting the building that builders are liable for. The damages to be repaired must therefore be covered under the ten-year warranty. If this is not the case, the construction work damage insurance will not apply (save where the policy has been extended to cover other types of damage).

In principle, construction work damage insurance must cover the total final cost of the construction repair work. Initially, insurers could not set coverage limits and were therefore

required to provide coverage for all repair works, even if the cost of the repairs was higher than the price of the construction work itself.

However, since a 2006 Reform, which was completed by Order No 2009-1422 of 22 December 2008, insurers may now stipulate limits of coverage for repair works on constructions for non-residential use only.

Since the implementation of the Reform, the amount covered under construction work damage insurance can now be limited to the total cost of construction declared by the project owner, with the exception of constructions for residential use. In addition, for projects involving construction costs exceeding EUR 150 million, the coverage amount can be capped below the total construction cost declared by the project owner, however the coverage amount cannot be lower than EUR 150 million (Article R.243-3 of the French Insurance Code).

At the same time, the option to limit coverage was also provided for ten-year builders' liability policies.

Only works on buildings are covered under this type of policy, and not civil engineering works.

Construction work damage insurance covers subsequent buyers of the building for as long as the policy lasts. It normally takes effect after the warranty of final completion expires, i.e. one year after the acceptance date. However, even before acceptance, mandatory construction work damage insurance can be used to cover problems in cases where the contract has been terminated by the project owner due to the contractor's failure to perform its obligations and the project owner has given formal notice to the contractor. This policy can also be used after acceptance when, during the one-year final completion period following acceptance, the contractor has not carried out the necessary repairs after receiving formal notice to do so from the project owner.

Construction work damage insurance ends ten years after the acceptance date.

The process for making a claim under mandatory construction work damage insurance and the insurer's payment of indemnities is regulated by Law.

The Law provides deadlines for payments on claims. The insurer must indicate its position regarding implementation of the policy within 60 days from receipt of the claim. The insurer also has 90 days as from receipt of the claim to notify its compensation proposal.

If neither of these deadlines is met, the insurer must pay and the insured party will be entitled to incur the expenses necessary to repair the underlying problem. Interest at double the statutory rate will then apply to the insurance proceeds.

However, if exceptional difficulties are experienced, the insurer can obtain an extended deadline of no more than 135 days.

A claim form must include certain mandatory details on the insurance policy and the loss in order to be valid. The insurer has ten days from receipt of the claim to notify the insured party that the claim form is invalid and to ask for the missing information. The abovementioned 60 and 90-day deadlines only begin to run upon submission of a complete claim form. If the insurer does not react within 10 days of receiving an incomplete claim form, the 60 and 90-day deadlines are considered to have retroactively begun to run as from the date the insurer received the claim.

In principle, the insurer can appoint a claims adjuster to ascertain whether the damage is covered by the policy (i.e. that it comes under the ambit of the ten-year warranty). The insurer may decide not to do so if after a simple review of the claim, it decides that the claim is unjustified or if the damage is valued at under EUR 1,800. In this case, the insurer must give the reasons for refusing to appoint a claims adjuster within a period of fifteen days from receiving the claim. If the insured party contests this decision, it can have a claims adjuster appointed. In fact, the insured party is required to first seek voluntary expert review by a claims adjuster before bringing any legal action against the insurer.

It is usually compulsory to underwrite construction work damage insurance before starting works save for (i) public entities, (ii) legal entities acting as project owners as part of a PPP and (iii) legal entities of a certain size (in turnover and number of employees) where the buildings constructed by these persons are zoned for any purpose other than residential.

### 2.1.3 Mandatory liability insurance

Construction work that qualifies for the ten-year builders' warranty must be insured.

As a reminder, the ten-year warranty covers damage that makes the work unsafe or unfit for its intended use. This warranty is a public policy requirement, builders are presumed liable unless they can demonstrate the damage arises from an external cause, i.e. from a *force majeure* event or misconduct committed by the project owner or a third party.

Builders and other parties treated as builders by Law (architects, contractors, technicians or any other party with a contract for services with the project owner) and the seller of the completed building (if that seller built the structure or had it built), are required to underwrite insurance for this type of liability.

## 2.2 Optional insurance

### 2.2.1 Optional damage coverage

Mandatory construction work damage insurance is only for damage covered by the ten-year warranty, i.e., damage that makes the building unsafe or unfit for its intended use.

Additional insurance policies may be underwritten for damage suffered by existing structures (e.g., for renovation works) or by facilities or equipment that come under the ambit of the builders' two-year warranty or even certain types of consequential losses such as loss of rent (*garantie de perte de loyers*).

Coverage amounts in all of these optional policies can be capped.

As a reminder, builders bear various types of liability, they may underwrite insurance for:

- Specific liability, such as that covered by the ten-year warranty (mandatory insurance), two-year warranty and warranty covering final completion;
- General contractual liability if the criteria for specific liability are not met; and
- Liability in tort for damage to third parties.

Only works referred to as using "standard techniques" (*technique courante*) is automatically covered under liability policies. The materials and processes defined in documents that set standards, such as French DTU standards (uniform technical documents), fall under this category.

If builders use non-traditional processes or materials, insurers are free to set both technical and pricing conditions for coverage on a case-by-case basis. The contractor must then have the insurer issue a document certifying that the contractor carries insurance coverage.

### 2.2.2 Comprehensive site risks policy (*police tous risques chantier* – TRC)

This is an insurance policy underwritten by the project owner or the contractor in addition to the mandatory construction work policy.

Comprehensive construction site insurance is intended to apply during the actual construction phase and the one-year final completion period following acceptance.

During the construction phase, any accidental material damage affecting the building or any temporary work necessary for the construction or the materials, equipment or fixtures on the construction site that are to be incorporated into the building are covered. Damage to existing structures during the construction phase can also be covered by such policies.

During the one-year final completion period following acceptance, the comprehensive site risks policy covers accidental damage to the building for causes arising prior to acceptance or due to blunders, negligence or misconduct committed by the builders returning to the site to resolve any snagging items.

The purpose of comprehensive insurance is to finance repairs and therefore applies regardless of which party is liable. The policy is intended to provide indemnities quickly to avoid delays in completing or commissioning the work.

### 2.2.3 Global site risks policy (*police unique de chantier* – PUC)

This policy brings the construction work damage insurance and the builders' ten-year liability together under a single policy.

It can cover the project owner, subsequent building owners, architects, engineering firms, contractors, subcontractors, property developers, sellers of the future building, etc. Its purpose is to fund repairs to problems with the building that fall within the scope of the builders' ten-year warranty.

For all insured parties, coverage is limited to the final total cost of the work.

## I. Tax issues

### 1. Non-commercial partnerships for the construction and subsequent of property sale

Non-commercial partnerships whose corporate purpose is the construction and subsequent sale of buildings, commonly called "SCCV", may be eligible for a preferential tax regime, codified in Article 239 ter of the French Tax Code, under certain conditions.

They then avoid corporate tax (which non-commercial partnerships are normally subject to when they engage in an activity considered commercial for tax purposes, such as a construction/sale activity) and are subject to the same tax regime as commercial partnerships carrying out the same operations.

The partners (and not the company itself) are taxed on the profits made by the non-commercial partnership in proportion to their rights, according to the tax regime specific to them (personal or corporate income tax).

## 1.1 Terms of application of the “preferential” regime

### 1.1.1 Form and articles of association of the partnership

In order to be able to claim application of the preferential regime, the partnership must be established as a non-commercial entity. Joint stock companies and limited liability companies are therefore excluded from the preferential regime. Similarly, with some exceptions<sup>1</sup>, non-commercial partnerships resulting from the conversion of a company with another form are not eligible for the regime under Article 239 ter of the French Tax Code.

The application of the special regime is also subject to the condition that the articles of association of the non-commercial partnership for the construction and subsequent sale of property provide for the unlimited liability of the partners as regards corporate liabilities. This liability is exercised over all their assets in proportion to their ownership rights in the company.

### 1.1.2 Corporate purpose

The specific regime applies only to companies whose corporate purpose is the construction of buildings for their subsequent sale.

The corporate purpose specified in the articles of association and the actual activity must be strictly identical: A non-commercial partnership whose corporate purpose does not include the construction of buildings for their subsequent sale cannot benefit from the provisions of the special regime, even if it engages exclusively in such activities (CE, 24 February 1988, No 59762)

Must the corporate purpose be exclusive?

The answer to this question varies depending on whether the other envisaged activities are considered commercial or non-commercial for tax purposes:

- The construction and subsequent sale activity is the only activity considered commercial for tax purposes that can be carried out autonomously. Other commercial activities are tolerated only if they are necessary for the performance of the construction and subsequent sale activity. The *Conseil d’Etat* thus considers that these operations constitute one of the ways in which the company has completed, in accordance with its corporate purpose, the sale of these buildings (for example, CE, 27 February 1989, No 57066 for the supply of furnishings, such as those for medical and restoration purposes, included in the sale of a building intended to be used as a retirement residence). This is particularly the case for companies that rent out constructed buildings on an incidental basis and prior to their sale (CE, 6 November 1998, No 171827 and CE, 4 May 2016, No 383135);
- In addition, the company may also engage in any kind of activity considered purely non-commercial from a tax perspective in conjunction with the construction and subsequent sale activity. The special regime thus applies to non-commercial partnerships for construction and subsequent sale of property that also engage in the long-term rental of bare buildings constituting fixed assets (CE, 28 November 2012, No 332110).

However, “the exceptional regime ceases to apply to non-commercial partnerships that (...) engage in other activities that, if they were carried out remotely, would render these companies subject to corporate tax (...)” (CE, 28 November 2012, No 332110). The special regime therefore does not apply to entities that, in addition to the construction and subsequent sale activity, engage in an activity deemed commercial from a tax perspective, i.e. an activity referred to in Articles 34 and 35 of the French Tax Code, such as the sale of undeveloped land or the sale of premises equipped with certain movable elements, when these operations cannot be regarded as incidental to the construction and subsequent sale activity.

## 1.2 Scope of the regime under Article 239 ter of the French Tax Code

Non-commercial partnerships for the construction and subsequent sale of property meeting the criteria of Article 239 ter of the French Tax Code are not subject to corporate tax and are covered by the same tax regime as commercial partnerships performing the same operations.

They are therefore necessarily not subject to corporate income tax (they cannot opt for this regime).

### 1.2.1 Taxation of corporate earnings

This tax regime is based on the following principle: the tax rules that the partners would have applied if they had carried out the same operations as the SCCV themselves must be applied to the share of the SCCV’s earnings to which each partner is entitled (in proportion to each partner’s ownership rights).

Implementing this principle means above all identifying the tax regime specific to each partner: Are they either subject to corporate income tax themselves or industrial, commercial, craft, or agricultural enterprises subject to a regime based on “actual profits”?

- If so, each share of earnings is treated according to the rules applicable to the corresponding partner, i.e. according to the rules for commercial profits (or according to rules derived from them);

- If not (particularly for partners who are natural persons involved for personal investment purposes or partners who are non-commercial enterprises not subject to corporate tax<sup>2</sup>), each share of earnings is subject to the rules applicable to each type of activity carried out by the SCCV, for example:

- . The rules on commercial profits for the activities, considered commercial for tax purposes, of construction and subsequent sale of property and rental of buildings in inventory;
- . The rules of land revenue for bare rentals, considered non-commercial for tax purposes, of buildings included in fixed assets.

Their corporate earnings corresponding to the construction and subsequent sale activity must therefore be determined according to the rules of General Law on industrial and commercial profits, which are similar to the accounting principles for merchants; They must thus record their operations on an accrual basis: The earnings to be declared for a financial year must generally include all profits earned during the financial year.

For example, in the situations referred to:

- In (a) and (b) above, the company must therefore submit form No 2031 (and its appendices) for this construction and subsequent sale activity (and commercial activities, particularly the rental of buildings in inventory, considered as incidental);
- In (a), the company must submit a form No 2072 for property rental income.

### 1.2.2 Liability of partners for taxation of earnings

Non-commercial partnerships for the construction and subsequent sale of property meeting the requirements set out in Article 239 ter of the French Tax Code are subject to the "regime of partnerships". Each partner is therefore personally liable for tax (whether personal or corporate income tax) on the share of corporate profits corresponding to the partner's ownership rights, even if these profits are not distributed.

As long as the non-commercial partnership for the construction and subsequent sale of property engages in its activity in France, its non-resident partners (whether a natural person or a legal entity) are, in principle, taxable in France for the amount of their stake in the company's earnings and must submit their form to the tax Authorities for individuals and foreign enterprises (CE, 11 July 2011, No 317024, Pln., Sté Quality Invest about a property investment company for the construction and subsequent sale of property). Given that French partnerships are considered "taxable persons" (they have a personality which is distinct from that of their members and engage in an activity that is their own), tax agreements that incorporate the OECD model do not oppose this taxation. Also, the tax personality of an SCCV precludes the application to its partners, who are not French residents, of the taxes (Articles 244 bis and 244 bis A of the French Tax Code) that they would have had to pay on sales of buildings in France that they own directly.

### 1.3 Consequences of transferring inventories to fixed assets

In accordance with the accounting rules for merchants, buildings constructed by a non-commercial partnership for their sale qualify as inventories, while unfinished buildings qualify as works in progress.

The corporate purpose specified in the articles of association and the actual activity of certain non-commercial partnerships may make provision, from the start, in addition to their main construction and subsequent sale activity, for a separate activity of bare rental of permanently held buildings (fixed assets). Furthermore, this rental activity may be added during the lifetime of the partnership.

When buildings constructed by the partnership (for sale) are transferred, as a result of a change of purpose, to property assets intended for long-term rental, this transfer from the "real estate inventory" to a fixed asset account is likely to result in restatements:

- In case of impairment of the building in inventory, this previously recognised impairment of the inventory should be transferred to fixed assets at the same time as the cost price of the building, the building then being depreciated in the books on a basis corresponding to the net cost price of this impairment.

However, in order to comply with divergent tax rules (the tax depreciation must be applied on the cost price), enterprises use two accounting practices:

- . The first, intended to show the cost price before the impairment of the building (used as the basis for the mandatory minimum tax depreciation provided for in Article 39 B of the French Tax Code), consists of cancelling the impairment recognised on the building in inventory, then again in recognising an impairment according to the rules applicable to impairment of fixed assets;
- . The second, which results in allocating a fraction of the new impairment to the recognition of a book depreciation allowance corresponding to the amortisation necessary for tax purposes in the company's earnings;

- The reconstitution of a depreciation allowance on buildings that are no longer part of the inventory is possible under the applicable general conditions regarding provisions for impairment of fixed assets ;
- However, it should be noted that impairments of buildings that are considered “investment properties” are not tax-deductible, according to a regime leading to the consolidation, for all investment properties, of their unrealised capital gains and losses and limiting the tax deduction to the net impairment likely to appear.

In addition, during the course of the construction and subsequent sale activity, when the non-commercial partnership for construction and subsequent sale of property completely abandons the sale of its constructions to devote itself exclusively to a rental activity, this constitutes a “change of activity”, which results in, pursuant to Article 202 ter of the French Tax Code, the tax consequences of a termination of business: Immediate taxation of operating earnings, profits benefiting from deferred taxes (provisions and capital gains whose taxation had been deferred), and capital gains on assets resulting from this tax termination.

Thus, these tax termination earnings must in particular be determined taking into account the capital gains or losses resulting from the transfer of buildings from an inventory account to a fixed asset account (CAA Bordeaux, 5 July 2007, No 06-376).

In this situation, there is a risk that the company will not be eligible for the “conditional mitigation” provided for in the second paragraph of Article 202 ter of the French Tax Code, making it possible, in case of a change of activity, to avoid the taxation of unrealised capital gains, provided that (i) no change is made to the accounting entries and (ii) the taxation of earnings and profits remains possible under the new tax regime applicable to the company. Once the buildings are allocated to an activity considered non-commercial for tax purposes, the second condition required to be eligible for the “conditional mitigation” might not be met.

## 2. VAT

VAT charged on construction costs may be recoverable or refundable during the construction in so far they are used for the purpose of a taxable transaction.

In an initial phase, builders are generally liable for the payment of huge expenses compared to their turnover. Consequently, they can be in a situation where the amount of input tax is higher than the amount of output tax, leading to a tax credit.

During this period, it will be relevant to assess whether it is worth claiming a monthly refund of such a tax credit. This procedure takes time and can lead to a tax audit, but it is often efficient when it is well prepared and documented.

## 3. Local tax issues

We have to distinguish between constructions of new buildings on bare land and redevelopment (even extensive redevelopment) of existing buildings.

### 3.1 Constructions of new buildings on bare land

The owner of the building land pays land tax (*taxe foncière*) on bare land during the construction phase.

It is not until the year following the completion of the building that the owner will be liable for land tax on buildings, plus any other local taxes that may be due on the building, such as the annual tax on office, commercial and storage premises, and parking areas in the Ile-de-France region, and the street sweeping tax (*taxe de balayage*), etc.

Please note that the notion of “completion” for local tax purposes differs from that used for planning formalities. Indeed, a building will be considered as “completed” within the meaning of local tax rules once the roof has been finished, the windows fitted in and the plumbing and wiring connected, even if the interior works have not been carried out or finished and the “DACT” form (*déclaration attestant l'achèvement et la conformité des travaux*) stating that the works are completed and compliant (which must be sent to the local Authority that issued the planning authorisation) has not been filed, or if delivery has been accepted subject to a list of snagging items to be remedied.

Please note: Upon completion of the works (for local tax purposes), the owner of the building must file a declaration of completion with the tax Authorities within a period of ninety days, using the appropriate form depending on the type of building (residential, offices, commercial or industrial). A temporary, partial exemption from land tax (on the share assessed by the *département*, for the first two years' taxation) is applicable, subject to the 90-day deadline being met.

### 3.2 Redevelopment of existing buildings

When a building is redeveloped extensively (to the extent that the roof is not built and the windows not fitted on the day the tax becomes due), the owner should consider whether it is worth applying to the tax Authorities to charge land tax on the bare land only (which is lower than for buildings), or even applying for an exemption from other local taxes that may be charged on the property.

Before making such an application, it is important to anticipate the consequences of being taxed on the bare land, because when the "new" building is finished, it will be qualified as a new-build within the meaning of the local tax rules. However, following the reform of the cadastral rental values that entered into effect on 1 January 2017, buildings completed after that date could be taxed more heavily than those completed before 31 December 2016.

Please note: When the works are completed, the owner has 90 days to file a declaration of completion with the tax Authorities (**see "Constructions of new buildings on bare land" above**).

<sup>1</sup> When the company results from the conversion of a commercial partnership or a company with tax transparency, the special regime can apply only on the twofold condition that, prior to the conversion, no building was disposed of and no units or shares were sold to a person other than an initial partner (*Article 239 ter, II-2° of the French Tax Code*).

<sup>2</sup> Also, industrial, commercial, craft, or agricultural enterprises subject to a regime based on profits other than actual profits.



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## A. Legal organisation of property in the presence of multiple owners

### 1. Co-ownership

Co-ownership is a form of concurrent ownership where two or more individuals or legal entities each own an identified, private unit (*lot de copropriété*) of a property.

Each unit comprises:

- A privately owned area (*partie privative*), used for the purpose it is intended for, e.g. housing, offices or retail businesses, etc.;
- A right over (i.e. a share in) the common use areas (*parties communes*), common building areas and structural elements that are a part of the common use areas.

Co-ownership is governed by the amended Law of 10 July 1965 (supplemented by the Order of 17 March 1967), most provisions being mandatory. A draft bill to amend the regulations applicable to co-ownership is currently being examined.

#### 1.1 Co-ownership regulations

The ownership of a unit requires unconditional compliance with the co-ownership regulations. These rules are set forth on a contractual basis and have to be registered at the land registry, as well as any subsequent modifications. They are usually drafted by a notary at the request of the developer or the building owner dividing the property.

Three types of provisions are required:

- Provisions regarding the distinction between private and common use areas, their intended use and the terms governing their enjoyment (provisions relating to the exercise of professional activities, posting signs for advertising purposes, etc.);
- Provisions regarding the apportionment of co-ownership charges;
- Provisions regarding the management of the building.

Co-ownership Regulations may also include a list of rules applicable within the property (*règlement intérieur*).

The co-ownership specifications (*état descriptif de division* (EDD)) identify each unit with a number, indicate its location and include a full description of the privately owned areas. The EDD defines each unit's share of both the general and special common use areas. The EDD is a notarised deed and may be integrated either into a bespoke deed, into the co-ownership regulations or into a book of requirements (*cahier des charges*) regarding the organisation of the collective administration. The EDD has to be summarised in a table that is either incorporated into the deed or attached to the latter.

Residential co-ownerships (in all or part) have to register on the Co-ownership Registry (*Registre d'immatriculation des copropriétés*). This registry includes core data regarding the co-ownership (management, accounts, construction). This obligation has/shall come into effect (i) on 31 December 2016 regarding co-ownerships with more than 200 units, (ii) on 31 December 2017 regarding co-ownerships with more than 50 units and (iii) on 31 December 2018 for all other co-ownerships. A statement shall be submitted annually within a period of two months from the general meeting called on to approve the annual financial statements.

#### 1.2 Co-ownership management entities

##### 1.2.1 The co-owners' association (*syndicat des copropriétaires*)

The *syndicat des copropriétaires* is the co-owners' association dedicated to the management of the common use areas of the property.

At least one meeting of the co-owners' association must be held every year (the ordinary general meeting) but meetings may also be held for other reasons (either ordinary or extraordinary general meetings).

Prior notice to attend a meeting must be sent out, at least 21 days in advance, to all co-owners. The notice must include the meeting's agenda as well as any necessary information that will enable the co-owners to make an informed choice during the meeting. Co-owners may request additional items to be added to the agenda (subject to the 21-day timeline mentioned above).

Co-owners may attend the general meeting in person or be represented by their chosen proxy, who may be anyone except the co-ownership manager (*syndic de copropriété*) – see below. The number of votes enjoyed by each co-owner corresponds to the percentage of common use areas

they own. If a co-owner owns over 50% of the co-ownership rights, the number of his or her votes will be reduced down to the sum of the votes enjoyed by the other co-owners.

The Law provides for different types of majority, depending on the degree of importance of the decision to be made:

- A simple majority (Article 24 of the Law of 10 July 1965) is required to approve the financial statements prepared by the co-ownership manager, the budget or any maintenance and repair works on the building and any authorisations granted to the property manager to instigate legal proceedings, except as regards the collection of co-ownership fees;
- An absolute majority (Article 25 of the Law of 10 July 1965) is required among other things, to appoint and re-elect the co-ownership manager, appoint members of the management board (*conseil syndical*), delegate powers, approve improvement works or works by a co-owner affecting the common use areas;
- A double majority (Article 26 of the Law of 10 July 1965) is required for more important decisions, such as the sale of common use areas of the property (without a change of use), amendments to co-ownership regulations governing the enjoyment of common use areas and building administration;
- Unanimity (Article 26 of the Law of 10 July 1965) is required for any and all disposals of common use areas (with a change of use), changes to the co-ownership regulations regarding the use or right of use of privately owned areas, or to the allocation of building fees. Broadly speaking, unanimity shall be required if the general meeting's resolution has an impact on (i) the use of the building, (ii) the enjoyment of the privately owned areas of one or more co-owners, or if it goes beyond the co-ownership's association's purpose.

Since the enactment of the ALUR Law and in order to renovate certain derelict properties under co-ownership, decisions regarding works to preserve either buildings or the health and safety of occupants are adopted by a simple majority vote.

In residential buildings (either as a whole or part) and subject to limited exceptions, the co-owners' association also now bears an obligation to create a work fund to facilitate performance of inevitable works (especially, energy renovations, roof repairs, replacement of collective heating facilities, etc.) and to spread the burden on co-owners over time by setting aside in advance the amounts necessary to finance such works.

### **1.2.2 The co-ownership manager (*syndic*) represents the co-owners' association.**

The co-ownership manager may be a volunteer (i.e. one of the co-owners), but is generally a professional holding a professional license (for a *syndic* activity) issued by the President of the Regional Chamber of Commerce and Industry (or, in the Ile-de-France region, by the County Chamber of Commerce and Industry).

Co-ownership managers are appointed for a maximum term of three years and may be re-appointed. The co-owners' management board shall organise a call for tenders regarding co-ownership managers every three years, unless the co-owner's general meeting decides otherwise (by an absolute majority vote).

Co-ownership managers can resign by serving three months' prior notice. Remuneration is determined on a flat fee basis for day-to-day services. Order No 2015-342 of 26 March 2015 defined the standard co-ownership management contract and the special services entitling the manager to additional remuneration.

Co-ownership managers are appointed to organise the day-to-day management of the property. Managers implement decisions taken by the general meeting, particularly in terms of arranging for any works voted on by the meeting to be carried out. They keep the co-ownership accounts. They have a duty to open a separate account for each co-owned property, and cannot be released from this duty by a vote of the co-owners general meeting. Managers collect the co-ownership fees. The co-ownership manager represents the co-owners' association by convening the general meeting, defends the association in any legal proceedings brought against it and instigates legal proceedings on its behalf. The manager keeps the records for the co-owned property.

Co-ownership managers are liable for their own misconduct and negligence, both with regard to the co-owners' association as a whole and to each individual co-owner.

If the manager is subject to any impediment, the chairman of the management board may convene a general meeting to choose a new co-ownership manager.

### **1.2.3 The co-owners' management board (*conseil syndical*)**

The co-owners' management board is elected by the co-owners for a maximum renewable term of three years. This management board is selected among the co-owners. The members elect their own Chairman.

The general meeting of co-owners may decide not to appoint a management board.

The board assists and supervises the co-ownership manager with all issues relating to the co-ownership and, in particular, issues opinions, with supporting arguments, regarding any works

whose cost exceeds the amount set by the general meeting. The board also audits the property manager's accounts.

### 1.3 Rights and duties of co-ownership

Each co-owner has a right to enjoy the common use areas and will share the service charges relating to these. All maintenance and improvement works affecting the common use areas or the external appearance of the property (including the installation of billboards, signs or professional plaques) must be authorised in advance by the general meeting.

## 2. Land tenure and ownership by division into volumes

### 2.1 Land tenure (*droit de superficie*)

Land tenure is defined as a right *in rem* enjoyed by a person, called the *superficiaire*, over the surface of an estate whose subsoil belongs to another person, called the *tréfoncier*.

Land tenure is an exemption to the principle of accession whereby ownership of the ground entails the ownership of all that is to be found above and below, according to Article 552 of the French Civil Code. This right leads to a separation between ownership of the ground and ownership of buildings or plantations established above ground.

Land tenure is a legal separation formalized by a contract for the benefit of the *superficiaire* who benefits from various prerogatives. These rights *in rem* may be freely transferred, attached and mortgaged.

The contract will set out the scope and term of the land tenure and will need to be registered at the land registry to be enforceable against third parties.

Land tenure often arises within leases such as the construction lease or the long-term lease (**please refer to Chapter V - Section B**). These leases are granted for a minimum period of 18 years and a maximum period of 99 years.

### 2.2 Flying freehold division structures (*division en volumes*)

A flying freehold division is a legal technique consisting of dividing a property into separate fractions, both horizontally and vertically, which may lie above or below natural ground level. Each fraction forms part of a geometrical three-dimensional volume defined by planes, cuts and dimensions. There are no common use areas between the various flying freehold units.

The structure was created by legal practitioners and legal authors - to enable certain planning projects. It is frequently used for complex real estate operations - such as *La Défense* - where the units belong to different public and private owners for different uses.

The primary aim of the flying freehold structure is to elude the regime of co-ownership defined above. Flying freehold structures are not subject to any specific legislation, but are based on the general principles of the French Civil Code.

#### 2.2.1 Flying freehold division specifications

The flying freehold division specifications identify the units that exist within the relevant property complex. The cadastral references and the surface area of the different plots, which make up the land base on which the operation is carried out, have to be recalled. They may also indicate the use assigned to each of the units.

The document must precisely determine each unit. In fact, the determination of the units is a legal and technical obligation.

This document has to be drawn up by a land surveyor who will provide details regarding the division based on plans and cross sections. This will include the composition of each unit, its characteristics and coordinates and surfaces areas, based on the NGF (*nivellement général de la France*) elevation benchmark.

Furthermore, the units will usually be encumbered by various easements which in this case have to be defined in a book of requirements (*cahier des charges*). The flying freehold division specifications contain this document which defines how to use the units and facilities, and will set out the apportionment of management, maintenance and repair service charges.

The flying freehold division specifications must be published at the land registry.

#### 2.2.2 The owners' management entity

In order to avoid requalification as a co-ownership, a collective property management association has to be set up for the purpose of ensuring the management and maintenance of the collective facilities of the property complex. The collective property management association may own units.

Several types of collective property management association may be established: the *Association*

*syndicale libre* (ASL), the *Association foncière urbaine libre* (AFUL) or the *Union de syndicats*. The latter may be set up where flying freehold units within the property complex are placed in co-ownership.

The most suitable options seem to be ASL or the AFUL. In an *Union de syndicats*, different co-owners' associations have to vote beforehand by an absolute majority (Article 25 of the Law dated 10 July 1965) to become members, whereas in an ASL or AFUL, each owner is automatically a member of the collective property management association.

The wording of the articles of association of a collective property management association is free.

## B. Leases

### 1. Commercial lease

Leases over buildings used for commercial and industrial purposes are governed by a statutory regime, set out in the Order of 30 September 1953, now codified under Articles L.145-1 *et seq.* of the French Commercial Code.

French commercial leases afford a high level of protection to tenants.

The main principle of the statutory regime governing commercial leases is "security of tenure" (*propriété commerciale*).

This principle grants the tenant the right to either request renewal of the lease or to receive compensation corresponding to the loss sustained where the landlord should refuse to renew the lease. Such compensation is generally equal to the value of the tenant's business.

#### 1.1 Terms of application of the statutory regime governing commercial leases

The statutory regime applies to leases over immovable properties or over premises in which a business concern is operated, whether this business concern is owned by a merchant or a manufacturer registered at the Commercial and Companies Registry (*Registre du commerce et des sociétés* - RCS) or by an artisan or tradesperson registered at the Trades Directory (*Répertoire des métiers*).

##### 1.1.1 There must be a lease

A lease requires personal, exclusive and permanent enjoyment of real estate. Consequently, a contract granting the enjoyment of property for several hours a day or for several days a week, or where the owner reserves the right to move the occupier to another place, cannot be defined as a lease.

##### 1.1.2 There must be premises

The lease must relate to a constructed building or closed and covered premises. In particular, advertising sites, hotel lobby windows and mobile cabins are excluded from the scope of the statutory regime governing commercial leases.

##### 1.1.3 There must be a business concern

Only commercial, industrial and artisanal business concerns are afforded the protection of commercial leases: Companies with a commercial form but a civil purpose are excluded (for example, architects, lawyers, accountants, insurance agencies, stockbrokers, consultants, etc.).

The business concern must have an independent client base that is managed autonomously: Dependent business concerns such as cafeterias situated within a racecourse or sports grounds are not included. Any person invoking the benefit of the statutory regime must provide evidence of an independent business concern and autonomous client base.

The issue of franchisees operating a pre-existing client base arises regularly: To benefit from the statutory regime franchisees will have to consequently prove that they have an independent client base.

The business concern must be effectively operated in the leased premises and must have been so during the last three years prior to the expiry of the lease. Certain other types of other premises - not receiving clients and where commercial transactions do not take place - enjoy the benefit of the statutory regime governing commercial leases: These are so-called "dependencies". To benefit from the statutory regime, these premises must satisfy a two-fold condition:

- They must be indispensable to run the business, in such a way that the loss thereof would compromise the business concern; and
- They must belong to the same owner as the main premises or, failing which, at the time the lease was granted, the landlord must have been aware that they were used together with the main premises.

### 1.1.4 The tenant must be registered

Tenants must be registered at the RCS if they are merchants or manufacturers, or at the Trades Directory if they are artisans or tradespersons.

The secondary establishment where a sales outlet is located must also be registered. If on the day termination notice is served, the secondary establishment is not registered, the landlord will be entitled to refuse to renew the lease over that establishment.

## 1.2 Statutory protection by extension

### 1.2.1 Statutory extensions

The statutory regime can be extended by Law to:

- Bare land (protection only applies to bare land where the tenant, with the express consent of the owner, has constructed buildings for a commercial, industrial or artisanal use);
- Public or private educational institutions;
- Municipal services managed directly by the city or town;
- Public sector business or public institutions engaged in an industrial or commercial business;
- Premises belonging to public institutions where certain business concerns are operated;
- Co-operatives and savings banks and provident funds;
- EIGs (*groupements d'intérêt économique*) with a commercial purpose; and
- Artists and authors of graphic or plastic works of art.

### 1.2.2 Contractual extension

A tenant who does not satisfy the statutory conditions may benefit from the statutory regime governing commercial leases provided that an agreement has been reached between the parties to apply this statutory regime and that the rental terms do not conflict with another mandatory statutory regime:

- Voluntary application of this statutory regime includes the tenant's right to renew the lease, since the statutory regime must be permanent, complete and applied in its entirety;
- If a mandatory statutory regime applies, there will be two competing regimes, and the provisions of the mandatory statutory regime will prevail.

However, since the Law of 4 August 2008 was passed, professionals who may automatically benefit from the statutory regime governing professional leases under Article 57-A of the Law of 23 December 1986 may waive the right to this statutory regime and opt for the statutory regime on commercial leases. In such a case, the tenant would no longer be entitled to terminate the lease at any time by giving six months' notice as is the case for a professional lease.

## 1.3 Establishment of commercial leases

### 1.3.1 Term of commercial leases

#### a. Term of the initial lease

Commercial lease legislation purports to ensure stability for the tenant's business.

The term of the initial lease must therefore be at least for nine years, and this is a mandatory public policy provision.

The parties may not deviate from this minimum term of nine years; however, they may agree on a longer term.

A lease longer than twelve years is subject to a registration fee of 0.60% (a total tax assessment of 0.715%, taking into account a withholding of 2.5% for assessment and collection costs, and the tax of 0.1% in favour of the State) based on the total rent and service charges, within a limit of twenty years.

Only perpetual leases are prohibited.

The tenant may, however, terminate the lease after the expiry of each three-year period, the right of three-year termination being a mandatory public policy provision.

It is however possible to provide that the tenant waives its right to terminate the lease at the end of one of the three-year periods, but only in the following four cases:

- Where the original lease was entered into for a term of more than nine years;
- Where the lease relates to premises built for a single use;
- Where the lease relates to premises used exclusively as office space;
- Where the lease relates to warehouse premises.

Moreover, expiry of the term of the lease does not entail termination.

The contract may only be terminated by prior notice served by the landlord or the tenant, or as a result of a request for renewal served by the tenant.

Notice of termination must be served by a process server's instrument (*acte d'huissier*) or by registered letter with acknowledgement of receipt at least 6 months' in advance.

Failing that, the lease will be extended beyond its contractual term for an unspecified period, with either party being able to terminate this extended lease period at any time.

However, if the lease is extended tacitly, notice to terminate the lease must (i) comply with the notice period set forth in the lease of no less than six months and (ii) be served for the end of the calendar quarter.

#### **b. Term of the renewed lease**

If the term of the initial lease was for more than nine years, the lease will be renewed for a term of only nine years, unless the parties agree to a longer term. In this case, the agreement may not validly inure until the renewal is entered into.

### **1.3.2 Rent under commercial leases**

#### **a. Rent under the initial lease**

The initial rent is not subject to any statutory provision. The parties have full discretion in negotiating the rent and rent will normally reflect market conditions.

The parties may agree that the tenant shall pay entry fee (*pas de porte*), upon entry into the premises. This sum may be categorised either as an additional amount of rent or as compensation for the depreciation in value of the premises due to the grant of a commercial lease.

The rent may also be determined in part or in whole according to a percentage of the turnover generated by the tenant on the leased premises, under an income clause or variable rent clause, which are very common in shopping centre leases.

These clauses provide for:

- Either a variable rent determined annually in accordance with a percentage of the tenant's turnover;
- Or, more often, a variable rent with a guaranteed minimum which will vary according to an annual indexation clause and a variable fraction calculated according to a percentage of the tenant's turnover (alternative income clause); or
- A variable rent added to a base rent (additional income clause).

Leases may require the tenant to pay a security deposit. If the security deposit and the rent paid in advance exceed two terms of rent, the tenant shall receive interest on the amount.

The landlord may also ask the tenant to provide a bank guarantee in addition to or instead of the security deposit.

#### **b. Variation of rent during the initial lease**

##### **i. Contractual rent review: Indexation clause**

The parties may expressly agree to an indexation clause for the rent.

The rent will then vary on the basis of this index, which must be directly related to the purpose of the lease or the business of one of the parties, failing which the index will be null and void.

The National Index for the Cost of Construction published by the *Institut national de la statistique et des études économiques* (INSEE) is considered to be directly related to commercial leases.

However, the "Pinel" Law of 18 June 2014 cancelled the reference to the National Index for the Cost of Construction for commercial leases and now only provides for the following two indexes:

- The Commercial Rent Revision Index (*indice des loyers commerciaux*), which applies to retail leases and is composed of three pre-existing indexes: The consumer price index (50%), the national index for the cost of construction (25%), and the retail trade turnover index (25%);
- And the Rent Index for Service Industry Activities (*indice des loyers des activités tertiaires*), which applies to service industry activities including activities carried out on premises used as office space or logistics platforms. This index is composed of three pre-existing indexes: The consumer price index (50%), the national index for the cost of construction (25%), and the retail trade turnover index (25%).

It is still possible to index the rent based on the National Index for the Cost of Construction or another index directly related to the activity of either party.

An indexation clause enables the rent to vary periodically (generally, annually) based on the variation of the index.

## ii. Two types of statutory rent review

### - Statutory rent review provided for in Article L.145-39 of the French Commercial Code

Under Article L.145-39 of the French Commercial Code, "should the lease include an indexation clause, a review may be requested whenever the rent calculated in accordance with this clause is increased or decreased by more than 25% compared to the price previously determined contractually or by Court Order." For leases concluded as from 1 September 2014, the rent variation that may stem from this review cannot exceed increases of more than 10% of the previous year's rent per annum.

As a result, if the rent has increased by more than 25% due to the indexation clause, it may be challenged in order to be set at the rental value.

### - Statutory three-year review

Another option, defined in Articles L.145-37 and L.145-38 of the French Commercial Code, is to review the rent every three years.

The three-year review enables the parties to request the rent to be reviewed provided that at least three years have passed since the beginning of the renewed lease or since the last negotiated or judicial determination of the rent.

Under the terms of Article L.145-33 of the French Commercial Code, the amount of the reviewed rent must reflect rental value.

In the event of a three-year review, the reviewed rent is normally capped since it may not exceed the variation of the quarterly Commercial Rent Review Index or the quarterly Rent Index for Service Industry Activities published since the previous voluntary or judicial determination of the rent.

However, if one of the parties can provide evidence of a material change in local commercial factors which has itself caused a variation in the rental value of more than 10%, the rent is then reviewed at rental value.

### - Aspects shared by the two mechanisms of rent review

The reviewed rent is due as from the request for review, but it is not immediately payable if the landlord and the tenant have not reached an agreement regarding the amount of the reviewed rent.

Either party may refer the matter to Court for judicial determination of the amount of the reviewed rent (Article L.145-56 of the French Commercial Code). Once the matter has been decided, the reviewed rent will take effect retroactively from the date of the request for review. Moreover, rent review does not entitle the owner to take into account the investments or management decisions of the tenant which may have affected the rent.

It should be noted that the statutory rent review mechanisms do not apply to leases that contain income clauses insofar as these clauses do not fall under the provisions of the statutory regime governing commercial leases and are governed by the agreement of the parties only.

## c. Rent of the renewed lease

### i. Theoretical principle: Determination at rental value

The rent of the renewed lease must reflect the rental value of the premises.

If the parties cannot agree on this value, the Law refers to five components, defined in Article L.145-33 of the French Commercial Code, which are used to determine the rental value:

- The characteristics of the premises;
- The intended use;
- The respective obligations of the parties;
- Local commercial factors that have an impact on the business operated by the tenant; and
- The prices commonly applied within the neighbourhood.

### ii. Exception: Capping of rent under the renewed lease

There is a notable exception to the principle of determination at rental value, known as the capping rule.

This rule, provided for in Article L.145-34 of the French Commercial Code, specifies that the rent under the renewed lease is only set at the rental value where there is a significant change to one of the first four components of rental value, as listed above.

If there is no such significant change, the rent under the renewed lease cannot exceed the variation in the quarterly Commercial Rent Review Index or the quarterly Rent Index for Service Industry Activities published by the INSEE since the date at which the initial rent of the expired lease was determined.

Failing any contractual clause specifying the reference quarter for the aforesaid index, the variation in the index calculated over the nine-year period preceding the most recently published index will be used. If renewal takes place after the date initially stipulated for expiry of the lease, the variation will be calculated on the basis of the most recently published index for a term equal to the time period which has elapsed between the initial date of the lease and the date of its effective renewal.

However, there are limits to this capping rule.

#### - Limits in connection with the term of the expired lease

The rent under the renewed lease does not fall within the scope of the capping rule where:

- . The original lease was entered into for a term of more than nine years; or
- . The lease was entered into for nine years but its effective term exceeded twelve years as a result of a tacit extension.

#### - Limits in connection with the type of premises leased

- . Bare land;
- . Single-use premises (premises which, according to their characteristics, can only have one use, such as a cinema or a hotel); and
- . Premises used exclusively as offices.

#### - Contractual limits

The parties may deviate by contract from the capping rule and freely fix the procedure for determining the amount of the renewed lease.

#### - Economic limits

If the renewed rent is less than the current rent or the price resulting from the application of the index, rental value shall prevail.

The tenant may therefore have the renewed rent set at an amount which is lower than the last rent paid, without having to establish that one of the components for assessing rental value has changed, if it is demonstrated that rental value is inferior to the amount resulting from the application of the capping rule.

#### iii. Terms of exclusion of the rent capping rules: Significant change in the components of rental value

It is possible to disapply the rent capping rules where significant changes have occurred during the previous lease, which have affected the running of the business.

These changes must:

- Be significant and their significance must have been acknowledged by a Judge;
- Have occurred during the expired lease; and
- Be related to one or more of the first four components of rental value as defined in Article L.145-33 of the French Commercial Code, and the variation of prices applied within the neighbourhood may not constitute grounds to disapply the cap.

The components of rental value which may be relied on are as follows:

- The characteristics of the premises (the area, the exterior, the facilities, etc.);
- The intended use as specified in the lease; an amendment during the lease would allow the tenant to extend the activity provided for in the lease;
- The respective obligations of the parties (e.g. increase of the land tax, etc.); and
- Local commercial factors that have an impact on the business operated by the tenant, e.g. renovation of the neighbourhood, demographic evolution, construction of new housing, creation of new means of transport or pedestrian walkways, etc.

An unfavourable change in local commercial factors may constitute grounds to disapply rent capping rules.

A combination of several minor changes to the components of rental value may also constitute an overall significant change.

There is also a special case that applies to improvement works carried out by the tenant. Improvements made by the tenant to the leased premises can sometimes constitute grounds to disapply rent capping rules; however, they are normally only taken into account during the second renewal following their completion, unless the landlord assumed responsibility for these, whether directly or indirectly.

#### iv. Gradual rent increase provided for by the "Pinel" Law of 18 June 2014

Where the rent of the renewed lease is not subject to the rent capping rules and must therefore be set at the rental value, the "Pinel" Law of 18 June 2014 established a mechanism to cap such rental value.

This mechanism provides that when the rent under the renewed lease is set at rental value, due to a "significant change in the components listed in 1° to 4° of Article L.145-33", or "if an exception is made to the rent capping rules due to a clause in the agreement relating to the term of the lease" (i.e. if the lease was entered into for a term of more than nine years), it will not be

immediately set at rental value, but will be incrementally increased on an annual basis by 10% per year until the rental value is attained.

This rental value capping mechanism does not apply to leases for premises used exclusively as office space, in which case the renewed rent is not subject to the provisions of Article L.145-34 of the French Commercial Code.

#### **v. Entry into force of the new rent**

The new rent is not due from the moment the renewed lease takes effect but only as from the date the landlord requests such.

It is therefore in the landlord's interest to state the rent of the renewed lease that it intends to receive:

- Either in the notice of termination containing the offer to renew it notified on the tenant; or
- In its response to the tenant within three months from a request to renew.

Failing this, the rent in force at the time of the expiry of the lease is due only until the landlord informs the tenant of the requested amount.

#### **vi. Renewal of leases containing a variable rent clause**

According to the Law, the determination of the renewed rent under a lease containing a variable rent clause is not within the scope of the statutory regime governing commercial leases and is governed by the agreement of the parties only. In the case of the renewal of such a lease, the rent is therefore determined according to the same clauses and without the possibility of being set at rental value, unless otherwise stated in the lease.

### **1.4 Life of commercial leases**

#### **1.4.1 Assignment of commercial leases**

##### **a. General principle of freedom of assignments**

To ensure that a tenant under a commercial lease is not in fact deprived of the right to transfer its business concern, any clause of a lease, regardless of its form, that prohibits the tenant from assigning its lease to the buyer of its business concern is deemed invalid.

##### **b. Validity of restrictive clauses**

The transfer of the lease without the business concern may be prohibited.

Similarly, clauses which subject transfer to various conditions such as prior approval of the transfer by the landlord, prior payment of any monies outstanding, drafting of the transfer agreement as a notarised deed to which the landlord is a signatory, etc., are considered valid.

Leases usually provide that in the case of assignment of the lease, the tenant will remain jointly and severally liable with the assignee for the tenant's obligations under the lease, in particular, the payment of rent and service charges.

Since the "Pinel" Law of 18 June 2014 was implemented, the term of such joint and several liability may not exceed three years from the assignment, unless otherwise stated in the lease.

If these clauses are not complied with, the lease may be terminated or the landlord may refuse to renew the lease.

#### **1.4.2 Sub-rentals**

##### **a. General principle of prohibition**

Unless provided otherwise in the lease, any total or partial subletting is prohibited.

##### **b. Possible contractual exceptions**

A lease may grant permission to sublet. However, a procedure must be complied with so as to protect the rights of the landlord: The landlord must be a signatory to the agreement and to successive renewals of the sublease.

As with the assignment of the lease, if the procedure is not complied with, a sublease that is not in due form may, in particular, not be enforceable against the head landlord or be sanctioned by the refusal of renewal.

However, consent to the sublease should not constitute a means of enrichment for the tenant, so that if the rent under the sublease is proportionally superior to that of the head lease, the head landlord may instigate proceedings against the tenant to have the rent under the head lease readjusted.

##### **c. Situation of the subtenant**

The head tenant is bound to the subtenant by all the obligations of a landlord. The subtenant may also request the head tenant to renew the lease to the extent of the rights that the tenant itself holds from the owner.

If the head tenant decides not to accept the renewal offered by the landlord, it will not have committed any misconduct with respect to the subtenant and shall not be liable to it for any eviction indemnity.

On the expiry of the head lease and if renewal is denied, the subtenant will be entitled to claim the renewal of the sublease directly from the owner of the building. However, this direct right may not be exercised if renewal under the head lease was offered to the head tenant.

This direct right of the subtenant to the renewal of the sublease is subject to four conditions:

- The head lease must not have been renewed;
- The sublease must have been entered into in due form and must be enforceable against the owner;
- If a portion of the rented premises is sublet, the premises must be capable of being divided by an agreement of the parties or as a result of the nature of the premises; and
- In any event, the subtenant must obviously satisfy the general terms applicable to the right to renewal; In particular, it must be registered at the Commercial and Companies Registry and must operate a business concern.

### 1.4.3 De-specialisation

De-specialisation is the addition to the lease of an additional intended use (partial de-specialisation) or a change of the existing use (complete de-specialisation).

#### a. Partial de-specialisation

The tenant may request permission to add related or additional activities to those uses permitted under the lease.

The landlord may not refuse this request for partial de-specialisation.

The landlord may, however, within a period of two months from being notified the partial de-specialisation request, dispute the fact that the requested uses are actually related or additional to those permitted under the lease.

De-specialisation that is authorised will not, however, immediately result in the disapplication of the cap on rent: This cap may only be lifted at the next three-yearly review following the request for de-specialisation, provided, however, that such decision has caused a substantial change in the rental value of the rented premises.

#### b. Complete de-specialisation

The tenant is entitled to request much more than just the extension of its business activities and may seek approval to completely change the intended uses initially specified in the initial lease.

Such change must be justified by the economic environment and the requirements of a rational organisation in the sector.

This change cannot be based simply on personal or economic choices specific to the tenant.

This is a significant procedure since the existing business will be transformed by setting up a new business. It is therefore subject to strict formalities and the landlord has three months to refuse or accept such change or subject the change to conditions.

The tenant may also have to pay an indemnity as a result of the right to such complete de-specialisation equal to the loss sustained by the landlord from the change in business. The rent may be readjusted immediately to correspond to market rental value.

A special type of complete de-specialisation is related to disability or retirement of the tenant. This de-specialisation can only be avoided by the landlord if the projected activity is not compatible with the use, the location or the characteristics of the building.

## 1.5 End of the commercial lease

At the end of the commercial lease, either party may decide to renew or terminate the lease.

### 1.5.1 Renewal of the commercial lease

#### a. Conditions of the tenant's right to renewal

To have the right to renew, the tenant must meet the following three conditions:

- Ownership of the business concern: The right to renewal may only be relied upon if the tenant owns the business concern that is operated from the premises;
- Operation of the business concern: The business concern must not be new at the time of renewal but must have been operated during the three-year period prior to the renewal. This term is calculated starting from the effective end date of the lease agreement; and
- Registration: The tenant must be registered at the Commercial and Companies Registry or at the Trades Directory at the date of the request for renewal or at the date of the termination notice.

Absence of registration at the relevant date shall constitute valid grounds to refuse to renew and subsequent registration shall not resolve this situation retroactively.

#### **b. Request for renewal by the tenant or termination with an offer of renewal from the landlord**

If no termination notice or request for renewal is served by either the landlord or the tenant, the commercial lease will be tacitly extended beyond its contractual end date.

It may therefore be in the tenant's interest to make the landlord react by serving a request for renewal.

Such a request will cause the initial lease to be terminated at the end of the contractual term of the lease or, in the event of tacit extension, on the last day of the calendar quarter the request is issued.

A request for renewal may only be issued by process server's instrument.

The landlord will have a period of three months to decide whether to continue the lease. If it does not reply within this time period, the renewal will be deemed accepted.

If the landlord accepts this request, the lease will be renewed according to the terms and conditions of the expired lease and only the amount of rent may be modified.

Termination of the lease may also occur at the initiative of the landlord, who may serve notice of termination with an offer of renewal

Such notice of termination must be served by process server's instrument or by registered letter with acknowledgement of receipt with at least six months' prior notice. During a period of tacit extension of the lease, termination shall only become effective at the earliest six months after being served and on the last day of a calendar quarter.

Similarly as for a request for renewal, notice of termination with an offer of renewal will terminate the initial lease and enact a new lease governed by the same clauses and terms as the initial lease, with the exception of rent, which will be set according to the terms set out above.

### **1.5.2 The right of option – The right to repent**

For every notice issued, the parties can subsequently decide to waive the effect thereof: This is known as the right of option and the right to repent.

#### **a. The right of option**

The right of option is the right the parties have to reverse their decision to renew the lease.

Both parties are entitled to exercise this right and shall have a period of one month following the final Court Order setting the renewed rent to reverse their decision.

The idea here is to enable the parties, who have only accepted the principle of renewal of the lease without any knowledge of the rent, to give up on the renewal once this parameter has been determined. Consequently, this right is only justified in the case of disagreement between the parties as to the rent under the renewed lease.

The right of option may be exercised at any time during the judicial procedure for the determination of rent, even prior to the initiation of such procedure.

Exercise of the right of option is not subject to any particular form or notice period.

The option is final and irrevocable. If the owner initially offers to renew the lease and then decides to refuse, it cannot reverse its decision a second time and will have to pay the eviction indemnity without any possibility of reversing this decision.

The option exercised by the tenant is also irrevocable. Once the tenant has refused the renewal of the lease, its occupancy shall be unlawful and in a *mala fide* capacity and it shall be required to surrender the rented premises to the landlord.

#### **b. The right to repent**

The right to repent is the very opposite of the right of option, its purpose being to enable a landlord who initially refused to renew a lease to avoid paying the eviction indemnity by offering to renew the lease. The right to repent can therefore only be exercised by the landlord.

The idea here is to enable a landlord who had refused to renew the lease without any knowledge of the amount of the eviction indemnity, to reverse this decision within a period of fifteen days from its knowledge thereof.

The right to repent is, however, subject to one of two conditions:

- The tenant must still be in the leased premises; or
- It must not already have leased or purchased another building for relocation purposes.

This right is not subject to any particular form and may be exercised at any time during the judicial procedure and even prior to the initiation of the procedure, but at the latest within a period of fifteen days from the judgment determining the amount of the eviction indemnity and which has authority of *res judicata*.

As is the case with the right of option, the right to repent is irrevocable.

As a result, the tenant will have the right to renew the lease. The new lease will begin as from the date of cancellation. The tenant nonetheless still has the right to cancel this renewal by implementing its right of option.

### 1.5.3 Definitive end of commercial leases

#### a. Termination by the tenant

The tenant may terminate the lease either during the term of the lease or at the end thereof.

##### i. Early termination by the tenant

There are two types of early termination:

- Triennial termination: The tenant can put an end to the lease on the expiry of a three-year period with six months' prior notice issued by process server's instrument. The notice period can be longer with the consent of the parties. Notice served tardily is not void but shall take effect at the end of the following three-year term. As already stated above, this right of three-year termination is a public policy provision; however, there are certain cases where the tenant may waive this right, including in particular for leases over premises used exclusively as office space (1.4.1.1).
- Termination at any time: A tenant who has requested to retire under a retirement pension scheme allotted under the social security system or who has been accepted as a beneficiary of a disability pension allocated by the social security system may terminate the lease at any time. The same form and deadline requirements apply as those for triennial termination.

##### ii. Termination at the end of the lease

By serving notice on the landlord, the tenant expresses its intention to terminate the lease.

It should be noted that the tenant thus waives the benefit of security of tenure and the right to the payment of an eviction indemnity.

The termination notice issued by the tenant does not need to state reasons. This would not, however, be the case where the tenant purports to terminate the agreement outside of the three-year periods, for example, to benefit from retirement rights.

The tenant must also comply with certain formalities. In particular, notice of termination must be served by process server's instrument with at least six months' prior notice (which may be extended by contract). In addition, if notice is served after the lease has been extended by tacit agreement, notice must also be served for the last day of the calendar quarter.

Once notice of termination is served it cannot be withdrawn. It does not have to be accepted by the landlord since it is a unilateral act.

#### b. Termination by the landlord

The landlord has several means at its disposal to definitively terminate the lease.

##### i. Early termination by the landlord

The landlord has a triennial right to terminate the lease in four cases where certain major construction works are to be undertaken on the rented premises:

- To construct or reconstruct: If the landlord wishes to reconstruct, the demolition works must have been completed. If the landlord can offer the tenant alternative premises, it will not have to pay any eviction indemnity;
- To raise the height of the existing property: Eviction of the tenant must be for the purpose of carrying out such works. The tenant will receive an indemnity equal to the loss sustained subject to a maximum of three-years worth of rent;
- For the purpose of constructing residential premises on all or part of bare land rented out. The termination notice may be partial in this case and only related to that part of the plot which is essential to the projected construction. The landlord must obtain planning permission prior to the issue of the termination notice. Unless replacement premises are offered up, the landlord may not exclude liability for the payment of an eviction indemnity;
- For the purpose of carrying out real estate restoration works in a protected sector requiring the premises to be evacuated. The premises must be located in a protected sector and the landlord must pay the tenant an eviction indemnity.

##### ii. Notice without an offer of renewal

The landlord can decide to serve notice to terminate the lease at the end of the contractual term without offering to renew the lease.

As with any termination notice, this notice should be served with at least six months' prior notice by process server's instrument or by registered letter with acknowledgment of receipt. If the termination notice is issued during a period of tacit extension of the lease, it must also be given for the last day of the calendar quarter.

The landlord has no choice but to offer an eviction indemnity to the tenant to compensate for the loss of its business concern.

The landlord may also issue notice without an offer of renewal and without an eviction indemnity where the tenant does not satisfy all the conditions to benefit from the statutory regime.

In such cases, the landlord must provide reasons for this decision in connection with a breach by the tenant or because the tenant does not satisfy the conditions for entitlement to renewal of the lease.

Except where it is not possible to remedy the breach (the breach being irreversible, it is no longer necessary to serve a formal demand on the tenant to put a stop to the breach), the landlord must, prior to issuing the termination notice, serve a formal demand on the tenant to stop breaching the lease and to provide it with a solution for such breach. The tenant has one month to act upon such formal demand. Failing which, a reasoned notice of termination may be sent to it. It is also necessary for the serious and legitimate grounds invoked to be validated by a Judge, who shall have full discretion in assessing the matter.

If the grounds are held to be invalid, the landlord will have to pay the tenant an eviction indemnity.

### iii. Eviction indemnity

If the landlord decides not to renew the lease and the tenant satisfies the conditions for entitlement to renewal, the landlord must pay the tenant an eviction indemnity.

The indemnity must correspond to the entire loss sustained by the tenant due to non-renewal of the lease.

The eviction indemnity is divided into two elements, as follows:

#### - The principal indemnity

The principal indemnity is based on the higher of the following two values:

- The estimated value of lost income, calculated using various methods that are specific to individual business concerns; or
- The estimated value of the loss of the leasehold right, calculated according to the rent differential method. This method consists in assessing the market value of the rent on the day of eviction and the value of the rent that would have been applied if the lease had been renewed.

This differential is multiplied by a coefficient that has varied over time and that is now calculated on the basis of the standing of the location and the type of premises the tenant is being evicted from.

In the event the business can actually be transferred to another available site, the valuation of the principal indemnity will only be made on the basis of the value of the leasehold right.

#### - Ancillary indemnities

- Indemnity for re-use: Corresponds to the costs that will be sustained by the tenant to take over an equivalent business concern to the one managed prior to the eviction;
- Indemnity for commercial disruption: This indemnity compensates the disruption to the tenant's business operations as a result of the eviction and ensuing relocation;
- Relocation indemnity: The cost of the relocation is assessed separately, based on a quote or invoice;
- Non-depreciated work: The tenant is fully indemnified for non-depreciated work, for which expenses have been incurred prior to the effective date of the termination; and
- Other indemnities: Other indemnities may, where applicable, be charged in addition to the above items, such as an indemnity for staff redundancies if the business may not be transferred, specific works required for the tenant's relocation to other premises, etc.

The indemnity must be appraised on the day that is closest to the eviction, i.e. the day of the effective departure of the tenant or, if the tenant is still on the premises, the day the Court reaches its decision.

In the case of transfer of title to the rented premises, the debtor of the indemnity is the landlord who has served notice, and not the new owner of the premises.

The tenant is entitled to remain on the premises for the entire period required in order to calculate the eviction indemnity and until it has been paid in full, provided that the tenant pays an occupancy fee and complies with the rights and obligations provided in the lease. The tenant then has a period of three months from the date at which the eviction indemnity has been paid in full to vacate the premises.

The occupancy fee is equal to the rental value, generally reduced because of the precarious nature of the occupancy.

If during the period that it remains within the premises the tenant does not comply with all the clauses of the lease, the landlord will be entitled to refuse to pay the indemnity.

The same applies to the conditions of application of the statutory regime that the tenant must continue to satisfy, except as concerns the condition as to registration, which is a condition deemed to have been satisfied at the effective date of the notice of termination.

## 2. Short-term leases

There is a legal option to deviate from the statutory regime governing commercial leases status by entering into a "short-term" lease regulated by the provisions of Article L.145-5 of the French Commercial Code.

This type of lease may only be entered into when the tenant enters the premises; However, since the Law of 4 August 2008, several successive short-term leases may be entered into, provided that the overall term of the leases does not exceed a term of three years.

The tenant must not remain in possession of the premises once the last short-term lease has expired, otherwise the tenant may be entitled to claim the benefit of the provisions governing commercial leases, which will automatically be granted.

A new 3-6-9-year lease would then take effect as from the day after the date of expiry of the short-term lease, and the tenant would also be entitled to a right to the renewal of the lease.

## 3. Residential leases

Residential leases are governed by the public policy provisions of Law No 89-462 of 6 July 1989, revised by Law No 2014-366 of 24 March 2014 relating to access to housing and to the reform of planning rules, known as the "ALUR" Law. This Law now applies to leases granted to natural persons for properties used as a primary residence together with any garages, parking spaces, gardens and other premises leased with the main property by the same landlord as well as to furnished rentals.

Leases for secondary homes, business premises, furnished short-term rentals and company housing are thus excluded from this statutory regime.

As is always the case in matters of public policy, tenants may only waive their rights under this statutory regime once these are vested (i.e. after the signature of the lease).

### 3.1 Unfurnished rentals

#### 3.1.1 Scope of the Law

Two new concepts have emerged since the ALUR Law was passed: That of primary residence and dependants.

A primary residence is defined as a "residence occupied at least eight months per year, except impediment due to a professional obligation, to health reasons or a *force majeure* event".

The person occupying the premises must be the tenant, the tenant's spouse or a dependant, provided that this person lives in the household: Children, ascendants over 65 years of age with low incomes or relatives with disabilities (Article R.351-8 of the French Construction and Housing Code).

Furthermore, whereas previously only spouses could legally be joint holders of the lease, this right is now granted to partners in a civil union (*PACS*), if they make a joint request.

#### 3.1.2 Increase in the number of standards

The ALUR Law provides for a number of new standards that the parties must comply with.

##### a. Exhaustive list of documents that may be requested from the prospective tenant

An Order enacted with the counsel of the *Conseil d'Etat* (French Administrative Supreme Court) establishes an exhaustive list of the documents that may be requested from prospective tenants.

##### b. Schedule of condition

The parties must use a standard form for the ingoing and outgoing schedule of condition, for which instructions are defined by Order No 2016-382 of 30 March 2016.

If no ingoing schedule of condition is prepared, the assumption that "the tenant is deemed to have received the premises in a good state of repair" does not apply.

The tenant may establish the schedule of condition within a period of ten days from entry into the premises, and the fees pertaining to the schedule of condition are borne in equal shares, the cost of which is set forth by Order No 2014-890 of 1 August 2014. As a result, since 15 September 2014, the cap on the fees for drawing up the schedule of condition is EUR 3 per square metre of living floor space, all areas combined. This cap may be revised on 1 January of each year by Ministerial Order.

## 3.2 Conclusion of residential leases

### 3.2.1 Form of residential leases

#### a. A written agreement

Residential leases must be drawn up in writing. A model agreement is provided by implementation Order No 2015-587 of 29 May 2015, which contains two model leases agreements (furnished and unfurnished) in its appendices, applying to leases entered into on or after 1 August 2015. A Bylaw dated 29 May 2015 also defines the contents of the information to be appended to certain leases. Leases must be notarised if their term is superior to twelve years. In the latter case, they must be registered.

Verbal leases, which are common practice in France, do have legal value but are problematic when they need to be proven, especially with respect to their term.

However, this practice seems incompatible with the recently introduced requirement to append certain documents on exposure to hazards or on lead exposure to a lease.

Moreover, an annual rent review would be impossible given the absence of the appropriate clause.

The option to review rent during the term of the lease is only available if expressly set forth in the lease itself by way of an indexation clause. This option is therefore not available to verbal leases.

#### b. Electronic contracts

Ordinance No 2005-674 of 16 June 2005 enabled provisions regarding the conclusion of electronic contracts to be inserted into the French Civil Code.

As of this date, information on goods or services and contractual terms and conditions may be transmitted electronically.

It is therefore theoretically possible to enter into a lease by electronic means, provided that the recipient of the lease accepts.

### 3.2.2 Contents of residential leases

#### a. Mandatory clauses

As is the case for any rental agreement, a residential lease must include certain pieces of information.

These include:

- The name or business name of the landlord and its address or the address of its registered office, together with, where applicable, those of its agent;
- The effective date of the lease;
- The term of the lease: This term will run for (i) a minimum of three years if the landlord is a natural person or a *société civile immobilière de famille*, i.e. a company established by blood relations and relations by marriage who are a maximum of four generations apart, or (ii) six years if the landlord is a legal entity. A change in the type of landlord after the effective date will have no effect on the term initially provided in the lease. Lastly, shorter lease terms (minimum of one year) are possible, depending on the situation, if the landlord (an individual) has to re-possess the property under circumstances that were determined in advance and the date of the occurrence is known to the landlord.

In addition to this preliminary information, the lease must also contain other details including:

- The name of the tenant;
- A description of the property including its consistency, its use, the private and common use equipment of the building, the equipment for access to information and communication technology;
- The cost and nature of works carried out since the end of the last lease or the last renewal;
- The amount of the median rent, the highest rent and the previous tenant's rent, if the previous tenant left the property less than 18 months before the signature of the new lease;
- The amount of the security deposit when required;
- The habitable floor area;
- A waiver of the universal rent guarantee (*garantie universelle des loyers* – GUL)
- An information note on "the rights and obligations of tenants and landlords", the details of which are defined by the aforementioned Ministerial Order from the Ministry of Housing.

If the habitable floor area, the reference rents or the last rent paid are not stated in the lease, the tenant has the right, within one month from the effective date of the lease, to serve a formal demand on the landlord to provide this information.

If no response is received, the tenant may bring the matter before Court to request "where appropriate, a reduction in rent".

If there is a discrepancy between the actual floor area and the floor area stated in the lease concerning more than one-twentieth (5%), the tenant may request "a reduction in rent in proportion to the difference".

Moreover, certain documents regarding the environmental status of the property must be appended to residential leases (**please refer to Chapter II - Section E for more details**).

These include a technical report, the ESRIS, a report on the risk of exposure to lead if the property was developed prior to 1949, the information on the risk of dry rot, an energy performance survey, a domestic gas and electrical survey, whose contents have been defined by Order No 2016-1104 and No 2016-1105 of 11 August 2016. Furthermore, an asbestos report must be made available to those tenants that should so request.

Other documents must also be appended, such as an ingoing or outgoing schedule of condition, the mandatory tenant's home insurance certificate, as well as extracts from the co-ownership regulations if the property is placed under the regime of co-ownership.

#### **b. Financial clauses**

The lease must also include specific references to the financial obligations binding on the tenant.

The lease must therefore set forth:

- The amount of rent to be paid;
- The terms and conditions of payment of rent, in advance or in arrears. Any clause requiring the tenant to pay rent by direct debit from a current account or by advance bill of exchange or promissory note shall be deemed invalid. Any clause authorising the landlord to deduct rent directly from the tenant's salary, within the transferable limit, shall also be deemed invalid;
- Rules for rent review: The ALUR Law provides that rent review is only possible if it is provided for in the lease. Reviews of rent are limited to the variations of the review index introduced by the Law of 26 July 2005 and replaced by the new *indice de référence des loyers* (IRL – rent reference index) by Law No 2008-111 of 8 February 2008. This new index corresponds to the average consumer price index (excluding tobacco and rents) over the last twelve months.

The landlord must request the application of the rent review within one year of its effective date. Otherwise, the landlord will be deemed to have waived the benefit of the clause for the previous year.

The rent review will only take effect as from the landlord's request.

- The amount of the security deposit: The Law of 8 February 2008 reduced the amount of the security deposit from two to one month's rent, excluding service charges, for leases entered into as from 9 February 2008. Tenants with pre-existing leases may not therefore ask their landlord for a refund for the equivalent of one month's rent.

The landlord only has one month from the receipt of the keys delivered by hand or by registered letter with acknowledgement of receipt to return the security deposit to the tenant if the outgoing schedule of condition is consistent with the ingoing schedule of condition.

Otherwise, the landlord will owe late penalties equal to 10% of the monthly rent for each month started.

The universal rent guarantee (GUL), a free and optional insurance coverage against unpaid rent, which was planned to be implemented on 1 January 2016, should be replaced by a State guarantee covering young workers and people in difficult circumstances.

### **3.3 Life of residential leases**

#### **3.3.1 Life of the initial residential lease**

##### **a. Obligations of the parties**

##### **i. The landlord's obligations are the following:**

- To provide the tenant with decent housing, i.e. premises in good condition and state of repair with facilities in good working order. If the premises do not comply with housing standards, the tenant may ask the landlord to bring them into conformity. Failing this, a Court may reduce the rent;
- To grant the tenant peaceful enjoyment of the premises and to guarantee such enjoyment both on its own behalf and on that of third parties;
- To maintain the premises in a condition suitable to their use and to undertake all repairs other than those which are incumbent upon the tenant; and
- The landlord must inform the tenant of the schedule of such works, which may be suspended at the tenant's request if the use of the premises becomes impossible;
- The period of 40 days set forth by Article 1724 of the French Civil Code has been reduced to 21 days. Beyond this period of time, the clause providing for compensation in favour of the tenant

will be enforceable;

- To provide rent receipts at the request of the tenant free of charge.

#### **ii. The tenant's obligations are the following:**

- To pay the rent and recoverable service charges: These service charges generally correspond to expenses relating to the supply of consumables (electricity, hot and cold water, central heating), expenses for maintenance and minor repairs (to lifts and service lifts) and to various taxes and charges (street sweeping tax – *taxe de balayage*), domestic refuse collection (*taxe d'enlèvement des ordures ménagères*), as well as all rental repairs defined by an Order enacted with the counsel of the *Conseil d'Etat*, unless they were caused by wear and tear, defective works, a building defect, an act of God or a *force majeure* event. Article 4 of Order No 2016-382 of 30 March 2016 defines how to assess wear and tear;
- To use the premises quietly;
- To insure the premises;  
The landlord may now take out a recoverable insurance policy on behalf of the tenant, if the tenant fails to provide an insurance certificate;
- To comply with the intended use of the premises;
- To ensure day-to-day maintenance on the premises;
- To refrain from making alterations to the rented premises without the landlord's permission; and
- To refrain from transferring the lease without the landlord's permission.

### **b. Assignments and subletting**

#### **i. Assignments**

A residential lease may only be assigned with the landlord's prior written consent.

The assignment must be notified on the owner of the property by notarised deed.

The assignment will be deemed void in the event of failure to comply with these formalities.

Valid assignments will entail a transfer of all of the tenant's rights and obligations to the assignee. The assignor will nevertheless remain jointly liable with the assignee for the performance of such obligations.

#### **ii. Subletting**

The tenant must obtain the landlord's prior written consent before subletting the premises.

As a precaution for the subtenant, the ALUR Law provides that the tenant must provide him/her with the landlord's consent and with a copy of the current lease.

The rent paid by the person subletting the premises may not exceed that of the head tenant. Failing this, the subtenant may claim a refund of the difference from the head tenant.

However, contrary to an assignment of lease, subletting does not result in the lease being transferred and does not therefore have any impact on the relationship between the head tenant and the landlord.

Nevertheless, there are exceptions to this rule, enabling, for example, the landlord to collect the tenant's rent directly from the subtenant. Similarly, the subtenant may bring a claim against the head landlord in the event of failure of its own landlord to act.

### **3.3.2 Life of renewed residential leases**

In urban areas where there is a significant imbalance between supply and demand in the housing sector, the ALUR Law provides for rent control between the parties at the time the initial lease is entered into and during its renewed term. This rent control mechanism applies to new leases as well as to leases renewed on or after 1 August 2015.

#### **a. Rent under the initial lease**

The rent may not exceed the reference rent defined by the *Préfet*, plus 20%. Exceptionally, this rent may be exceeded and give rise to an additional amount of rent where the housing has special features in terms of location or comfort compared to housing in the same category located in the same area. Implementing Order No 2015-650 of 10 June 2015 provides clarifications regarding the implementation of this mechanism.

#### **b. Rent under the renewed lease**

In principle, the clauses, terms and conditions of the lease will not change on renewal.

However, landlords may initiate lease renewal proceedings that enable them to review rent, if such rent has clearly been underestimated.

The concept is unclear, however, as this may be interpreted in either of two ways:

- It may correspond to rent that is lower than the average reference rent; or
- It may correspond to rent that is lower than the lowest rent observed in the same area.

In any event, the references used must be comparable, i.e., of equivalent quality and comparable characteristics. The above-mentioned Order provides further information: The references must mention the "type of housing, whether individual or collective" in leases entered into recently but also in leases entered into more than three years ago.

As a general rule, the landlord will afford the tenant the opportunity to renew the lease in exchange for an increase in the rent, whose amount shall be set out in the offer.

In terms of the applicable formalities, offers to renew at a higher rate of rent must comply with the same requirements that apply to notice.

This offer must also contain:

- The provisions of Article 17 of the Law of 6 July 1989 (which essentially explain the procedure of the rent of a renewed lease);
- The proposed amount of rent; and
- The list of references used to establish the new rent. This list may be appended to the offer.

If any one of these requirements is not fulfilled, the offer for a renewed lease will be declared null and void.

Once the tenant has agreed to renew with an increase in rent, the increase will be applied in increments of one-third or one-sixth, depending on the term of the lease.

However, where the tenant refuses the renewal, either explicitly or tacitly (i.e. by not responding within the four-month period prior to the expiry of the lease), either of the parties may refer the matter to the rent assessment committee for the appropriate administrative area.

If the rent assessment committee does not issue an opinion within two months from the referral of the matter, either of the parties may bring an action before Court. If neither of the parties brings the case to Court, the lease will be automatically extended under the existing terms and conditions for the rent, which may be revised.

Lastly, there are numerous regulations setting limits on rent increases, particularly in areas where statistics reveal an atypical situation. In 27 towns listed in an Order, the rent amount requested by a landlord in a new or renewed lease has, since 1 August 2012, may not exceed the amount of the last rent paid by the previous tenant. The rent can be updated based on changes in the IRL (*indice de référence des loyers* – rent reference index). However there are exceptions if the landlord has made improvements to the premises between the previous and the new lease or, if the previous lease was undervalued.

### **c. Term of the renewed lease**

The renewed lease will have a term of at least three years if the landlord is a natural person or *société civile de famille*, i.e. a company established by blood relations and relations by marriage that are a maximum of four generations apart, or of six years if the landlord is a legal entity.

A landlord may offer to renew a residential lease for a longer term, but the tenant can always refuse this offer.

If the lease is not cancelled or if neither of the parties gives notice, the lease will be tacitly renewed. Consequently, the lease will automatically be renewed for a three-year period if the landlord is a natural person or *société civile de famille*, or for six years if the landlord is a legal entity.

## **3.4 Termination of residential leases**

A lease is generally terminated when one of the parties gives notice to the other party. However, a lease can also be terminated by mutual consent between the parties or by implementation of the termination clause.

### **3.4.1 Termination by the tenant**

The tenant, who is not bound by the term of the lease, may give notice to the landlord at any time, provided that such notice is given three months in advance. Notice may be given by registered letter with acknowledgment of receipt, by a process server's instrument (*acte d'huissier*) or by hand delivered letter in return for a receipt or signature.

However, this notice period is reduced to one month in the following circumstances:

- Tenants relocated for professional reasons or who have lost their job;
- Tenants getting their first job;
- Tenants finding a new job after being unemployed;
- Tenants whose health (confirmed by a medical certificate) requires a change of residence, regardless of age;
- Tenants receiving unemployment benefits;

- Housing located in “high demand” areas as defined under Regulations;
- Tenants receiving a disability allowance;
- Tenants who are allocated social housing.

### 3.4.2 Termination by the landlord

The Law of 6 July 1989 is extremely protective of the tenant’s interests.

Notice must contain evidence of the legitimate and reasonable grounds stated, as well as information to the tenant on possible remedies and compensation, where applicable. The landlord may only give notice to the tenant six months in advance by registered letter with acknowledgement of receipt or by process server’s instrument. It is now also possible to serve notice by hand in return for a receipt or signature.

Most importantly, the landlord may only give notice for the end of the lease and for one of three reasons, which are as follows:

- Notice for occupancy: The future occupier of the premises must be the landlord, the spouse, ascendants or descendants of the landlord or of the landlord’s spouse, the common-Law husband or wife of at least one year or the person with whom the landlord has entered into a PACS (*pacte civil de solidarité* – civil partnership) prior to the date of notice. The landlord may not re-possess the premises for a niece or nephew. The notice must state the name of the beneficiary and how the beneficiary and landlord are related.

If the property was purchased while occupied, notice may only be given from the end of the current lease or, if the lease expires less than two years after the purchase, after a period of two years;

- Notice for legitimate and reasonable cause: Particularly if the tenant has failed to satisfy one of the obligations incumbent upon him under the lease agreement, such as aggressive behaviour or non-compliance with a clause barring subletting. The matter may be automatically brought before a Judge if the grounds for notice are not justified by legitimate and reasonable cause;
- Notice for sale: In this respect, the landlord must first offer the property to the tenant, given that the latter has a right of first refusal (unless the building has been declared unfit for housing or unsafe, issued with a dangerous building ordinance or if the sale is to take place between blood relations who are a maximum of three generations apart). The sale offer is valid for the first two months of the notice period. If the tenant refuses the offer or fails to respond within this two month period, the right of first refusal will lapse and the owner will be free to sell the property to a third party. If the tenant accepts the offer, the sale must be finalised within a period of two months (or four months if taking out a loan);
- If the property was purchased while occupied, notice may only be given from the end of the first renewal of the current lease.

Landlords of unsanitary housing may not give notice.

For notice to multiple tenants (“Aurillac” Law), the Law has reduced the limit from ten to five housing units in the same building, and existing leases are automatically extended for three more years beyond their contractual term when the building is located in an area of “high demand”;

- Finally, in the event of a sale following the division of a building into units, and if the tenant does not accept the landlord’s offer, the landlord is required to immediately inform the mayor of the town of the price and terms of the planned sale. Failing this, the deed of sale could be declared void.

The town then has a period of two months to decide whether or not to purchase, in order to “ensure that the tenants remain on the premises”.

The town has the option to apply to the Judge in charge of expropriation matters to determine the sale price.

Re-possession of the property is conditional on replacement housing being found for tenants over 65 years of age whose income is lower than the maximum income applied for the allocation of social housing, defined by Ministerial Order.

### 3.4.3 Cancellation of the lease

#### a. Cancellation by a Court

Cancellation of a lease agreement by Court can be initiated as a sanction (i.e. the termination of the agreement) for the breach of one or more clauses of the lease.

Any kind of breach may be applicable provided that it is sufficiently severe: The Court is responsible for determining to what extent the behaviour of one of the parties may justify cancellation.

For example: A lease may be cancelled for serious and ongoing failure to maintain the property or the repeated failure to pay rent and/or service charges.

## **b. Implementation of the cancellation clause**

The landlord is able to implement a cancellation clause in three specific cases:

- Failure to pay the rent;
- Failure to pay service charges; and
- Failure to pay the security deposit.

The cancellation clause may only be implemented two months after the issue of an order to pay citing the clause in question, if the tenant subsequently fails to pay.

The order to pay must comply with certain formalities to be deemed valid. It must specify the breaches committed and the potential sanctions; It must be served in due form; It must cite the provisions pertaining to automatic cancellation from the Law of 6 July 1989 together with those pertaining to the exercise of the right to housing; And it must state that the tenant has the option to apply to the appropriate relief fund.

The order to pay is served on the tenant by a process server.

Since 1 January 2015, landlords who are legal entities are required to bring the matter before the *commission départementale de coordination des actions de prévention des expulsions locatives* (Local Commission for the Coordination of Actions to Prevent Tenant Evictions - CCAPEX) before serving a writ of summons for termination of the lease. If the tenant fails to respond, the landlord will have a summons served on the tenant in order to make an official record of the implementation of the cancellation clause.

The landlord must also notify the *Préfet* of the summons at least two months before the hearing. During this time period, the *Préfet* will contact the relevant social welfare organisations.

The lease will be terminated and the tenant from then on will be considered a *mala fide* occupier. As a consequence, failure to vacate the property on the date of cancellation will result in the tenant being liable to pay an occupancy fee.

These proceedings will not necessarily result in the property being returned to its owner. In fact, if it is established that eviction would result in excessive disruption to public order, the *Préfet* will not enforce the eviction.

In such event, the owner will be entitled to bring an action against the State to obtain partial relief for the loss incurred.

## **4. Other agreements**

### **4.1 Real estate licenses (*concession immobilière*)**

Created by Law No 67-1253 of 30 December 1976, a real estate license is an agreement whereby the owner of a developed or a non-developed property confers the enjoyment thereof to another party, known as the licensee for a period of at least twenty years, in consideration for the payment of an annual fee.

Similarly to the long-term lease and the construction lease, this type of lease is not subject to the General Law of leases. However, contrarily to these leases, a real estate license does not grant a primary *in rem* right of enjoyment.

Constructions which may be provided for are not the main purpose of a real estate license. The licensor has to reimburse the licensee for any added value or the cost of the expenses, if lower.

A real estate license may be terminated at any time by mutual consent of the parties. There is no renewal right on expiry of the contract.

A real estate license is highly attractive for the licensee if the intended use of the building licensed is commercial, industrial or artisanal. In this case, if the agreement is not renewed because of the continued refusal of the owner, the latter can neither engage in a similar activity as the licensee, nor confer this right to any third parties during the five year period following the expiration date, unless there is any exception.

### **4.2 Construction leases (*bail à construction*)**

Governed by the Articles L.251-1 *et seq.* and R.251-1 *et seq.* of the French Construction and Housing Code, Construction leases:

- Primarily require the tenant to construct a building and allow the tenant to grant necessary easements on the land being leased;
- Grant the tenant a right *in rem*, which may be freely mortgaged, transferred and seized;
- Are granted for a period between eighteen and ninety-nine years inclusive (seventy years for leases concluded prior to 3 January 1976), without any tacit renewal possible;

- Transfer to the tenant the property of the developed construction and the obligation to maintain the building in a proper state of repair throughout the term of the lease and to support costs and repairs. After the expiry of the lease, the landlord shall freely become the owner of the construction, unless agreed otherwise;
- Fix the payment of a price in various forms (periodic rental, delivery of the buildings either at the end of the lease or during the lease).

The main characteristic of the construction lease is the tenant's commitment to improve the property by building constructions. To that extent, the parties must ensure that the leased land are able to support the relevant constructions. The contract may require the tenant to make a specifically designated use of the future buildings.

Construction leases have to be freely transferable and the free rental of the developed constructions may not be restricted or prohibited. Every lease and all other contracts granted in application thereof will expire at the end of the construction lease.

The parties have to determine what will happen to the buildings when the lease expires. If nothing is organised in the construction lease, the buildings will return to the owner without the latter being required to pay any compensation.

Moreover, construction leases are exempted from value added tax (VAT). But, the parties have the option to subject the construction lease to VAT which will then be payable at the date of execution of the lease.

To ensure that the lease is enforceable against third parties, construction leases must be registered at the land registry.

#### **4.2.1 Direct taxation of construction leases**

##### **a. Rules applicable during the lease**

Rents and other benefits of any kind received by the landlord during the lease are considered as property income. Such income is subject to the tax-base rules of:

- Income tax in the category of property income if the landlord is an individual (or a tax transparent entity he owns); or
- Income tax in the category of corresponding professional benefits if the landlord is an enterprise (or a tax transparent entity owned by this company) and the property is assigned to an operating activity; or
- Corporate tax if the landlord is a company (or a tax transparent entity owned by this company).

Where the rent is paid by delivery of properties or fractions of buildings or by delivery of securities granting entitlement to ownership of or enjoyment to such properties, the landlord is taxed on the value of these assets (calculated according to their cost price), for the year or reporting period where the assets were allocated to it, with the possibility of requesting the taxation to be spread over a period of fifteen years.

##### **b. Rules applicable upon expiry of the lease**

In principle, the lease provides that the ownership of constructions built by the tenant shall be transferred to the landlord at the end of the lease (i) but it may also conversely provide for a transfer of the land to the tenant (ii).

(i) The main appeal of the construction lease lies in the tax regime applied when the constructions built by the tenant return to the landlord at the end of the lease without compensation. The principle remains that this benefit constitutes taxable property income for the landlord. However, on the one hand, the text expressly provides for the valuation of this income at the cost price of the constructions for the tenant and not at actual value of the constructions at the time of the transfer of ownership. On the other hand, the same text provides that the delivery of the constructions does not give rise to any taxation when the term of the lease is at least equal to thirty years. Between eighteen and thirty years, a reduction of 8% per year beyond the eighteenth year is applied on the cost price of constructions.

Where delivery of constructions to the landlord is taxable, the taxation may be spread over a period of fifteen years, which ceases if the asset is disposed of.

(ii) Where the agreement contains a clause providing for the transfer of ownership of the land to the tenant in return for the payment of additional rent, the generated capital gains are taxed as follows:

- If the landlord is an individual: The capital gains are taxed according to the regime for real estate capital gains of individuals. The amount of the net capital gains is determined at the time of execution of the lease according to the value of the asset as of that date; The holding period taken into account for the establishment of capital gains is the period between the date of acquisition of the asset by the lessor and the date of transfer of ownership at the end of the lease;

- If the landlord is an enterprise or a company: The capital gains will be taxed respectively according to the regime of long-term capital gains and corporate income tax will be paid at the standard tax rate. The amount of net capital gains will be determined at the time of execution of the lease according to the value of the property on that date.

### **c. Cautions regarding the tax risks associated with construction leases**

#### **i. Regarding possible extensions to construction leases**

The extension of a lease does not normally compromise the tax regime, provided that such extension is expressly agreed (CE, 25 January 2006, No 271523) and it is not regarded as an amendment to a material term of the original lease. Failing that, the extension of the lease thus entered into shall be considered as the conclusion of an ordinary lease resulting in the taxation of the landlord on the initially scheduled date of any income corresponding to the value of the construction built by the tenant pursuant to the lease (TA Toulouse, 31 May 2005, No 01-1696).

#### **ii. Early termination of the lease results in taxation of the landlord on the cost price of the constructions delivered**

Case law in the field of direct taxes gives the effects of an early termination to:

- The contribution or transfer of land by the landlord to the tenant (CE, 5 December 2005, No 256916, CE, 21 December 2007, No 289807);
- Merger of the landlord and tenant companies (CE, 7 February 2007, No 288067);
- Simultaneous assignment by the landlord and the tenant of their rights to a single purchaser (CE, 21 November 2011, No 340777);
- An operation involving two companies that are separate but which belong to the same economic group whereby one becomes the owner of the land and the other becomes a shareholder of the tenant company (CAA Versailles, 30 December 2013, No 12-00608).

#### **iii. Regarding the recognised asset value of constructions delivered upon expiry of the lease**

The *Conseil d'Etat* (French Administrative Supreme Court) has ruled (CE, 5 November 2014, No 366231) that the landlord can claim the benefit of the exemption only up to the limit of the cost price of the constructions delivered, even where it recorded these constructions at their market value. However, if the landlord recorded the received constructions at their market value, the tax Authorities are entitled to add the difference between the market value and the cost value of constructions delivered to it back into the taxpayer's taxable profits. In other words, the method according to which constructions received are recorded at the end of the lease proves decisive.

If they are recorded at cost price, the taxation of the capital gains will be deferred to the subsequent disposal of the asset. If actual value is recorded, the taxation of the capital gains is immediate.

### **4.2.2 VAT and Stamp Duties**

Construction leases are in principle exempted from VAT but the lessor can apply for taxation thereunder. If so, the lessor will be liable for VAT at the time of payment of rent. However, VAT will be paid at the time of execution of the contract on the value of the repossession right (*droit de reprise*) reduced by the sum of total rents and a repossession fee (*indemnité de reprise*) payable to the lessee if provided by the lease agreement.

### **4.3 Long-term leasehold (*bail emphytéotique*)**

The long-term leasehold is governed by Articles L.451-1 *et seq.* of the French Rural Code (*Code rural*). This leasehold confers on the tenant, the long-term leaseholder, a right *in rem* entitling it to construct and grant leases and easements, for a period between eighteen and ninety-nine years inclusive, without any tacit renewal possible.

Similarly to construction leases, a long-term leasehold may be freely transferred, mortgaged and seized. However, the long-term leaseholder also has miscellaneous obligations. Mainly they are required to maintain the building in a proper state of repair. Moreover, they have to pay rent, called the *canon emphytéotique*.

Contrarily to construction leases, long-term leaseholds may not require a specific use to apply to the building to be erected. As for construction leases, a long-term leasehold may be freely transferred. However, in this case, assignments may not be partial, unless agreed otherwise.

To ensure that the lease is enforceable against third parties, it has to be registered at the land registry.

On the expiry of the long-term leasehold, the constructions or improvements carried out by the tenant shall fall within the ownership of the landlord, without compensation, unless agreed otherwise.

#### 4.4 Long-term housing lease (*bail réel immobilier relatif au logement "BRILO"*)

Since its creation by Ordinance 2014-159 of 20 February 2014, the long-term housing lease has been governed by Articles L.254-1 to L.254-9 of the French Construction and Housing Code. It is reserved for the production of affordable accommodation.

This type of lease is designed to apply primarily in areas where the market is tense and in which there needs to be an intermediate housing offer between the social housing sector and the free housing sector. In fact, these tense areas are defined as municipalities which belong:

- Firstly, to a continuous urban area of more than 50,000 inhabitants and defined by Article 232 of the French Tax Code, i.e. municipalities subject to vacant dwelling tax;
- And, to municipalities with a high rate of population growth with over 15,000 inhabitants defined by an Order in application of Article L.302-5 of the French Construction and Housing Code.

The purpose of this type of lease is offer lower prices for housing by separating the land which remain within the ownership of the landlord and the building which will be temporarily the tenant's property. Therefore, the price for dwellings is lower to the extent it shall not include the cost of the land which can be significant.

Housing governed by this regime is to be occupied as a primary residence throughout the term of the lease, by individuals whose income does not exceed a maximum limit set out in an Order.

#### 4.5 Precarious occupancy agreements

Since its creation by Pinel Law No 2014-626 of 18 June 2014, the precarious occupancy agreement has been governed by Article L.145-5-1 of the French Commercial Code.

Although dealing with commercial premises, the precarious occupancy agreement is not subject to the statutory regime governing commercial leases. It is a contract whereby the parties express their will to grant the occupier merely a precarious right of enjoyment for a limited financial compensation.

A contract can only be described as a "precarious occupancy agreement" if two criteria are met:

- The occupier's right is precarious (uncertain term of occupancy; possible termination of the agreement without prior notice) implying a particularly low fee;
- There are special circumstances beyond the parties' control (geographical location; transitional situation of the building such as pending expropriation, the intermittent and temporary nature of occupancy).

Precarious occupancy agreements are not limited in time and may last as long as the precarious grounds prevail.

As the occupier's right is precarious, the latter may not claim the benefit of right of renewal or the payment of an eviction indemnity.

### C. Asset and/or property management

As the management of a real estate asset requires a great many skills, it may be worthwhile outsourcing all or part of these functions to a real estate professional.

An asset and/or property management agreement may cover various areas:

- Accounting management, e.g. payment of co-ownership charges, payment of contractors working on site, issuance of invoices, collection of rent and service charges, payment of taxes, etc.;
- Lease management, e.g. assessing rents and leasing commercialisation strategy, analysis of potential tenants, negotiation of lease terms, lease drafting, etc.;
- Technical management, e.g. claims handling, work management, operation and maintenance contracts management, etc.;
- Administrative management, e.g. monitoring tenants' compliance with lease agreement provisions, rents indexation, establishment and update of the rental situation, dispute management, etc.

The asset/property manager is subject to the Hoguet Law and must hold a professional license. The professional license shall be for management activities and - depending on the scope of the agreement - transactions activities (**please refer to Chapter II - Section A for further details**).

An asset and/or property management agreement is an agency agreement subject to specific mandatory legal requirements:

- It must be written and executed prior to the start of any mission;

- The Hogue Law sets forth the mandatory provisions to be included in the agency agreement, including its purpose, duration, contractor's fees, etc.;
- The agency agreement must be recorded in the related register.

Until 2017, failure to comply with the requirements above resulted in the agency agreement being declared void. Since 2017, the agency agreement shall only be subject to voidability.

Particular care shall be applied to the provisions of the agency agreement relating to the collection of rents and service charges and its related compensation. Since 2014, service charges in connection with rents cannot be re-invoiced on tenants. The agency agreement must thus make a clear distinction between collection of rents and collection of service charges (and related fees) to avoid any future disputes.

## D. Hospitality management

### 1. Hotel management agreement

This way to operate a hotel has become very popular for upgrade hotel categories in the hotel industry. The owner of the building and of the hotel business (*fonds de commerce d'hôtel*) grants a hotel operator an "agency agreement" to manage the hotel on its behalf and in its name based initially in particular on Article 1984 of the French Civil Code.

#### 1.1 Term of the hotel management agreement

A management agreement is generally granted for a period of fifteen to twenty-five years. The agreement can provide for renewal options subject to the agreement of the parties for periods ranging between five to ten years.

#### 1.2 Payment of "key money"

In view of the opening of the hotel, the hotel owner is required to conduct significant renovation works in order to comply with the operator's brand operating standards. Within the framework of the contract negotiations, the owner may require the operator to participate financially in the completion of the renovation works by paying a financial contribution known as "key money".

In return for the payment of key money, the operator can request an increase in operating fees and/or a longer contract term so as to be able to amortize the key money over the contract period. The hotel operator will also request a refund of the key money if the management agreement is terminated at the owner's initiative prior to its term, or in the event of owner's default.

#### 1.3 Operating fees

The fees payable by the operator to the owner generally include two aspects:

- A base fee, which is generally between 3 to 5% of total revenue;
- An incentive fee between 7 to 12% on Gross Operating Profit, or GOP (total revenue less operating expenses). In order to encourage the operator to enhance performance, the owner can condition the payment of the incentive fee to the achievement of financial objectives contemplated by the management agreement;
- Other service fees seeking to compensate booking, marketing and other services may be applied, and vary between 1 to 4% on total revenue or revenue per room.

#### 1.4 Operator Performance Test

Performance tests allow the owner to penalize the operator, if mutually agreed GOP or revenue per available room (RevPar) is not met at the expiry of a period of four to six years after the hotel is opened to the public or at the expiry of the initial term. The criteria of the performance clause does vary from time to time but often depends on actual performance of the hotel compared to a budget and actual performance of rivals of such hotel.

In such a case, the owner has the option of terminating the agreement if the economic performance criteria are not met or requesting that the operator pay the difference between the contractual performance threshold and actual operating profit (a "right to cure").

### 1.5 FF&E replacement

During the term of the agreement, Furniture, Fixtures & Equipment (FF&E) will need to be replaced and the operator will want to make sure that money is reserved for this purpose. This issue is critical to ensuring that the hotel remains attractive in a highly competitive market.

In practice, the owner and the operator agree that the annual budget shall contain a line item for FF&E replacement. This line item varies between 3 to 5% of gross revenues and increases during the first years of the agreement, generally reaching a cap in the sixth year of the contract. The FF&E reserve belongs to the owner of the hotel, who remains the beneficiary of the funds, notably if these are not fully used up by the end of the agreement.

### 1.6 Non-disturbance agreement

In practice, hotel owners have significant bank debt due to the acquisition and construction of the hotel. In this case, lender benefits from security interests that can, if enforced, significantly impact the operation of the hotel.

Certain hotel chains have put in place tripartite agreements known as a “Non-Disturbance Agreement” (NDA). These agreements seek to protect the operator if security interests are enforced by the lender, and the lender will take this opportunity to obtain certain specific guarantees from the operator.

As an example, these NDAs may contain mutual obligations of the lender and the operator in the event of an owner’s default, providing an opportunity to cure intended to avoid the termination of the agreement by the operator, or the direct payment to the lender by the operator of amounts due to the owner. This practice has a more limited impact in France than in a Anglo-Saxon jurisdictions.

### 1.7 Personnel

The issue of the hotel’s payroll, which represents a significant financial item, gives usually rise to long negotiations. If the owner benefits from the operator’s know-how in the area of personnel management, personnel in France is usually hired by the owner, who is legally the employer.

In practice, so-called “reverse hotel management” agreements have arisen, through which the operator is the sole employer of the hotel’s personnel and takes on the full brunt of the “employee risk”. In exchange, the operator obtains the owner’s covenant to reimburse it for remuneration and termination expenses. In practice, however, this type of arrangement may create legal issues and must be drafted very carefully.

At the end of the agreement, there is a debate regarding the fate of the employees who should normally be transferred under Article L.12224-1 of the French Labour Code (*Code du travail*) to the owner or to the new hotel operator.

## 2. Commercial lease agreements

Various operating methods have been developed in the hotel industry over the past several years. Today, three different categories of lodging structures have emerged: Hotels, tourist residences and serviced accommodation (or hotel-styled residences).

Article D.311-4 of the French Tourism Code (*Code du tourisme*) defines a tourist hotel as a classified commercial lodging establishment offering guest rooms or furnished apartments for rent for short-stays characterized by a rental in days, weeks or months, but who (other than exceptionally) do not elect domicile at such establishment. The establishment can also provide restaurant services. The establishment is operated year-round on an ongoing basis or only during one or several seasons. The establishment is known as a seasonal hotel when it is open for no more than nine months per year over one or more periods.

Atout France, which is an economic interest group, issues hotel ratings (from 1 to 5 stars) which is valid for five years.

Similar to hotels, tourist residences are defined as classified commercial accommodation operated on an ongoing or seasonal basis (Article D.321-1 of the French Tourism Code).

Serviced accommodations or hotel-style residences constitute a mode of operation halfway between a hotel and a tourist residence, being specified that these residences do not benefit from an administrative classification.

### 2.1 Application of the statutory regime governing commercial leases

Pursuant to Article L.145-1 of the French Commercial Code, the application of the statutory regime governing commercial leases is subject to the operation of a business (*fonds de commerce*) within the leased premises.

While the application of the statutory regime governing commercial leases does not raise any difficulties for hotels, the benefit of this regime has long been debated with respect to tourist residences and serviced accommodation. However, Judges will not hesitate to apply the statutory regime governing commercial leases to an operator of a tourist residence furnishing services to its customers within the leased premises. If this criterion is met, the statutory regime governing commercial leases will apply (Cass. 3<sup>rd</sup> civ., 10 February 1999 No 97-14.669, Garbarinio v. Sté Green Parc).

Regarding serviced accommodation, Courts apply the statutory regime governing commercial leases, holding that it does not matter whether the hotel-style services furnished by the operator are ancillary to the furnished rental, as the offering of such services is a factor forming part of the choices available to occupiers and it is of little significance whether they ultimately use these services as a whole only moderately (Paris CA, 25 January 2012, No 10/06401: AJDI 2012, p.197).

## 2.2 Regarding the term of leases

In accordance with the provisions of Article L.145-4 of the French Commercial Code, the term of a commercial lease for a hotel, tourist residence or service accommodation cannot last for less than nine years.

Hotel and serviced accommodation operators benefit from the option of being able to terminate the lease every three years. However, lawmakers created specific provisions applying to operators of tourist residences, set out in Article L.147-7-1 of the French Tourism Code (instituted by Law No 2009-888 of 22 July 2009). This Article provides that commercial leases signed between owners and operators of tourist residences referred to in Article L.321-1 of the French Tourism Code must last at least nine years, and cannot be terminated at the end of three-year periods. In a decision dated 9 February 2017, the French Supreme Court ruled that the provisions of this Article are a matter of public policy, even if they are not included among the mandatory provisions referred to in Article L.145-15 of the French Commercial Code, and applied to leases in progress as of the effective date of Article L.145-15 of the French Commercial Code, i.e. 25 July 2009 (Cass. 3<sup>rd</sup> civ., 9 Feb. 2017, No 16-10.350). However, to date, the issue as to the applicability of Article L.145-7-1 of the French Commercial Code to renewed leases remains up in the air, and a review of the preliminary parliamentary studies seems to indicate that lawmakers solely wished to avoid the termination of a commercial lease by the operator before the end of the initial nine year term (which had the effect of jeopardizing the tax benefits of landlord-investors) and not to apply a firm nine-year term on a renewed lease.

This firm nine-year term only applies to tourist residences referred to in Article L.321-1 of the French Tourism Code, i.e. classified tourist residences. Serviced accommodations are not impacted by the application of the provisions of Article L.145-7-1 of the French Commercial Code.

## 2.3 Regarding rent on renewals

According to Case law, hotels, tourist residences and serviced accommodations constitute single-use premises.

Indeed, Article R.145-10 of the French Commercial Code relating to the setting of rent for single-use buildings provides that the "price for leasing premises built in view of a single use may (...) be determined in accordance with the practices used in the sector in question."

In the sector in question, i.e. hotels, serviced accommodation and tourist residences, the hotel method is customarily applied.

Traditionally, in the hotel sector, the rental value of the leased premises is determined using the so-called "hotel method", which is based upon theoretical turnover (including taxes) determined using the prices advertised, which are higher than those actually applied. However, this traditionally used method did not correspond to market practice, since prices are no longer set on a yearly basis or based upon peak- and low-seasons, but change on a daily basis depending on room occupancy and reservations ("dynamic pricing" practice).

The *Compagnie des experts en immobilier commercial et d'entreprise* (commercial and corporate real estate expert body) which is competent within the jurisdiction of the Paris Court of Appeals initiated a reflection aimed at reforming the traditional hotel method (AJDI, October 2016). The Compagnie's proposals consisted of determining rental value as follows:

- Seeking the "feasible price per room" on the basis of sources made available to the Compagnie, with the price differing depending on location, room and category of the establishment;
- From this "feasible price per room", VAT and sojourn tax is deducted in order to obtain theoretical revenues excluding taxes;
- Application of an allowance for fees paid to OTAs;
- Adjustment of theoretical revenue depending on the occupancy rate determined using statistical data;

- Application of the revenue rate using the new coefficients: 21 to 25% for establishments with lesser locations offering practically no services other than lodging (so called "prefecture hotels", 1 and 2 stars), 18 to 21% for hotels equivalent to 1 to 2 stars that are located in unremarkable areas and having reduced ancillary services; 15 to 18% for 2 and 4 star hotels located in the centre of town or on the outskirts of town, and 12 to 15% for a 5-star hotel. Regarding hotel residences, the rates are generally between 25 and 35%.

#### 2.4 Regarding works carried out in rented premises

Concerning hotels, works carried out by hoteliers are subject to a specific legal regime: The owner of a building in which a hotel is operated cannot object, notwithstanding any provision to the contrary, to improvement works carried out by a tenant at its expense and under its responsibility (Article L.311-1 of the French Tourism Code). This ability to carry out improvement works impacts the state in which the premises are returned, since the landlord cannot require that the premises be returned to their prior state, as the premises are returned in their current state (Article L.311-4, para 4 of the French Tourism Code).

Before commencing work, the tenant must inform the owner of its intentions via registered letter with acknowledgement of receipt. This notice must enclose an execution plan, specifications and an estimate of the cost of the proposed works. There are two possibilities: (i) If the works do not affect the building's structure, the landlord can commence once notice has been served, and (ii) if the works affect the building's structure, the landlord has two months to inform the tenant whether it accepts or refuses the proposal.

Regarding determination of renewal rent, the French Tourism Code provides that the work carried out by the tenant during the term of the current lease and the term of the renewed lease following that lease, and for a period of twelve years "commencing upon the performance period referred to in Article L.311-2" cannot be taken into account when setting the rent for the renewed lease. In effect, the owner cannot request any increase in rent based on a reflection of the enhancements resulting from building improvement works. However, this neutralising mechanism only applies if the tenant notified the landlord of its intention to carry out the works.

The provisions of the French Tourism Code regarding works do not apply to serviced accommodation or tourist residences.

#### 2.5 Legal obligations applying specifically to tourist residences

The operator of a tourist residence has specific obligations regarding:

- Disclosure to all owners, once a year, of the balance sheet for the prior year. This balance sheet must specify average occupancy, material events over the year and the amount of and change in the residence's principal expense and revenue line items. Owners who so request may obtain their residence's operating account (Article L.321-1 of the French Tourism Code);
- Disclosure to the investor at the time the residence is marketed. Indeed, the marketing documents must include information concerning, in particular, the project itself, the project sponsor, the manager of the residence, the tax and financial benefits of investing in the tourist residence and the eligibility criteria required to benefit from such advantages, and the various statuses the acquirer-investor may have;
- The investor's obligation to pay the tenant an eviction indemnity if the lease is not renewed, which indemnity must be equal to the harm caused by failure to renew.

### 3. Franchise agreements

A hotel franchise agreement allows a hotel operator (the "franchisee") to benefit from the know-how, image, brand and distribution network of a hotel chain (the "franchisor").

In practice, the franchise agreement is generally used for so-called "budget" hotels, but is becoming more common with upgrade hotel categories.

#### 3.1 Regarding the pre-contractual duty to disclose

In France, the provisions of a franchise agreement are essentially governed by the Law of 31 December 1989, known as the "loi Doubin" (Article L.330-3 of the French Commercial Code). This Law provides a framework for the pre-contractual phase and notably provides for a duty of disclosure to the franchisee. When the franchise contract carries exclusivity obligations, a pre-contractual information file (*dossier d'information pré-contractuelle*, or "DIP") must be furnished.

The DIP, whose contents are defined in Article R.330-1 of the French Commercial Code, specifies in particular, the enterprise's length of existence and experience, the state of the market and the market's development prospects, the size of the operator network, the term, the conditions upon

renewal, termination and assignment of the agreement, as well as the scope of the exclusivity obligations.

The DIP and the draft franchise agreement are communicated at least twenty days before the contract is executed or, as the case may be, before the payment of any monies.

### 3.2 Regarding the principal provisions of franchise agreements

Term of the hotel franchise agreement: The initial term generally lasts between ten to twenty years, being noted that the contract generally contemplates renewal options.

Franchise agreement fees: In addition to the key money generally paid by the franchisee to the franchiser, the contract generally provides for:

- A base fee ranging from 2 to 5% of lodging revenue or total revenue;
- Additional fees connected with the hotel's pre-opening phase;
- Fees compensating additional services rendered by the franchiser: Marketing fees (between 2 to 4% of lodging revenues, commercial and booking fees of 2 to 5% of lodging revenues, awards program fees of 1 to 2% of the lodging revenue and miscellaneous fees reaching up to 2% of lodging revenues).

Brand standard issues: The franchisee must comply with the chain's brand standards and other standards. These provisions are therefore heavily negotiated, since compliance with these standards requires the franchisee to make frequent investments and to undergo frequent controls by the franchisor.

## E. Tax issues

Like in most other countries, French taxation of income achieved by companies is structured around two alternative tax regimes:

- The corporate income tax system, which entails a company to pay itself tax on its own results, as will be described below. Special developments will be devoted to the tax group regime;
- The partnership taxation system, leading a company to transfer to its partners the obligation to pay tax on its results. This scheme has been considered above (**please refer to Chapter IV - Section I, our comments addressing non-commercial partnerships**).

### 1. The standard corporate income tax system

#### 1.1 Territorial scope

Corporate income tax only affects the profits of companies operating in France, and those in respect of which the right to tax is granted to the French State under a bilateral tax Treaty. According to almost all of these Treaties:

- The management of a building shall not constitute a permanent establishment within the meaning of those tax treaties, whenever the lack of means in personnel and equipment does not enable the characterization of the exercise of an activity other than that relating to the simple provision or rental of a property;
- The right to tax income and capital gains deriving from properties located in France is granted to the French State.

#### 1.2 Determination of taxable income

The taxable income of companies and commercial companies subject to corporate income tax in France is determined based on the accounting data featuring in the income statement (income and expenses) and in the balance sheet (change in net assets during the financial period).

This accounting data is that of the statutory accounts (as opposed to that of the consolidated accounts).

Statutory accounts are governed by French accounting regulations, which sometimes depart from IFRS Regulations.

Most often, the tax result of the financial period is determined from the accounting result, and by restating this according to the adjustments (deductions and amounts added back) provided for by the tax regulations.

##### 1.2.1 Regarding income

- Operating income:
  - . As a general rule, rental income is recorded and taxed over the lease period;

- . As an exception, and especially when significant, rent-free periods have to be “linearised” over the entire occupancy period provided for in the lease, for accounting and tax purposes.
- Financial income - the parent company regime:
  - Provided the qualifying criteria are fulfilled, companies or branches subject to French corporate income tax may opt for a full exemption for dividends received from their subsidiaries. Symmetrically, the management costs relating to the stake, fixed at a flat rate of 1% or 5% of those dividends, are not deductible from the tax result of the receiving company. Similarly, any tax credit attaching to dividends paid by foreign subsidiaries is to be written off, if the dividend is exempt at the level of the parent company.
  - . First, to qualify for this regime, the parent company and its subsidiary must both be subject to corporate income tax at the standard rate; But, on the other hand, no specific legal form is required for their incorporation.
  - . Second, the parent company must be the full legal or bare owner of the securities, which must be entirely paid up and have either to be in registered form, or to be held by an approved financial institution.
  - . Third, as a general rule, the parent company is required to own at least a 5% stake in its subsidiary, and, to definitively validate the exemption, to have finally held these securities for at least two years.

### 1.2.2 Regarding expenses

With some exceptions (the main ones being recalled below), the expenses contributing to the determination of the accounting result are tax deductible. For management of buildings, this covers personnel expenses, fees and commissions, and certain taxes relating to real estate activities (certain general taxes, such as the corporate income tax, the social contribution incidental to this tax, or the tax on certain vehicles, are thus not deductible).

In addition, certain expenses are tax deductible only if they are recorded in the company accounts (in particular, provisions and amortisations).

- For real estate management, these tax adjustments concern mainly:
  - . Certain loan interests (**please refer to Chapter III - Section G**);
  - . Provision for depreciation recorded on “investment property” (or on the securities of companies holding such property) recorded as fixed assets: While the level of accounting impairment corresponds to each asset (or group of assets), the tax deductible depreciation is assessed at the level of all the buildings qualifying as an “investment property”;
  - . For all buildings recorded as tangible assets:
    - o Some amortisation:
      - In certain situations, the accounting rules defining the basis and/or periods of amortisation of the buildings may differ from the corresponding tax rules;
      - More rarely, the accounting and tax criteria determining whether a property qualifies as a stock or a fixed asset, may diverge: Should a building qualify as a stock (non-depreciable) for accounting purposes, and as a capital asset for tax purposes, difficulties (or even handicaps) may arise, with regard to the amount of the deductible amortisation and of the capital gain on resale;
    - o When a building is subject to both depreciation and amortisation, specific accounting entries are necessary to preserve the maximum tax deduction for depreciation.

### 1.3 The use of tax losses

Tax losses recognised for a tax period may be carried forward or, optionally, backwards.

Tax losses carried back may entitle for a refund of previous corporate tax. This reimbursement can be obtained from the sixth year following the fiscal deficit period.

In the meantime, losses carried forward, and those carried back during the five year period preceding their repayment, could be netted against the corporate income tax due in respect of new profit periods. However, such appropriation is subject to a double cap. For each new tax period, losses may thus be off set against any profits:

- i) First, up to a limit of EUR 1 million;
- ii) Second, (for losses remaining after i)) for 50% of the amount of profits, over and above the first limit.

#### 1.4 Corporate income tax rate

The standard corporate income tax rate amounts to 33⅓%. This rate is in the course of being progressively reduced to:

- 28%, for profits up to EUR 500,000, and 33⅓% beyond that amount, for tax years beginning on or after 1 January 2018;
- 28%, for profits up to EUR 500,000, and 31% beyond that amount, for tax years beginning on or after 1 January 2019;
- 28%, for the full amount of profits, for tax years beginning on or after 1 January 2020;
- 26.5%, for tax years beginning on or after 1 January 2021;
- 25%, for the full amount of profits, for tax years beginning on or after 1 January 2022.

As an exception, several real estate entities benefiting from a specific tax status may apply the reduced rate of 19% to certain capital gains **(please refer to Chapter II - Section B)**.

Entities subject to standard corporate income tax whose turnover (VAT excluded) amounts to EUR 7.63 million or more are also liable to a social contribution equal to 3.3% of the total amount of corporate income tax, minus relief capped to EUR 763,000 per twelve month period.

Thus, globally the overall standard tax rate applicable to the portion of taxable income exceeding EUR 2,289 million is almost 34.44%.

#### 1.5 Permanent establishments: A withholding tax on deemed distributions

According to Article 115 quinquies of the French Tax Code, disposable income of French permanent establishments of foreign companies is deemed to be distributed to shareholders who are not French residents.

Thus, the 30% withholding tax on dividends is to be levied on those earnings by the permanent establishment, and to be paid to the French Treasury on a provisional basis: A refund may be claimed within a short time period, by proving either that the withholding tax base exceeded earnings actually distributed during the twelve month period following the tax year during which the withholding tax was levied, or that dividends have been paid out to French residents.

Roughly one hundred tax Treaties concluded by France provide for more favourable rules: Companies whose head office is located on the territory of the other contracting State may benefit from reduced rates, or may be exempt from the payment of such tax.

## 2. The tax group regime

According to Articles 223 A to 223 U of the French Tax Code, companies subject to corporate income tax may opt for a tax group regime, for a five-year period tacitly renewable.

Under this regime, a French parent company can pay corporate income tax (and the accessory social contribution) in lieu of all of the companies which are members of the tax group.

For each financial period, the parent company can include all companies eligible to be members of the corporate group, or only a portion of them.

### 2.1 Principal qualifying criteria

The parent company must own at least 95% of the capital of each company which is a member of the tax group during the full fiscal year, directly or indirectly through companies of that group (a tax group may also be implemented with French companies whose share capital is at least 95%-held, directly or indirectly, by a parent company established in a EU or EEA Member State having signed an assistance Treaty to combat tax evasion and avoidance in France).

The parent company cannot be 95%-held or more by another corporation liable to corporate income tax.

With some exceptions, all companies member of the tax group must close their financial periods - which must be twelve months long - on the same date.

### 2.2 Assessment of the group's tax result

The group result is composed of the algebraic sum of the taxable income or loss of each group member, which continues to determine and declare its own tax results.

This group result is then subject to certain restatements (deductions and amounts added back), mainly related to intra-group provisions and depreciations, intra-group capital gains and capital losses, intra-group subsidies.

Since the tax group does not have a separate legal personality from that of the parent company, the tax result of the group (profit or deficit), is that of the parent company.

### 2.3 Situation of the parent company and its subsidiaries with regard to corporate income tax

Although the parent company is liable to the corporate income tax due on the tax group result, each member of the group remains jointly and severally liable for the payment of corporate income tax should the parent company default.

As a general rule, each subsidiary has to reimburse to the parent company the tax it should have paid on its own tax result had it been taxed separately.

### 3. VAT issues

The rental of furnished professional premises and parking spaces is subject to VAT at the standard rate of 20%.

The rental of unfurnished professional premises is, in principle, exempt from VAT. The landlord can elect for taxation under VAT, which will enable it to deduct the VAT incurred on the acquisition and/or the construction of the property.

The election for VAT may be made at the time of the acquisition of the properties and applies from the first day of the month during which the election was notified on the tax Authorities and up until the election is revoked. Property owners may only revoke a VAT election as from the first day of the ninth calendar year following the one during which the election was exercised.

Election is possible when the tenant is liable for VAT and uses the building for its commercial activities – it is also possible where the tenant is not subject to VAT (for example a public body using the building for its administrative activities), but in this case, the VAT election must be expressly stated in the lease agreement.

Where a property changes hands multiple times, the VAT election may be transferred to the new owners.

### 4. Local taxes issues

Certain local taxes are due by the owners of property, regardless of whether they occupy it themselves or make such available to third parties (e.g. the land tax, the annual tax on certain premises located in Ile-de-France region, the street sweeping tax, etc.).

In the second case above, it may be worth stating in the rental agreement that the local taxes, billed in the name of the owner, will be invoiced back on the occupier. Owners who do not occupy the building personally will also be liable for the *cotisation foncière des entreprises* (CFE) at the minimum rate, unless they have other premises than those that are leased out.

Also, owners should have to pay the *cotisation sur la valeur ajoutée des entreprises* (CVAE), regardless of whether they occupy the premises personally or lease them out. Owner-occupiers cannot deduct an allowance for depreciation of the building from the added value they produce, but landlords can deduct such allowances from their added value, on the condition that the rental period exceeds six months (except derogatory depreciation, and in proportion to the length of the rental, lease or management contract).

Other taxes are due by the occupier, such as the CFE calculated on the basis of the cadastral rental value of the premises used, the tax on commercial areas, or the CVAE, which is calculated on the basis of the added value produced by one's own business. The rents (and supplemental rental costs, such as taxes re-invoiced) paid by the occupier to the owner of the building are not deductible from the value added, if the rental period exceeds six months (or if the contract is a lease or management agreement).

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