# REAL ESTATE NEWSLETTER

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### News




CMS Bureau Francis Lefebvre


## EDITORIAL

Dynamic demographics, an ageing population, rising dependency levels, increasing student population, rising property prices, etc. The need for affordable housing for those on low incomes, students, the elderly or dependent has never been so great.

This issue of our Real Estate Newsletter is dedicated to social-purpose real estate, reflecting not only the vital and complex challenges inherent in this issue, but also the scale and the specific nature of the different asset types in this sector, which figures large in the French real estate landscape.

The situation leaves no room for ambiguity: it is vital not only to increase the current stock of social housing, student accommodation, retirement homes and long-term elderly care facilities, but also to renovate, restructure and upgrade existing stock.

These needs are pressing and inevitably call for substantial capital investment and therefore the intervention of public and private-sector investors.

The issue has grown in importance in French politics, galvanising many front-line public-sector and government actors, alongside local authorities and their partners.

Social-purpose real estate is also increasingly attractive for private investors.

The sector is of potential interest across the real estate market, for a range of actors from individuals in search of investment opportunities and financial or institutional investors seeking new opportunities, to real-estate professionals interested in growth drivers.

Since the economic, fiscal and regulatory environment is constantly shifting, it seems appropriate to address a number of the current legal and taxation issues specific to certain facets of social-purpose real estate.

In view of the growth in investment in nursing care facilities, this issue recaps on some important points of vigilance to keep in mind during the acquisition of a company that holds this type of asset.

The ever-resourceful tax system provides for a number of specific measures for social-purpose real estate, which we will address in light of most recent developments, i.e. the Censi Bouvard law, tax rules applicable to social housing, VAT rules applicable to long-term elderly care facilities, local taxes, and the tax treatment of European not-for-profit organisations.

Lastly, we will update our readers on the most recent legislative developments in the area of residential and commercial leases, as well as on the reform of taxation of private real-estate capital gains.

Please read on. ■

Alexandre Delhaye, associate

# Acquisition of a company operating long-term elderly care facilities: legal vigilance points

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Investments and acquisitions in the long-term elderly care facilities sector are increasingly frequent and are attracting interest from a growing number of investors (large players in the sector, specialist investors, investment funds, etc.). Although as medical-social establishments, long-term elderly care facilities constitute a separate asset class, they nonetheless have a number of characteristics in common with the hotel sector, since they offer para-hotel and food services, and with hospitals, given that long-term elderly care facilities are care homes first and foremost providing on-going and daily assistance and care to the elderly, regardless of their dependency level.

While the due diligence prior to the acquisition of a company operating long-term elderly care facilities must cover all the usual points for acquisition audits (identifying fiscal and social risks, verifying ownership of the assets held by the company and its securities, review of financial statements, etc.), it must also focus in particular on the regulatory and real estate aspects of the deal.

***"As medical-social establishments, long-term elderly care facilities constitute a separate asset class, but nonetheless have a number of characteristics in common with the hotel sector and with hospitals".***

Long-term elderly care facilities in France operate within a specific regulatory framework (*Code de l'action sociale et des familles* - Social work and family code) from the date of creation. The code requires that future operators comply with a call for projects procedure, obtain an authorisation order to operate the facility and enter into a tripartite agreement over several years with the Conseil général and the Health Insurance system. Even though in principle the government licences remain in force in the case of the acquisition of a company's shares (unlike in the case of the sale of the goodwill, which would require the approval of the competent state authorities since it would entail a change of operator), the regulatory due diligence should seek to verify that the company is in possession of the required valid authorisations, which reflect the actual operation of the facility (e.g. number of beds) and that it has complied with its regulatory obligations (e.g. carry out works required pursuant to inspection committees, compliance with the clauses of the tripartite agreement). The regulatory due diligence must also examine the regulations that are not specific to long-term elderly care facilities, such as the regulations governing public buildings or those addressing health and safety issues.

The real estate due diligence should examine ownership of the building and its condition in order to identify and estimate the cost of the works that may be needed to renovate the facilities, upgrade them to the required standards, or the extension options that exist. The real estate valuation is clearly essential and will be a factor in negotiating the transaction price, as well in all cases where outsourcing or refinancing is envisaged (e.g. write-down of unrealised capital gains). It is also important when it comes to registration duties, since it will determine whether or not the company is classified as investing predominantly in real estate.

In the case of a lease, it is imperative to analyse the commercial lease to - ensure that the clauses (term, responsibility for payment of works, guarantee substitution, etc.) are acceptable to the purchaser and that there are no grounds for termination of the lease based on default by the company.

Of course, these central concerns could be effectively covered by specific provisions in an assets and liabilities security agreement, which could supplement the due diligence conducted by the purchaser, thereby bolstering the latter's protection. ■

# Tax reduction under the Censi-Bouvard Law: a real tax incentive for all?

**Any assessment of the tax incentive introduced by the Censi-Bouvard law must weigh the reduction in income tax against the loss of the right to depreciate the fraction of the investment cost price that served as the basis for the calculation of the tax reduction.**

Censi-Bouvard provides a tax reduction to individuals in exchange for the acquisition, up to 31 December 2016, of new or renovated residential units intended for rental as furnished accommodation, when these units are in residences providing approved services for the elderly or disabled (including long-term elderly care facilities), homes and approved care homes, residences with services for students or listed tourist facilities (article 199 sexvicies of the French General Tax Code).
The owner must undertake
to lease the furnished accommodation for at least nine years to the operator of the residence in which the accommodation is located, and the furnished letting may not be operated as a non-professional (LMNP - non-professional landlord of furnished property).
For housing units acquired after 1 January 2012, the tax reduction is 11% of the cost price of the unit(s) within the limit of €300,000 per year. The tax reduction is spread over nine years (1/9th of the amount of the tax break each year) and the fraction of the tax reduction credited each year is used in the calculation of the overall ceiling on tax advantages under Article 200-O A of the French General Tax Code. The income generated by furnished lettings is taxed as profit/(loss) from industrial and commercial activities. Subject to being governed by a real tax regime, this profit/(loss) is determined after deduction of the depreciation of the building and the furnishings.
In accordance with Article 39 G of the French General Tax Code, the depreciation of buildings (but not furniture) granting entitlement to the tax reduction may only reduce the taxable amount of income from real property by the amount of the depreciation of the cost price exceeding the amount used for the calculation of this tax reduction.

The loss of the right to depreciate the fraction of the cost used as the basis for the calculation of the tax reduction is not only definitive, but applies throughout the entire depreciation period, and therefore extends beyond the nine-year period over which the tax break is spread. While the amount of the tax reduction is independent of the taxpayer's marginal tax rate, - the amount of the tax benefit generated by building depreciation depends on this rate. Before applying the tax reduction introduced by the Censi-Bouvard scheme, LMNPs (LMNP - non-professional landlord of furnished property) would do well to weigh up the amount of the tax reduction they are entitled to as a result of the proposed investment against the loss of the right to depreciate the fraction of the cost price of the building used as the basis for this tax reduction. The tax impact of the definitive loss of the right to deduct the depreciation should be assessed taking into consideration: the probable investment period (and therefore the probable depreciation period), the amount of other expenses - notably financial - to be deducted from the income, and the provisions of Article 39 C by virtue of which the depreciation amount may not exceed, in a given financial year, the difference between the amount of the rental income and other expenses (taking account of the fact that theoretically this loss of the deduction right is temporary, but may become definitive for non-professional landlords). ■

*"Loss of the right to depreciate the buildings giving entitlement to the income tax reduction is definitive and applies for the entire depreciation period".*

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# New tax incentives for social housing: unfinished symphony

**The 2014 Finance bill proposes some help for social housing organisations by introducing fiscal measures aimed at reducing the cost of building social housing and facilitating access to reserved land.**

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It stands to reason that the social housing sector is covered by special tax measures. Article 207 1 4 of the French General Tax Code establishes a tax exemption for companies in the sector. In 2005, to promote development of social housing, this exemption was adjusted to concentrate on operations defined as meeting the general interest under Article L.411-2 of the French Construction and Housing Code (*code de la construction et de l'habitation* - CCH). Such general interest activities primarily comprise the construction, acquisition, allocation and management of rental housing for persons on low income (while the social housing organisation's other operations are taxed under common law).

Legislative provisions currently under discussion in the French parliament include new measures which, if passed, should contribute to generating new momentum in the sector:

– VAT lowered to 5% (from 7% currently) applicable to the construction and renovation of social housing and access to home ownership for low-income households;

– exemption for capital gains by individuals for the sale of real estate to social housing organisations from 1 January 2014 to 31 December 2015. This last measure is actually a renewal of a measure already applied and in force up to 31 December 2011, and which was a definite success. It generates positive impacts on both sides of the equation: a tax break for the seller, which automatically has the effect of lowering the purchase price for the purchaser. This drop in the price of buying land for social housing organisations is particularly apposite at a time when the French government is committed to a programme to build 150,000 social housing units per year.

Whereas the scheme that applied until 2011 provided an incentive for both individuals (tax exemption) and companies (corporation tax rate reduced to 19% from 33.33%), the 2014 Finance bill, as adopted at its first reading by the French National Assembly, restricts the capital gains measure to individuals only. Three amendments to extend it to companies were rejected by the National Assembly's Finance Committee. This rejection by the Committee is all the more surprising, given that, on average, social housing organisations purchase as much land from individuals as they do from companies.

In other words, by limiting it to capital gains by individuals, the efficacy of the measure is more or less halved. It is clear from reading through the debates in the National Assembly's Finance Committee that the rejection of the proposed amendments was based on a completely unjustified fear created by misreading the text of the amendments before it. In fact, whereas the aim of the proposed amendments was to apply the benefit of the measure to companies selling buildings to social housing organisations, the rapporteur général interpreted the measure as being aimed at reinstating a much broader instrument, which would also produce a benefit in terms of the capital gains generated by companies selling land to non-French operators in the social housing sector (SIICs - listed real estate investment trusts, SCPIs - real estate investment trusts and SPPICAVs - variable-capital companies investing primarily in real estate). The amendment would therefore have generated a boon for the latter at a cost to the taxpayer without any attendant benefit to the public purse.

It is to be hoped that members of parliament will return to the text for a more careful reading of the amendments and act fairly to promote access for - and only for - social housing organisations to the land reserves they so desperately need. ■

*"Legislative provisions currently under discussion in the French parliament include new measures which, if passed, should contribute to generating new momentum in the sector."*

# VAT system applicable to property operated as long-term elderly care facilities

Investors leasing buildings to the operators of long-term elderly care facilities should focus on three issues in particular: the tax on the construction cost, the VAT rate applicable to the rental income and the impact of receipt of subsidies.

**Construction cost**

Owners of buildings for lease are not entitled to a reduction on the tax levied on the cost of construction, unless the rental income is subject to VAT. In principle, this applies to buildings intended for furnished lets to be operated by managers of long-term elderly care facilities. However, it excludes premises for accommodation in an establishment classed as residential homes for the elderly under Article L633-1 of the French Construction and Housing Code, for which the law links the VAT on the rent to the VAT system applicable to the operator.

When VAT is applicable to the rent, a lower rate of 5.5% may apply to the portion of the premises "intended for the accommodation itself, as well as the reception areas, common areas and administrative areas that do not themselves generate any income other than the rent paid by the clients for furnished accommodation" (Rep. Min. Victoria: AN 20 December 2005, p. 11777 no. 76984).

**Rent rates**

When subject to VAT, the rents charged for premises assigned to uses other than accommodation are charged VAT at the normal rate, even when the operator is eligible for the reduced rate is exempt from VAT for the services provided in the building. The lessor must therefore break down the amount of the rent charged according to the rate of VAT applied. If not, the manager risks rejection of the right to deduct the VAT invoiced in error.

**Subsidies**

Careful attention should also be paid to the state investment aids that may be received for the construction of buildings intended for operation as long-term elderly care facilities. While receipt of such subsidies does not erode deduction rights, the subsidies should be regarded as subject to VAT.

In cases where the legal entity managing the facility does not own the building, there must be a commitment on the part of the owner to reduce the fees and rent paid by the amount of the investment subsidy (notably, the Order dated 6 June 2013, JORF (Official Gazette) no. 0142 of 21 June 2013, page 10320).

In a comparable situation, the French Council of State (CE 29 January 2010, No. 299 113, SARL Les Jardins de Beauce), an analysis of which appeared in the official journal of public finances (BOFIP), opined that such subsidies, although intended to finance an investment, should be regarded, given the aim of the operation overall, as directly linked to the rents charged and should be subject to VAT.

To wit, part of the aid received by the owner lessor must be paid back to the Treasury in the form of VAT. ■

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# Local taxation of social-purpose real estate

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Owners of social housing may be eligible for property tax exemptions under a range of different measures. The exemptions apply exclusively to housing occupied as the principal residence. In the case of construction of social housing occupied as the principal residence, the duration of the exemptions varies as follows:

– 15 years for social housing funded by state aid for low-income housing (Article 1384 of the French General Tax Code);

– 15 years, extended to 25 years when the decision to grant the loan funding was made in the period from 1 July 2004 to 31 December 2014, and to 30 years when the buildings meet a number of environmental quality criteria for new buildings used as the main residence and at least 50% funded by State loans and eligible for the reduced rate of VAT (Article 1384 A of the French General Tax Code);

– 15 years, extended to 25 years, when the decision to grant the loan funding was made in the period from 1 July 2004 to 31 December 2014, for the acquisition of social-purpose buildings for rental, and for housing with improvements financed with aid from the National Housing Agency (ANAH) by approved organisations not engaged in profit-making activities, with a view to rental by disadvantaged persons (Article 1384 C of the French General Tax Code);

– 15 years, extended to 25 years, when the development is funded with state aid granted in the period from 1 July 2005 to 31 December 2014, for temporary or emergency accommodation structures;

– 25 years for institutional investments in so-called 'intermediate' housing from 2015 (2014 Finance bill, Art. 55).

This system is subject to the location of the development, integration in mixed building projects with at least 25% of the area given over to social housing and rentals according to rent ceilings and lessees' resources for the application of the tax reduction under the "Duflot" scheme. Besides meeting the various conditions of the measures, the benefit of these temporary exemptions and their extensions is subject to the filing of the required declarations within 90 days of completion of construction. All supporting documentation demonstrating that the conditions for each of the schemes have been complied must be included with the declarations.

Social housing operators are exempt from the French local business tax (*Contribution Economique Territoriale* - CET):

– either by right, which is the case of local authorities involved in social activities (operating a retirement home for example) and social housing organisations;

– or because of the non-professional nature of their activity - i.e. not-for-profit.

***"Exemptions apply to property tax and the local business tax, but the residency tax should not be neglected."***

In principle, the exemption implies that the residency tax (*taxe d'habitation*) applies to the buildings they have available, except those freely accessible by the public.

However, and subject to filing an annual declaration, managers of social housing, such as residential homes or non-profit organisations (approved or by agreement) may not be liable for the residency tax for those housing units located in the said residential homes or for those they rent in order to sub-let them and provide them to disadvantaged groups on a temporary basis. The same holds true for operators of long-term elderly care facilities, managed on a non-profit basis, in which the residents are not considered as being in private and exclusive residential accommodation. Under these circumstances, managers may claim the exemption from the residency tax claimable by the resident. ■

# Development taxation: exemption tools for social housing

In France in the past three years, we have seen a raft of measures to reform taxes on development. Eagerly awaited by real estate professionals for more than 25 years, the measures will end an overly complex tax system. The introduction of the development tax system also includes new exemption and tax-relief tools, according to how the housing ranks as low-cost or very low-cost. Aiming to provide clarity and legibility, the exemption mechanisms relating to the preventive archaeology tax (*redevance d'archéologie préventive*) or the low density tax (*versement pour sous-densité*) have been aligned with the development tax system.

**Development tax (*taxe d'aménagement* - TA):** builders of social housing can claim either full or partial exemptions (relating to the common areas only) which apply by right, or on an optional basis, after deliberation by the governing body.
Housing classed as very low-cost housing funded by subsidised loans for social housing (PLAI) and, in the overseas territories, very low cost rented housing (LLTS)[1], is exempt from all development tax. This full exemption applies not only to the housing area itself, but also to appurtenances, such as cellars, lean-tos and closed and covered parking areas[2].
Social housing developments or social accommodation funded by subsidised State loans that are eligible for the reduced rate of VAT referred to in Article 278 sexies of the French General Tax Code may also be fully or partially exempt[3]. The exemption is optional, that is to say, the local authority's governing body must decide. The following are concerned: housing funded through the social housing incentive loans, *prêt locatif à usage social* (PLUS), the *prêt locatif social* (PLS) or a help-to buy-incentive loan (*prêt social de location-accession* (PSLA). Housing that qualifies under the 0% loan scheme under Article L31-10-1 of the French Construction and Housing Code may also be exempt within the limit of 50% of their area[4].
Lastly, Article L. 331-12 of the French Urban Development Code provides that a reduction of 50% on the value of the development tax (TA) applies to residences and accommodation that may be eligible for the optional exemption. However, this does not concern housing funded through a help-to-buy subsidised loan (*prêt à l'accession sociale* - PAS), a rental investment incentive loan (*prêt locatif intermédiaire* -PLI) or an agreed loan, since these are subject to tax under common law. For building permits delivered in 2013, the development tax is €410 in the Ile-de-France region and €362 outside this area.
Note that all of the exemptions and reductions above also apply to social housing sold to social housing organisations either off-plan (VEFA) or built.

> ***"The exemption mechanisms relating to the preventive archaeology tax or the low density tax have been aligned with the development tax system."***

**Low density tax:** Exemption from the development tax, by right or on an optional basis also applies to the low density tax[5].

**Preventive archaeology tax:** exemptions applicable to the preventive archaeology tax are those defined in paragraph 2 of Article L. 331-7, namely, very low-cost housing funded by PLAI loans[6]. Other categories may also be entitled to a 50% reduction, as a result of the entitlements under the development tax scheme[7]. ■

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*1. Art. L 331-7 2 of the French Urban Development Code.*
*2. Circular of 18 June 2013 on the reform of taxation of development.*
*3. The discussion provides for a percentage of the area assigned to social housing benefiting from the exemption.*
*4. art. L. 331-9 of the French Urban Development Code*
*5. art. L 331-41 of the French Urban Development Code.*
*6. art. L. 524-3 C. patr.*
*7. art. L 524-7 I. C. patr.*

# European and French not-for-profit organisations: equal treatment under the tax system?

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The theme of this issue calls our attention to an interesting and original question: what are the tax implications for a European not-for-profit organisation operating in the social housing sector in France? To answer this question, we must first ascertain the eligibility of non-profit organisations to avail themselves of the stipulations of the tax conventions signed by France and for the application of community law.

### Application of tax conventions

According to Article 4§1 of the OECD's Model Tax Convention, "the term, 'resident of a contracting State' means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, [...]"

Therefore, the issue that concerns us is to establish whether an international non-profit organisation, assumed not to be subject to local corporation tax because of its not-for-profit status, may be considered as resident under the meaning of the tax conventions based on the OECD model.

The French Council of State has examined this question. In an Order dated 14 October 1985, it determined that a British denominational association could claim the benefits of the Franco-British tax convention to prevent the application of French withholding tax to the income it paid out. Similarly, in its ruling of 14 January, the Montreuil Administrative Court ruled that a German retirement insurance fund could also claim the benefits of the Franco-German tax convention to be exempt from French withholding tax on French dividends. On 15 July 2011, the same court ruled that the Franco-British tax convention applied to a large British foundation given that "the quality of British resident [...] is not subject to a condition of effective payment of taxes in the United Kingdom; that it is an established fact that the Foundation, which is headquartered in London, is subject to British tax law; and that, consequently, it may claim the stipulations of the Franco-British tax convention."

> ***"A European non-profit organisation would be entitled to operate non-profit activities in the social housing sector in France, under the same conditions as an equivalent French non-profit organisation."***

### Application of community law

The other question that arises is whether a European non-profit organisation can refer to community law to claim similar tax treatment to French non-profit organisations in France. Case law leaves no room for doubt here. In an order dated 14 September 2006 concerning the Centro di Musicologia Walter Stauffer, the European Court of Justice ruled that a member state that exempts the rental income received in its territory by national non-profit organisations, and that refuses to grant the same exemption to a foundation recognised as a general interest foundation in another member state, restricted the free movement of capital between member states.

The French Council of State applied this case law in its Order of 13 February 2009 relative to Stichting Unilever Pensionfoends. In this case, a pension fund established in Holland was deemed to be comparable to a French non-profit organisation and to be entitled to the same tax exemption on dividends generated in France as in a Franco-French context.

In this regard, in an Order dated 16 May 2013, the Versailles administrative court of appeal ruled that comparability between a British non-profit organisation and a French one must be determined overall, without the need for a perfectly matching situation. The fact that the methods for deciding the compensation paid to the directors of a British foundation were not in line with French rules was not sufficient for the court to rule that the Foundation was not operated on a not-for-profit basis. In conclusion, we are of the opinion that a European non-profit organisation would be entitled to operate non-profit activities in the social housing sector in France, under the same conditions as an equivalent French non-profit organisation. ■

# Reduction in the VAT rate applicable to social housing

The third amending Finance Act for 2012 introduced a 10% tax rate for the construction and renovation of social housing. The rate applicable to such operations had already been increased from 5.5% to 7% as of 1 January 2012[1], with the introduction by the legislature of a second reduced VAT rate.

In his speech delivered at Alfortville on 21 March 2013, French President Hollande announced that the lower of the reduced rates - to be maintained at 5.5% - would apply to the construction of social housing due for completion from 1 January 2014, including developments in progress, as well as for some improvement works. The consequences of this announcement are reflected in the 2014 Finance bill. However, this text reduces the scope of the social housing scheme, including under certain conditions, transfers of buildings located close to areas covered by the agreement signed with France's urban renewal board, the Agence Nationale pour la Rénovation Urbain (ANRU).

These changes come with temporary measures, according to which the new lower tax rate will apply to current developments when it is the most favourable (reduced from 7 to 5.5%). The 5.5% rate will apply to acquisitions and deliveries of social housing completed as of 1 January 2014.

Hence, the lower rate will apply to sales of buildings off plan if the completion date occurs from 1 January 2014. These are off-plan sales:

– to social housing organisations who rent them under the conditions defined in Article L 351-2, paragraphs 3 and 5 of the French Construction and Housing Code;

– to individuals whose resources assessed on the date of signature of the preliminary contract or the contract of sale do not exceed the resources used to assess eligibility for the PLS social housing incentive loan, plus 11%[2], and provided that the assets assigned as the main residence are located in a neighbourhood covered by an agreement with the French urban renewal board or entirely located less than 300 metres from the boundary of these areas.

An adjustment will be made in respect of the amounts already paid for these off-plan sales in 2013 and taxed at 7% to apply a 5.5% VAT rate to the development overall.

Furthermore, when the building is constructed by social housing organisations as the owners, the 5.5% VAT rate will be due on to the delivery of the building to the organisation itself. According to the Finance bill, the scope of application of the reduced VAT rate to constructions in the immediate vicinity of the areas covered by the agreement with the ANRU will apply as of 1 January 2014. Under current provisions in force, the 7% rate applies to the sale or construction of housing (all other conditions being fulfilled) in an area covered by an agreement with the ANRU or an area within 500 metres of the boundary of such neighbourhoods.

*"The 5.5% rate will apply to acquisitions and deliveries of social housing completed as of 1 January 2014."*

It is planned to reduce this peripheral area down to 300 metres. Beyond that limit, the normal 20% VAT rate will apply. However, the lower 7% rate will be restricted to sales for which a preliminary contract is signed before 1 January 2014, as well as for sales of housing in developments that have not yet come on the market, located within the 500 metre limit, but for which the building permit application was filed prior to 16 October 2013, following an amendment. ■

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1. *Excluding temporary provisions introduced.*
2. *BOI-TVA-IMMO-20-20-20 no.120.*

# ALUR bill on the private rental market: some major innovations

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Section 1 of the ALUR (Access to housing and urban renovation ["*Accès au Logement et un Urbanisme Rénové*" – ALUR]) bill amends and supplements the legal framework governing relations in the private rental market, for both furnished and unfurnished housing constituting the lessee's principal residence. A raft of adjustments has been made to the Law of 6 July 1989, introducing new provisions, some of them major changes. A definition of the furnishings required has been added to the law governing the rental of furnished housing in order for the unit in question to qualify as such. The French Senate also added a provision on joint tenancy.

The concept of principal residence for unfurnished lets governed by the Law of 1989 is defined as the home occupied for at least eight months of the year, excluding absence for professional duties, for health reasons, or in the event of force majeure, by the lessee or the lessee's spouse, or by one of their dependants, under the meaning of the French Construction and Housing Code.

The bill includes provisions whereby the lease contract must be drawn up according to a standard contract defined by an Order of the French Council of State. This standard contract must include (1) the median benchmark rent and the upwards adjusted median benchmark rent for the type of rental accommodation and defined by the State's representative or the local authority in certain urban areas specified by the law, (2) the last rent paid by the previous tenant when they left the rented accommodation less than 18 months before the signature of the lease, as well as (3) the amount and nature of any work performed since the last contract ended or since the last lease renewal.

The bill tends to step up protection of tenants when a building is sold off in lots (split sale), since it will apply to the sale of more than five units in the same building, instead of the 10 previously. This provision concerns termination of leases after the law's entry into force. The bill also amends Article 10 of Law no. 75-1351 of 31 December 1975 relative to the tenant's right of first refusal for the first sale following division of the building.

The bill seeks to clarify the rule governing the breakdown of payment to persons authorised to perform or assist in the performance of preparing or negotiating a lease: the law makes the lessor exclusively responsible for this payment, except for payments related to drawing up the inventory and preparing the lease, which will be shared between lessor and lessee, within certain limits.

In continuous urban areas with populations of more than 50,000 where there is marked imbalance between supply and demand, the ALUR bill provides for an annual median benchmark rent, an upwards adjusted median benchmark rent and a downwards adjusted median benchmark rent, calculated by reference to a price per square metre of net floor area, type of housing unit and geographical area, to be set by the representative of the State. The base rent for housing units rented in these areas will be set freely between the parties when the lease contract is entered into, but within the limit of the upwards adjusted median benchmark rent. An additional exceptional rent may be justified in certain cases. The rent can be revised annually, on the date agreed between the parties. On renewal of the lease, the rent may be reduced, if it is above the upwards adjusted median benchmark rent, or raised, if it is lower than the downwards adjusted median benchmark rent.

A significant measure in the bill is the creation of a universal rent guarantee as of 1 January 2016. The aim of this provision is to cover payment defaults in the private rental sector, for both unfurnished and furnished lets.
The guarantee would replace the security deposit for eligible tenancies and be administered by a government body. ■

# Pinel bill: measures may affect the status of commercial leases

Bill no. 1338 on crafts, trade and micro-enterprises, presented in the French National Assembly on 21 August last by Minister Sylvia Pinel, includes a number of measures of direct relevance to the status of commercial leases.

The bill may be debated by Parliament at the end of the year. It proposes to introduce changes applicable to leases agreed or renewed from the first day of the third month following official publication of the law.

**Cross leases**

To promote the use of cross leases pursuant to Article L. 145-5 of the French Commercial Code (*Code de commerce*) the maximum term of this type of lease or successive cross leases would be increased from two to three years.

**Commercial leases**

**Construction cost index abandoned**

The bill proposes to discontinue reference to the construction cost index for the three-year rent reviews and for determining the cap on the renewed lease. With the aim of smoothing variations in rents, the only indices used under these proposals would be the commercial rents index and the tertiary activities rents index.

**Broader role for the regional conciliation boards**

To encourage recourse to mediation, the competence of the conciliation boards would be expanded to rent reviews, charges and works.

**Introduction of a maximum variation in rent for renewals where the rent cap is removed**

In cases where the commercial lease cap is removed, the rent increase would be 'smoothed', that is to say, the rent under the renewed lease may not be increased in one year by more than 10% of the rent paid during the previous year. However, the bill provides that this limit would not apply when the exception to the cap follows the implementation of a clause in the lease relative to its term or the method for setting the rent. In practice, in the event of lifting the cap on the renewed rent at a theoretical annual amount of €60,000 at 1 January 2014, whereas the previous annual rent was €30,000, the upwards adjustment in the rent arising as a result, namely of €30,000, would be applied:

– at 1 January 2014, an annual rent of €30,000 + 10 % = €33,000

– at 1 January 2015, an annual rent of €33,000 + 10 % = €36,300

– at 1 January 2016, an annual rent of €36,300 + 10 % = €39,930

– etc.

**Obligation to prepare an inventory and an inventory of charges**

The bill would introduce a mandatory inventory based on inputs from both parties on taking possession and returning the premises. The lease would also have to include a precise inventory of charges with the breakdown of these charges between the parties. An Order of the French Council of State would specify the charges which, by their nature, may not be passed on to the lessee.

**Introduction of a right of first refusal for the lessee**

The lessee would have a right of first refusal if the commercial premises are sold, and the sale would be null and void were that right to be violated. If the seller accepts the offer, which must be submitted within one month, the lessee would then have a further two months to sign the sale agreement.

**Changes to local authorities' right of first refusal**

In the future, under the Pinel bill, local authorities would have the right to delegate their right of first refusal on businesses, crafts funds, commercial leases and land to an inter-area cooperation body, a public body whose purpose is to exercise this right of first refusal, or to the concessionaire of a development project. ■

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# Amendments to the taxation of private real estate capital gains

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The 2014 Finance bill as adopted at its first reading in the French National Assembly confirms some of the reforms to the taxation of capital gains from private real estate, introduced by an instruction dated 9 August 2013, for transfers completed as of 1 September 2013.

For individual income tax, the exemption applies after a 22-year holding period, and the reduction for the detention period is 6% for each year of the holding after year five and until year 21, and 4% as of year 22.

For the social security charges (at an overall rate of 15.5%), the exemption only applies after a 30-year holding period, but the tax relief is tapered according to an amended scale: 1.65% for each year the property is hold after year 5 and until year 21, 1.60% for year 22, and 9% for each year thereafter.

Capital gains on undeveloped building land will not qualify for any tapered tax relief based on retention period, as of 1 March 2014. On the other hand, exceptional additional 25% relief for some capital gains generated by the sale of real property or the rights to these assets has been confirmed (income tax and social security contributions) for sales concluded between 1 September 2013 and 31 August 2014.

The bill introduces changes to the exemptions that applied to sales by non-residents of their residence in France. This system, which was conditional upon the free availability of the asset and applied for a period of two years after departure abroad, is extended to capital gains from the sale of rented property, for a period of five years from the transfer of residence. However, in return for this concession, the exemption from capital gains tax will be a maximum of €150,000. ■

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