MOORE STEPHENS

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Update

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French Finance Act 2018

The Finance Act for 2018 was published on 31 December 2017. Below is a summary of the main points. The changes to wealth tax, the abolishment of *taxe d'habitation* for a majority of French residents and the introduction of a flat tax on income related to financial investments are of particular interest.

Changes to wealth tax

TThe previous wealth tax has been replaced by a real estate wealth tax (*"Impôt sur la fortune immobilière"* or *"IFI"*). The new tax applies to real estate assets only. Shares in companies owning real estate directly or indirectly are considered real estate assets to the extent of the value of the underlying real estate. All companies owning property in France, whether French or foreign, listed or not, are concerned even if the real estate does not constitute the majority of the company's assets. Indeed, the new text abandons the notion of *"prépondérance immobilière"* which previously determined the shareholder's wealth tax liability.

Properties which have a commercial or business use are exempt whether held by an individual or by a company.

The mechanisms of the tax have not changed: the threshold and the rates remain the same. An allowance of 30% still applies to the main residence of the tax payer. When the threshold of €1,300,000 is reached, then the net value of real estate assets above €800,000 is taxed. As a reminder the following rates apply:

Net value of real estate (€)	Rate Applicable %
Up to €800,000	0
From €800,000 to €1,300,000	0.50
From €1,300,000 to €2,570,000	0.70
From €2,570,000 to €5,000,000	1.00
From €5,000,000 to €10,000,000	1.25
Above €10,000,000	1.50

An important change concerns deductible debt. Certain restrictions have been introduced as regards loans taken to purchase, renovate or maintain the taxable real estate asset. For example, interest only loans (so called "in fine" loans) are now treated as if they were amortized annually. A formula is provided for the calculation of deductible debt based on the period of the loan and the time elapsed since subscription. Certain family loans are no longer deductible unless it can be demonstrated that these are at arm's length and not contracted for tax reasons only. For high value properties (above €5 M) there is a cap on the amount which can be deducted if the loan exceeds 60% of the value of the property (only half of the amount exceeding the 60% limit will be deducted).

The calculation of the value of shares of real estate owning companies still needs some clarification, in particular as regards the treatment of debt in the company. We are awaiting the official guidelines from the tax authorities in this respect.

Local property tax exemption ("*taxe d'habitation*")

The *taxe d'habitation* which is due by the occupant of a property (tenant or owner as the case may be) will be abolished for certain French resident tax payers over a period of three years.

Non-residents will not benefit from this new measure as it only applies to the tax payer's main residence and it is expected that those who are not exempt from the *taxe d'habitation* will see their tax bill increased.

The reform is gradual and those who qualify (estimated to be 80% of French residents) will see their *taxe d'habitation* in relation to their main residence decrease by one third in 2018. In 2019 a 65% decrease will apply and a full exemption applies in 2020.

The exemption will apply to those who do not exceed the following reference income* ceilings:
For a single individual: €28,000
For a couple without children: €45,000.
For a couple with one child: €51,000
For a couple with two children: €57,000
For a couple with three or more children: the ceiling is increased by €6,000 for each child.

Those who are subject to the real estate wealth tax (IFI mentioned above) will not benefit from the *taxe d'habitation* exemption irrespective of income levels.

Flat tax on income from financial investments

Dividends, interest and capital gains generated by financial investments will be taxed at source at a flat rate of 30% including income tax and social charges. This measure replaces the taxation at the progressive rates (0-45%) previously in place to which social security contributions were added. The new flat tax should be more favourable for most tax payers as the income tax is capped at 12.8% to which is added the social security charge at 17.2%.

It should be noted that the allowances under the previous regime are no longer applicable (for example, the 40% allowance on dividends and 50%, 65% and 85% on capital gains depending on time of ownership).

The flat tax should also apply to gains derived from life insurance products.

Social contribution increase

The CSG (*"contribution sociale généralisée"*) rate is increased resulting in a total of 17.2% in social contributions which are added to income tax (included in the flat tax regime mentioned above).

The Government has retained the controversial application of social tax of 17.2% in addition to capital gains and income tax payable by non-residents on revenue generated by French real estate (ie rental income and capital gains).

The total tax charge on the sale of a French property for a non resident will therefore be 36.2% to which is added the additional capital gains tax ranging from 2% to 6% applying to gains above a certain level.

* The reference income (*"revenu fiscal de référence"*) is calculated by the tax authorities and is based on the net income received by the household to which is added certain exempt income which is taken into account for the application of the progressive rates.

Income tax rates adjustment 2018

The income tax rates have been increased by 1% to cover inflation and the below rates apply in 2018:

From €	To €	Rate
0	9,807	0%
9,807	27,086	14%
27,086	72,617	30%
72,617	153,783	41,00%
Above 153,783		45,00%

An additional tax continues to apply to high earners as follows:

- For an individual: an additional 3% applies to reference income* between €250,000 and €500,000 and an additional 4% for reference income above €500,000.
- For a couple taxed jointly: an additional 3% applies to reference income between €500,000 and €1,000,000 and an additional 4% for reference income above €1,000,000.

Corporate tax cut

The corporate tax rate will be reduced to 25% progressively during the Macron presidency. The below cuts will be implemented over the period:

2018	28% on first €500,000 profit. 33.33% on profit above €500,000
2019	28% on first €500,000 profit. 31% on profit above €500,000
2020	28% on all profit
2021	26.5% on all profit
2022	25% on all profit

Small and medium size companies continue to benefit from a reduced rate of 15% as before.

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