

# (R)evolution?

**ALAIN MOREAU, JEAN-LUC BOCHATAY AND GUILLAUME AUBINEAU** EXPLAIN THE KEY PROVISIONS OF THE NEW SWISS-FRENCH CONVENTION ON INHERITANCE TAX, EXPECTED TO ENTER INTO FORCE IN JANUARY 2014

**A**s expected for some time, Switzerland and France have recently amended the *Inheritance Tax Convention 1953* (1953 Convention). If adopted, the new convention (whose entry into force is expected by 1 January 2014) will allow France to restore its right to tax inheritance, notably on immovable property held indirectly in France, or the assessment of the place of domicile of the heir – in France – where the domicile of the deceased was outside of France.

## Scope of application of the new convention

As with the 1953 Convention, the new convention would not cover gift tax. Its scope would be limited to inheritance tax, i.e. French inheritance tax (including, presumably, the tax introduced by the new law on trusts dated 29 July 2011), and Swiss inheritance tax that is now only levied by the cantons and communes.<sup>1</sup>

The new convention would apply to persons domiciled in one of the contracting States upon their death, i.e. a person who, pursuant to this State's law, is liable to inheritance taxes by virtue of their domicile (excluding persons liable to inheritance tax in said State only for the assets located therein). Where there is a conflict of residence, the text would apply the standard OECD Model criteria.

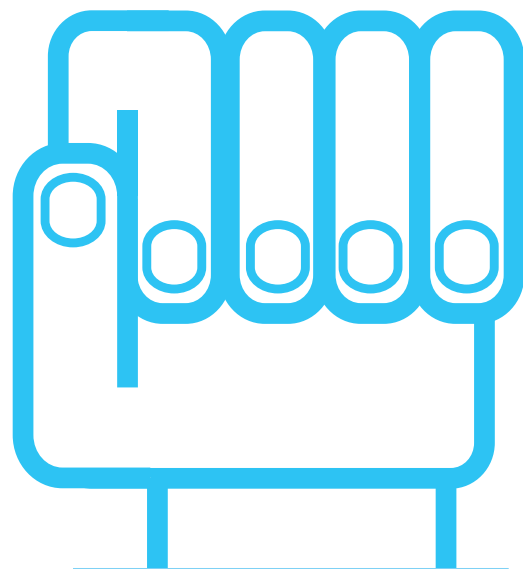
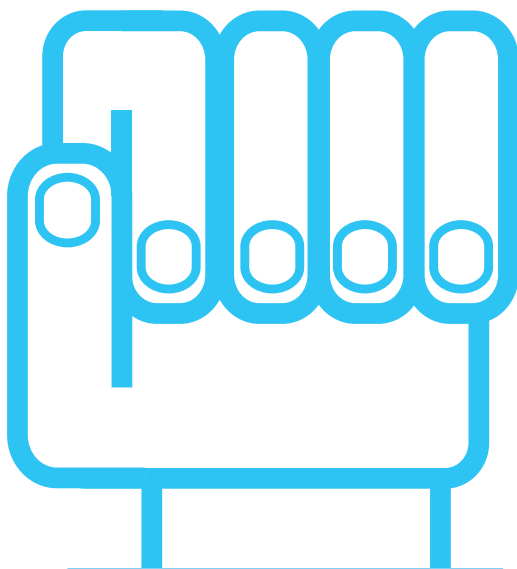
## The notion of immovable property

According to the 1953 Convention, the notion of 'immovable property' is strictly defined and does not include shares of real estate companies (notably the French *Société Civile Immobilière* – SCI), which should therefore only be liable to tax in the State in which the deceased was last resident.

The new convention provides for a wider definition of this notion, including shares of real estate companies (incorporated in France or abroad). In this respect, the new convention expressly sets out that shares, units or other rights over a company or a corporation whose assets are composed of more than 50 per cent of their value of real estate (directly or indirectly through one or several other companies or corporations) located in a contracting state qualify as 'immovable property'.

This provision, which derives from article 750 ter 2° para 4 of the French Tax Code (FTC), would allow France to tax shares of real estate companies (i.e. those whose assets are mainly composed of immovable property located in France).

In this respect, an immovable property located in France and held indirectly, for instance, through a SCI by a *de cujus* resident in Switzerland, shall be taxable in France. Under the 1953 Convention currently in force, this property is tax-exempt in France and often exempt in Switzerland (notably in transfers between spouses and to children).



However, the new convention goes further, providing that immovable property is deemed part of the inheritance of a person domiciled in a contracting State when it belongs to companies or corporations of which the deceased, on their own or with their family, holds more than half of the capital, directly or indirectly through one or several other companies or corporations.

This provision, which derives from article 750 ter 2° para 2 of the FTC, would allow France to tax immovable property located in France owned by companies that do not qualify as real estate companies, but that are controlled directly or indirectly by the *de cuius* with their family.

In this context, very few immovable properties held in France by non-residents will remain outside the scope of the French inheritance law.

### Right to tax

The 1953 Convention establishes an exclusive right of taxation for each State, according to which immovable property held personally (*en nom*), ‘furniture’, including linen, household goods and objects of art and collections, are subject to tax only in the country where they are located at the time of the death of the *de cuius*, and the other movable assets are subject to tax only in the State where the *de cuius* had their last domicile.

As regards France, the new convention would considerably extend its right to tax. Under the new convention, French inheritance tax scope will cover the following:

- The overall inheritance assets if the *de cuius* was domiciled in France at the time of death. This provision derives from article 750 ter 1° of the FTC and would allow France to apply its domestic territoriality rules. In this situation, under the 1953 Convention, assets taxable in Switzerland (i.e. in the main, immovable property located in Switzerland) were only subject to Swiss inheritance tax.
- All movable, tangible or immovable assets of the estate, located in France if the *de cuius* was domiciled in Switzerland at the time of death. This provision derives from article 750 ter 2° of the FTC and would allow France to apply its domestic territoriality rules. In this situation, under the 1953 Convention, assets located in France, other than immovable property, were subject only to Swiss inheritance tax.
- The overall inheritance assets (granted to the heir) if the heir (of a *de cuius* resident in Switzerland) is resident in France at the time of the death of the *de cuius* and has been resident in France for at least six years during the previous ten years. This provision derives from article 750 ter 3° of the FTC and would allow France to apply its domestic territoriality rule.

Thus, heirs of a *de cuius* domiciled in Switzerland who are French residents would be liable to inheritance taxes in France

– including on the deceased’s assets located in Switzerland (movable and immovable assets). In this situation, under the 1953 Convention, the overall assets of the *de cuius* are not taxable in France (with the exception – in the main – of immovable property located in France).

This provision of the new convention does not follow the principle set out by the OECD in its 1982 Model, under which the right to tax the overall inheritance assets is primarily granted to the State of domicile of the *de cuius*.

The convention signed with Germany, which obviously served as a framework for the negotiation of the new convention, also permits expressly to take into account the State of domicile of the heirs for the assessment of French inheritance tax.

The French tax authorities have also recently considered that the convention signed with Italy on 20 December 1990 does not preclude the application of article 750 ter 3° of the FTC (taxation in France of French resident heirs on their overall assets).<sup>2</sup>

As regards Switzerland, the new convention does not extend its right to tax compared to the 1953 Convention. Conversely, under the new convention, Switzerland would notably lose its right to tax French immovable property held by a Swiss resident *de cuius* via companies.

### Methods for avoiding double taxation

In the 1953 Convention, double taxation is avoided in France and in Switzerland via an exemption with progression method, triggering the establishment of planning strategies favouring the State with the most attractive inheritance tax regime (i.e. in general Switzerland).

Pursuant to the new convention, the exemption with progression method would remain applicable as regards Switzerland. However, concerning France, double taxation would now be avoided via the tax credit method, i.e. by the possibility of deducting from French inheritance tax the tax already paid in Switzerland. French domestic tax law also provides (in article 784 A of the FTC) for a similar mechanism for the avoidance of double taxation through the granting of a tax credit in France equivalent to the tax paid abroad. The imputation of foreign inheritance tax on French inheritance tax is limited to the foreign tax paid on assets (movable or immovable) located outside of France.

In this context, this new convention only seems to validate the application of French domestic law (indirect holding of real estate and inheritance tax territoriality rules). The interest of implementing such an unbalanced text in favour of France compared to a situation where the 1953 Convention would be simply terminated seems very limited (notably with respect to the possibility of offsetting Swiss tax on French inheritance tax on a larger basis than with article 784 A of the FTC and to settle conflict of residence between the two countries).

In the light of the above commentary on the provisions of the new convention, it will be necessary to review and update the inheritance planning strategies put in place under the 1953 Convention. Careful and professional cross-border advice will be required, notably with respect to article 10 of the new convention, providing for a rather wide-ranging anti-abuse provision.<sup>3</sup> ■

**1** In general, their legislation provides for the exemption (or very low rates) of taxes between spouses and direct line as well as taxation according to the family relationship for the other categories, but also inheritance tax that may be levied by the Confederation if the project aiming at subjecting inheritance above CHF2 million at a 20 per cent tax rate at the Federal level is adopted.

**2** (Rép. Morel-A-L’Huissier: AN 8 février 2011 p. 1261 n°92034). This decision (Réponse Ministérielle) is contrary to the Instruction 7 G-599 dated 26 April 1999, which specifies that the conventions concluded by France with respect to gifts and inheritance tax exclude the application of article 750 ter 3° of the FTC.

**3** Under this article 10, the benefit of a total or partial exemption resulting from the implementation of the present Convention shall not be granted when the main purpose of the deceased or of his heir or legatee was to obtain a more advantageous tax situation and that the granting of this advantage in such circumstances would be contrary to the purpose and to the object or the concerned provisions.



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