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Client Alert

Tax Practice Group

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Investment in French real estate: France-Luxembourg double tax treaty changes

On 5 September 2014, the Governments of France and Luxembourg signed an amendment to the France-Luxembourg treaty dated 1 April 1958 (the "Treaty"), which will have an impact in the future for certain investments in French real estate.

Indeed, the amendment introduces new provisions under Article 3 paragraph 4, allocating the right to tax capital gains from the disposal of shares in predominantly real estate entities exclusively to the State where the real estate assets are located.

Under the amendment, a company, trust or any other institution or entity, is a predominantly French real estate entity if more than 50% of its value derives directly or indirectly from French real estate assets. Real estate assets that form a part of the entity's own business activity (such as hotel activities) are not taken into account for purposes of this provision.

Under the current Treaty, capital gains from the sale of shares in a French or Luxembourg company with predominantly French real estate are not taxable in France.

The Amendment will have effect from the beginning of the calendar year following the month following its ratification by both States, in the case of income for which tax is withheld at source, or on financial years opened after the calendar year following its entry into force (for taxes on income not withheld at source). Thus, if each State ratifies and notifies the amendment at latest in November 2014, the amendment will therefore apply to capital gains realized on or after 1st January 2015. This would be an unusually rapid ratification process.

In France, such gains are taxed at the overall tax rate of 34.43% (or 38% if the temporary 10.7% surtax applies).

Taking advantage of the ratification timing, it may be opportune to reorganizing existing Luxembourg based investments before the amendment applies. Such restructuring must however be carefully considered on a case by case basis, in the light of tax reassessment operated by the French tax authorities where certain restructuring put in place

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previously to the entry into force of the second amendment to the Treaty, was treated as abusive and thus ineffective under French law.

As far as structures in place through a French SPPICAV are concerned, the disposal of its French assets remains tax exempt in France and subsequent dividend distribution complying with its distribution obligation can still benefit under certain conditions from the reduced withholding tax rate provided by the Treaty.

In addition, the press release published by the Luxembourg Ministry of France indicates that France and Luxembourg will continue working on the update of the Treaty. Future amendments could concern distributions of OPCI.

We will keep you informed of developments in the ratification process in both France and Luxembourg and will be pleased to invite you to a coming event in our offices to discuss these changes, consequences and solution more in details.

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