 Marccus Partners

**France:
Tax and Legal aspects
of real estate investment**

INTRODUCTION

The purpose of this survey is to provide real estate investors with key tax and legal information on the French real estate market. Like all other markets, real estate business is engaged in a globalization process, moving from national to international investment structures.

This trend is apparent, on one hand, on the investor side of investment funds which are gathering investors from different countries and continents and, on the other hand, on the investments side, each real estate fund being interested to find the right balance between return and risk. In this respect, an internationalization of the investment policy offers an efficient hedging approach, mixing the position in the real estate cycles of the different real estate markets. In this survey, we will focus on French legal and tax regulations that apply to real estate investment funds investing in France.

Marccus Partners, as a member of an international tax and legal network, is servicing its clients for their international investment policy and offers them the best opportunities that may exist on the different markets. Willing to make the world more global and our advice more integrated, Marccus Partners and its international real estate practice group has been

active in the real estate market for more than 10 years.

We decided to establish this survey in order to help you understanding the main tax and legal issues linked to real estate investments funds in France.

We will hence highlight the basics to be known by a foreign investor and the common investment structures used in France. This French report is divided into two parts:

- the first part addresses legal issues such as different types of leases, legal treatment of an asset or share deal, the main legal exposures associated with a real estate acquisition, different legal formalities and filings to be observed upon a real estate acquisition, how the ownership of a real estate asset can be reviewed, existence and legal value of the commercial and/or real estate register etc.
- the second part deals with the tax aspects and gives an overview of the main taxes linked to real estate acquisition and exploitation. It further analyses the different tax treatment of an asset deal or a share deal. This report also analyses some French fund and partnership investment structures.

We hope that this report will help you in initiating new projects.

Yours sincerely,

Jacques-Henry de Bourmont
Silke Nadolni

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1. Overview

The real estate market in France is extremely well structured from a legal point of view. The system allows international individual and corporate investors to acquire, hold and sell real estate property. Foreign investments can generally be made freely but may be subject to declarations and informing the French authorities following the transactions pursuant to the foreign investment control legislation (law of 2003).

1.1. Types of ownership

It is possible to acquire various long term rights over real estate such as a construction leases, 99 year leases or a concession and a right of usufruct, or absolute ownership. There also exists the so-called volumes division (*division en volume*) which is a horizontal division of the title.

1.1.1. Absolute ownership (freehold)

A person owning the freehold of a property (*pleine propriété*) is the owner in perpetuity. This enables the property owner to use the property, sell it, grant rights over it (in particular mortgages), receive all profits and benefit from all advantages arising from the property.

The proof of title of absolute ownership pursuant to an acquisition results from notary deeds. To be enforceable against third parties, real estate sales or arrangements granting security interests over real estate must be recorded with the Land Registry.

Special publication procedures apply in the local areas of Haut-Rhin, Bas-Rhin and Moselle.

There are two legal schemes to divide property among different owners: co-ownership and division by volume.

1.1.2. Co-ownership (*copropriété*)

Co-ownership allows a building to be divided into different types of occupancy (apartments for residential use, offices or commercial premises). It can also be used to divide a piece of and into parcels. The freehold on the various privately owned sections is held severally by each separate co-owner, whereas all common areas (main wall, staircases, garden, etc.) are usually jointly owned by all the co-owners. Each co-ownership will have its own regulations (*règlement de copropriété*) to which all owners are deemed to adhere. The regulations relate to the use and enjoyment of the premises and the management of the building or land.

1.1.3. Division by volume (*division en volumes*)

Division by volume is a legal technique that divides ownership of real property into separate areas, both horizontally and vertically, on various levels defined by reference to a plan, section and share. The resulting areas are called *lots de volume*. There are no common areas. Each volume is a separate property, subject to various easements in favour of the neighbouring volumes (right of passage, etc.). The owner has all rights and obligations attached to freehold ownership.

1.1.4. Leasehold

Under French law, there are the following categories of property leases governed by various laws:

- leases referred to as “free” leases, under civil law,
- residential leases,
- professional leases (i.e. for architects, doctors, lawyers, etc.),
- commercial leases,
- rural leases.

Of special interest to real estate are two types of leases: construction leases (*bail à construction*) and long-term leases (*bail emphytéotique*). Another important lease which is often granted to professionals is the commercial lease.

1.1.4.1. Construction lease (*bail à construction*)

The *bail à construction* gives the tenant the freehold over the property. It is a long-term lease (18-99 years) of land on which a building will be built or substantially renovated. When the lease expires, the return of possession of the building to the landlord or the transfer of ownership of the land to the tenant (depending on the terms of the lease) may qualify for favourable tax treatment. This may enable an investor (generally the tenant) to finance its acquisition over the duration of the lease.

The main obligation of the tenant is to build or (in case of major works) renovate the building on the landlord's land, and to maintain the building in a good state of repair during the term of the lease. The tenant bears all charges, taxes and duties payable for the construction of the building.

The rent can be in cash or in kind. If paid in kind, it often consists of the transfer of ownership of the building at the end of the lease.

By law, ownership of the building automatically passes to the owner of the land at the end of the lease. However, the lease agreement may provide that ownership of the land will in fact pass to the tenant upon expiration of the lease.

The lease must be executed in the form of a notarized deed which has to be registered at the land registry.

1.1.4.2. Long-term lease (*bail emphytéotique*)

A long-term lease (18 to 99 years) confers the freehold over the property to the tenant, which can be mortgaged and transferred. The main differences between the long-term lease and the construction lease are that the construction lease must stipulate an obligation to build while this is not required in the long-term lease, and the completion of the long-term lease involves the immediate termination of the guarantees granted by the tenant, though in the same circumstances the guarantees granted by the tenant of a construction lease end on the date fixed in the lease.

The lease must be executed in the form of a notarised deed which has to be registered at the land registry.

1.1.4.3. Commercial leases

Commercial leases are governed by the decree dated 30th of September 1953, codified under Article 145-1 and following of the French commercial code. The regime applies if the following requirements are met:

- the lease must be granted for a commercial, industrial or craft activity,
- a business must be carried out from the premises,
- the business must belong to the tenant,
- the tenant must be registered at the Companies and Commercial Registry or at the Arts and Crafts Registry for the premises in question.

Commercial leases are granted for a minimum period of nine years. The tenant has the right to end the lease at the end of every three-year period. After expiration, the tenant benefits from a statutory right of renewal of the lease. The landlord can refuse to renew the lease, but this entitles the tenant to compensation.

The rent is freely fixed between the parties. Usually, it is indexed annually, whereas the chosen index has to fulfil certain conditions. The tenant and the landlord are entitled to ask for the rent to be reviewed after at least three years have run from the commencement date or the previous rent renewal. On renewal, parties often do not agree on the rent. Either party may then apply to the Court to fix the rent, which will be, in principle, the market rent.

Sub-lending is prohibited, unless otherwise stipulated. Permitted use clauses are standard. The tenant might not use the premises for any other activity without obtaining the landlord's prior consent. If the parties are unable to agree, statutory provisions set out a procedure to follow for extending the permitted use to ancillary activities or to add or change the permitted use.

1.2. Warranties (mortgage, etc.)

In case of financing, the transaction is commonly secured by a mortgage (*hypothèque*) or a lender's special lien (*privilège de prêteurs de deniers*). The mortgage is a security right on property which does not dispossess the debtor and by which the creditor is entitled to have the property sold regardless of the owner or to be paid by preference. Contractual mortgages must be notarised. After a rather complex situation, the property will be sold by auction.

The lender's special lien guarantees repayment of a loan made in view of the acquisition of real estate. In order to be granted, the loan agreement must be notarized and specify that the sums are intended for the purpose of acquiring property. This lien may only be granted in a case the loan was made prior to the acquisition.

2. Acquisition structures

2.1. Asset Deal

2.1.1. Due diligence, main risks

Before signing a binding sale and purchase agreement, the seller must provide the buyer with the following information:

- plans of the real estate,
- an urban zoning document,
- the title deeds (30 years prior),
- copies of the leases,
- building permits,
- a land registry certificate pursuant to the mortgage.

Depending upon the location and the prior use of the real estate, an environmental audit of the real estate may need to be carried out.

2.1.2. Purchase agreement, main issues

Before the final deed of sale, several preliminary engagements may be entered into such as letters of intent, call or put options or promises to purchase and to sell. Most option agreements require the beneficiary to pay a deposit of between 5% and 10% of the purchase price. Under French contract principles, if the parties agree upon the purchase price and the object (e.g. the real property), the sale is deemed completed. Therefore, once an offer is accepted by the seller, it becomes a binding agreement.

However, it is possible to enter into a purchase option arrangement. In this case, the parties will enter into a so-called two sided sales promise (*promesse synallagmatique de vente*) by which they will be committed to sell and buy the real estate if certain conditions are met. It is also common practice for the buyer to pay to the seller a deposit, usually 10% of the purchase price.

Once the conditions precedent have been satisfied (e.g. waiver by local authorities of any preemption rights, financing commitments, etc.) the sale is completed or deemed to have been completed.

The purchase of property assets before or during its construction is generally made in the form of a sale of the property for the possession on completion (*Vente en l'Etat Futur d'Achèvement, VEFA*). The main characteristic of the VEFA is that the ownership of the land passes to the purchaser upon execution of the deed but the ownership of the building itself passes to the purchaser as the construction of the building progresses. The purchase price is paid in instalments on completion of the various stages of the construction. Following the completion of the whole construction work the entire building is delivered to the purchaser.

2.1.3. Formalities

All deeds transferring real estate must be registered at the Land Registry and executed before a notary.

2.2. Share Deal

Instead of investing directly by acquiring real estate, the investment may be made indirectly through the acquisition of a vehicle which owns real estate.

2.2.1. Due diligence, main risks

The due diligence procedure to be carried out when acquiring the vehicle is more complex than for the direct acquisition of real estate. Not only must the real estate itself be investigated, but also the legal status of the vehicle and its liabilities.

2.2.2. Share purchase agreement, main issues

The transfer of shares in a SA, SCA and SAS may be effected by a transfer order. The transfer of shares in a SCI, SNC and SARL needs to be registered with the Commercial Court. In practice, however, a sale and purchase agreement is executed.

2.2.3. Formalities

Please refer to section 2.2.2. above.

2.2.4. Particular issues for real estate companies

French law distinguishes between civil and commercial companies. A civil company cannot carry out commercial activities nor have commercial activities as its purpose. The most important corporate vehicles are the following:

- *Société Civile Immobilière (SCI)*: this civil law real estate company may own, manage and lease real estate.
- *Société Anonyme (SA)*: this commercial stock company must have at least 7 shareholders.
- *Société par Actions Simplifiées (SAS)*: the SAS is a simplified version of the SA and can be formed with a sole shareholder.
- *Société A Responsabilité Limitée (SARL)*: in this corporate form, a minimum share capital of merely 1 Euro is required.

Except for the SCI, the shareholders' liability is limited to the value of their contribution.

3. Main types of real estate funds

3.1. Closed-end and open-end funds

The *Sociétés Civiles de Placement Immobilier (SCPI)* are listed on a regulated market. The management company needs to be approved by the controlling authorities. The minimum share capital is 760,000 €, and 15% of the statutory capital must be subscribed during the first year.

3.2. REITs: SIIC (listed Real Estate Investment Companies)

The *Sociétés d'Investissement Immobilier Cotées (SIIC)* are also listed on a regulated French stock exchange, with a minimum capital of 15 million €. The main purpose must be the acquisition or the construction of buildings with a view to letting them own or hold, directly or indirectly, stakes in companies having such a purpose.

1. Overview

1.1. Main tax rates for 2008

- Transfer tax on shares of real estate companies: 5%
- Real Estate transfer tax 5.09%
- VAT 19.6%
- Corporate income tax 33.33% (plus surtaxes)
- Personal income tax 0% to 40%

1.2. Financing issues

Investment funds may use different types of financing, mainly equity capital, bank financing and internal indebtedment (i.e. loans from a parent company...), all three mixed depending on the will of the investors and the policy of the fund (long-term exploitation, speculative investment, etc.).

In each case, investors will have to make sure they comply with tax provisions, in order to secure but also optimize the investments from a tax standpoint. For example, interest paid in the case of internal debt are subject to thin capitalization rules (like in most countries). The latter have been recently modified, and the new regime has been effective as of January 2007. Basically, the deductibility of interest granted by companies related to the investment fund will be affected if their rate is higher than the market rate, and if certain limits are crossed (loan exceeding 1,5 times the amount of capital, amount of interest exceeding 25% of the operating result before tax increased by intragroup interest, and amount of interests exceeding interest received from related companies). Moreover, the interest may also be subject to a withholding tax, if paid abroad by a French debtor. European law exemption may however apply if the beneficiary of the interest is a EU parent company according to European provisions (the EU parent company must hold at least 15% of the French debtor).

1.3. Structuring possibilities

Investors may decide either to perform a direct purchase of the real estate, or to acquire the real property through a share deal.

Investors may also decide to set up a parent company in order to centralize investments (equity capital, as well as indebtedment). In such cases, it is important to make sure that no additional taxes will arise from the structuring as compared to the situation of a direct investor.

Moreover, subject to the respect of legal conditions, very specific structures or regimes can be used, such as the SIIC regime, or the SCPI regime (see point 4 below). The use of a partnership not subject to CIT may also give rise to opportunities in certain cases.

2. Acquisition structures

2.1. Asset deal

2.1.1. Transfer tax (registration duties)

The sale of completed buildings is in principle subject to standard registration duties for a total amount of 5.09% of the sale price or, if higher, of the market value of the real estate. Transfer of non completed buildings will be subject to French VAT instead of the standard registration duties (see below 1.1.2.).

Moreover, compensation to the land registry (*salaire du conservateur des hypothèques*) equal to 0.10% of the transaction value is due on the transcription of the sale in the land registry.

2.1.2. VAT

- On the purchase price

The purchase of real estate property is only subject to VAT (as opposed to registration duty) at the standard rate of 19.6% in the following cases:

- purchase of land to be built on within four years of the sale,
- purchase of an incomplete building (reconstruction, substantial work),
- first sale of a new building occurring within five years of the completion of such a building.

In this case, the registration duties of 5.09% are not due. But a minimal tax rate amounting to 0.715% has to be paid.

- VAT regularisations

If the sale of a property is not subject to VAT, part of the VAT initially deducted by the vendor may have to be regularised. The regularisation period covers the following 9 years as regards deductions made up to 31/12/1996 and 19 years as regards deduction rights born afterwards. The amount to be regularised is equal to the VAT initially deducted less 1/10 (respectively 1/20) per calendar year or portion of calendar year the property was held.

This regularisation is due by the vendor. Based on a certificate which the vendor has the obligation to give, the purchaser will be allowed to deduct this VAT. For this reason, the VAT regularisation is usually recharged by the vendor on a contractual basis, thus increasing the sale price of the property included in the basis of the registration duties.

2.2. Share Deal

2.2.1. Purchase of partnership shares

A 5% transfer duty is assessed on the document transferring shares in a company which is not allowed to issue transferable stock certificates (partnerships, but also SARLs or SCAs).

2.2.2. Purchase of corporation shares

A mere 1.10% registration duty will be charged when a written contract is established for the transfer of shares in a stock company ("Share purchase agreement"). However, this duty has a ceiling of 4,000 € for any transaction.

If the company's assets consist mainly of real estate, it has to be regarded as a real estate company (*société à prépondérance immobilière*) within the meaning of section 726-2° of the French Tax Code (FTC). The sale of shares of such companies is not subject to the registration duty at the normal rate but for an amount of 5% of the purchase price, to be paid within 30 days following the transaction. The transfer duty is assessed on the sale price of the shares (or their fair market value, if higher), not on the value of the underlying property.

3. Taxation of current income and capital gains

3.1. Current income

3.1.1. French private investor

The French Tax Code does not contain any general definition of taxable income for personal income tax purpose. Rather, the code contains a number of definitions of different categories of taxable income. The particular definitions and rules for calculating income in each category can differ significantly. In the following developments we only will focus on the most significant category for real estate owners, i.e. real estate income, which is essentially composed of rent from leasing developed real estate property owned by the taxpayer. Income from unfurnished buildings that the taxpayer leases is subject to income tax in the category of real estate income. The taxable income is determined by deleting the gross real estate income from the fees related to the property.

The regime applicable to private persons must also be applied to partnerships which do not opt for the liability to corporate income tax. The term private real estate company (*SCI*) designates any of

the private companies whose purpose is real estate, for example construction companies, real estate investment companies, or even cooperative ownership companies, etc.

SCI's are transparent, which means that each member is taxed individually, unless the company has opted to pay corporate taxes, and even if the taxable income is determined at the level of the company.

3.1.1.1. Determination of the income

The total income of a fiscal household is subject to tax. This means that, in principle, a French resident is taxed on his worldwide income. Income is computed on an annual basis.

The taxpaying household pays tax during a given year on income earned the prior calendar year.

The lack of a tax residence according to the French tax law or the Double Tax Treaties however does not exclude taxation if the revenue is from a French source or if the person has one or more residencies in France, whether owned or rented.

3.1.1.2. Deductions

- No more flat deduction

The 14% flat deduction no longer applies as of January 1st, 2006.

This flat deduction covered many kinds of management fees (process fees, post, telephone, brokers fees...), insurance expenses and amortisation costs.

Those costs and expenses are still deductible from real estate income, but with no possibility to apply the flat deduction any more (except in certain cases).

- Further expenses

Besides the current expenses described above, other expenses are also deductible, such as associated with repainting the real estate.

Those deductible expenses include fees for repairs, maintenance and upkeep, improvement expenses, fees for management and caretaking, insurance premiums, real estate and related taxes, and interest expenses related to acquisition costs and to finance deductible expenses.

Please note that these further deductible expenses are listed in the French Tax Code. Each case should be further analysed before taking the expenses into account.

- Loss offset

As a general principle, expenses linked to the building can only be deducted from real estate income. Should the expenses be higher than the income, a real estate loss can occur. This loss (as far as it is not linked to interest expenses) can be off set against the general taxable income, to limit of 10,700 €. Should the general income not be sufficient, the deficit can be off set against the general income of the six following years.

For the loss over 10,700 €, the deficit can only be off set against further real estate profits of the following ten years.

3.1.1.3. Tax rate

Each year all individuals subject to French income tax must file income tax returns detailing their income. The normal date for filing the return is March 15 of each year, but non-residents receive automatic extensions.

The total taxable income of the household has to be divided within family shares. For example, two family shares are accorded to a married couple, to which one-half share for each of the first two children, and one full share for the third and subsequent children is added.

The tax rate is progressive, dependent on the family share. For the 2007 income, the tax payable is dependent on following tax rate schedule (for one family share), subject to potential future modification:

Up to	5,687 €		0.00%
From	5,687 €	To 11,344 €	5.5%
From	11,344 €	To 25,195 €	14%
From	25,195 €	To 67,546 €	30%
Up from	67,546 €		40%

Non-residents subject to personal income tax are also subject the same tax rates. But as an exception, the minimum tax rate cannot be under 20%. Thus, the effective tax rate amounts, depending on the French source income, to between 20% and 40%.

3.1.1.4. Withholding tax

If the non-resident holds French real estate directly or through a French partnership, the French source real estate income is taxable in France. No withholding tax is levied.

But the French real estate could also be held by a French company subject to French corporate income tax. The income received by the non-resident is not real estate income but a dividend subject to taxation in his place of residence.

According to French tax rules, the withholding tax to be paid amounts to 25% of the dividends paid by the French company. The tax is collected by the payer institution, which is required to verify the tax residence of all dividend recipients.

However, more Double Tax Treaties with France reduce the rate of the domestic withholding tax on dividends. For example, the Double Tax Treaty between France and Germany provides that the withholding tax may not exceed 15% of the gross amount of the dividends.

3.1.2. Company investor

French corporate income tax is in principle only assessed on earnings from an undertaking exploited in France. Earnings and losses occurring outside of France are excluded. This means that a foreign company which does not usually exercises a commercial activity in France should not be subject to corporate income tax.

However, a foreign company that leases real estate property that it owns in France has to be taxed in France, even if it does not have a permanent establishment in France and does not engage in any business there.

3.1.2.1. Tax base

Corporate income tax is assessed on an annual basis. The company is required to take into account at the end of its financial year all accrued income and all incurred expenses.

- Deductions

The French Tax Code provides for three kinds of deductions from the gross income. These three items are the general operating expenses, depreciation and amortisation, and the tax deductible retained earnings.

Operating expenses are defined as expenditures that diminish the net worth of the undertaking but do not add a capital asset to the balance sheet.

According to French accounting and tax rules, acquisition costs, which do not increase the value of the property, such as registration duties, notary and broker fees, can thus not be added to the acquisition price of the property.

Such costs can either be deducted as a cost the year they are borne or booked as a separate asset and depreciated over a maximum period of five years. The choice between the immediate deduction and the depreciation does not have any tax impact as the losses occurred within the year of acquisition can be off set against each kind of income in the following years.

Improvement and repair work do not constitute an immediate charge but should basically be added to the value of the building and be depreciated, if the improvement were to be regarded as a new item added to the building or if repair work was likely to extend the expected usage time of the property. On the other hand, simple maintenance and repair work would constitute costs which could be deducted immediately.

Furthermore, interests relating to loans granted to finance the acquisition or the improvement and repair works are deductible in some limits.

- Depreciation

The Property forms a fixed asset and is therefore subject to depreciation but only with respect to the share of purchase price linked to the construction, the land is regarded as a non-amortisable good and is not subject to depreciation. There are no general guidelines regarding the respective value of land and buildings so that it is the investor's responsibility to define the appropriate allocation based on market surveys, considering the location of the Property and the quality of the construction.

As regards the depreciation rate to be applied on buildings, neither tax law nor accounting principles provide for the duration of depreciation of a building, so that reference has to be made to the depreciation period usually retained.

However, new accounting rules have been come into force in France, which have fiscal consequences. For fiscal years beginning January 1st 2005 and thereafter, a building cannot be depreciated on its whole as for the preceding year. Each component of the building now has to be depreciated separately according to separate depreciation plans depending on its own using time.

- Loss carry forward

A company that realized a loss during a specific tax year may carry it over and deduct it as an expense of the first succeeding profitable tax year. If net income for the first year is not sufficient to absorb all the losses, the remaining losses can be off set against profits of the following years, without any time limit.

3.1.2.2. Tax rate

Each year, the company will have to file a tax return within three months of the end of its financial year.

The standard corporate tax rate is set at 33 1/3% of the net income calculated above.

Furthermore, some surtaxes are due, depending on the corporate tax amount to be paid. As from January 1st, 2006, the 1.5% additional contribution is not due anymore.

However, companies which are liable for more than 763,000 € corporate income tax have to pay a social surtax equal to 3.3% of the corporate income tax due. This second surtax will still be due in the following years.

A minimum corporate income tax, whose level is scaled according to the annual turnover is due even in loss situations. This tax can be set off against the corporate income tax paid for the given year. In absence of taxable profit this tax forms a credit to be off set against corporate tax liabilities of the two following years.

3.1.2.3. Withholding tax

If the French real estate is held by a French company subject to French corporate income tax, dividends received by the non-resident company are liable for tax in its place of residence.

According to French tax rules, the withholding tax to be paid amounts to 25% of the dividends paid by the French company. The tax is collected by the payer institution, which is required to verify the tax residence of all dividend recipients.

However, according to the European Directive relating to parent companies, no withholding tax is levied when the beneficiary of the dividends holds more than 15% of the French subsidiary.

3.2. Capital gains (asset deal or share deal)

3.2.1. Individuals

3.2.1.1. Direct sale

At the start of 2004 an overhaul of the capital gains tax regime took effect, simplifying it and substantially lowering the rate paid by some non-resident foreigners.

Capital gains of French residents are taxed at 27% (16% + 11% for social assessment).

Non-resident foreigners having capital gains deriving from the disposal of French property are taxed at a rate of 16% if their place of residence is in the European Union, and at the rate of 33.33% in others cases. The 11% social assessment are not due if the seller is a resident of another EU member state.

Furthermore, no capital gains tax is charged when a property has been held by the owner (resident or not) for more than 15 years. Capital gains from the sale of property owned for between 6 and 15 years are subject to reductions of 10% of the taxable amount for each year, starting with the sixth year.

For property owned for ten years, the tax is thus based on 50% of the original capital gain.

3.2.1.2. Sale of shares

Capital gains on the sale of shares in a company subject to CIT are taxed at a flat rate of 29% (18%, +11% for the social assessment which is not due if the investor is resident in the European Union). Transfers of shares by physical persons in a partnership that has not opted for CIT trigger the taxation of any capital gains determined under the rules for real estate capital gains for individuals. They are calculated based on the difference between the purchase price and the sale price of the shares.

3.2.2. Company investor

3.2.2.1. Direct sale

If the investor is a French partnership that has not opted for corporate income tax (elsewhere, it is treated like a corporation), the taxation depends on the shareholders qualification (individual, corporation or other partnership).

If the investor is a French corporation, The capital gains are determined by the difference between, on one hand, the sale price of the property, and on the other hand, its original purchase price, reduced in the case of existing buildings by a sum equal to 2% of its amount for each full year the building was held. The capital gains realized have to be added to the corporate income tax base and taxed at the same rate (33 1/3%).

For foreign companies, a separate tax at the rate of 33 1/3% (16% if the investor is a partnership located in the EU for individual shareholders) of the capital gains realised has to be paid upon registration of the completed sale. For corporations, this tax can be off set against the corporate income tax of the fiscal year in which the capital gain has been realised. Should the corporate income tax be lower than the tax on capital gains, the surplus amount is reimbursed by the French tax authorities.

Some Double Tax Treaties signed by France may disallow the application of this taxation.

3.2.2.2. Sale of shares

If the investor is a French partnership that has not opted for corporate income tax (elsewhere, it is treated like a corporation), the taxation depends on the shareholders qualification (individual, corporation or other partnership).

If the investor is a French corporation, the capital gains resulting from the disposal of shares are taxed at a rate of 33 1/3%.

If the investor is a foreign company, a separate tax at the rate of 33 1/3% (16% if the investor is a partnership located in the EU for individual shareholders) of the capital gains realised has to be paid upon registration of the completed sale. For corporations, this tax can be off set against the corporate income tax of the fiscal year in which the capital gain has been realised. Should the corporate income tax be lower than the tax on capital gains, the surplus amount is reimbursed by the French tax authorities.

Some Double Tax treaties signed by France may disallow the application of this taxation.

Moreover, according to the interpretation of the France-Luxembourg DTT, no capital gains taxation occurs (neither in France, nor in Luxembourg) when a Luxembourg company sells its participation in a French real estate partnership (SCI).

3.3. Other tax issues

3.3.1. VAT

The leasing of furnished professional premises is subject to VAT at the standard rate of 19.6%. On the contrary, the leasing of unfurnished professional premises is, in principle, exempt of VAT and therefore, as regards buildings completed more than 15 years ago, subject to a special 2.5% rental tax. The lessor can, however, formally declare its option for the submission of the rent to VAT within 15 days following the acquisition. This election is valid for 10 years and is renewable and irrevocable. The election for VAT entitles the lessor to recover any input VAT linked to the acquisition, the rental income and the maintenance of the Property. However, should the lessor only be partially submitted to VAT (with regards for example to the leasing of dwellings), the input-VAT is limited to this pro rata. In the case whereby rent is not submitted to VAT, a contribution on rental income is levied. However, this contribution is only due with respect to rents of buildings which have been completed for more than 15 years. The contribution on rental income represents 2.5% of the rental income and is in principle to be paid by the lessor, together with the income tax or the corporate tax.

3.3.2. Wealth tax

Individuals domiciled in France are subject to wealth tax on their world wide property. Individuals who are not domiciled in France are only subject to this tax on their property physically located in France. Shares in unquoted foreign companies preponderantly holding French real estate are considered as French property pro rata to such holdings. The tax base includes the fair market value of all taxable assets owned by the individual in their private assets. Business assets are excluded from this tax. Thus, a foreign property owner whose total net assets in France exceed 760,000 € becomes subject to the French wealth tax (*Impôt de Solidarité sur la Fortune* or *ISF*). This tax starts at a rate of 0.55% up to 1,220,000 €, and rises through several bands to a maximum of 1.80% on assets of more than 15,810,000 €.

3.3.3. 3% tax on French real estate held by companies

As a general rule, this tax applies to all legal entities, whatever their form, and in whatever country they may be headquartered, provided that they own, either outright or through intermediaries, property which is located in France (French real estates located in France must represent more than 50% of the total French assets of the company).

This requirement was originally imposed to prevent property owners from avoiding payment of the French wealth tax, the capital gains tax, or transfer fees by using corporations to mask property transactions between physical persons.

This tax is levied annually on the value of properties held on January 1st each year by entities. As from January, 1st 2008, trusts or comparable institutions are subject to this tax.

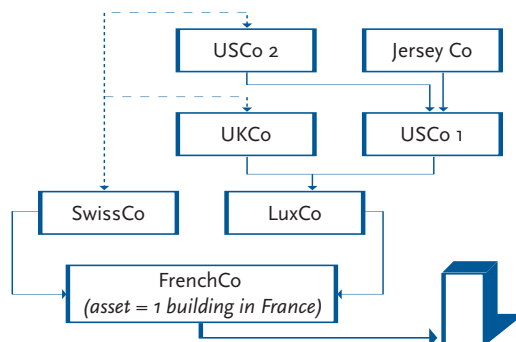
There are no deductions for indebtedness arising from the purchase of the property. This tax is due by any entity in a chain of participation in proportion to its underlying share in the property, with joint liability of any company in the chain of ownership. Physical persons as well a large number of entities are globally exempt from this tax.

From now on, exemptions mainly concern:

- Entities that are not a real estate company (i.e. companies whose assets are not mainly composed of real estates) wherever they are established. All the non real estate assets must be taken into account to determinate whether the company has a real estate preponderance, and no longer only those held directly.
- Pension funds, some real estate investment collective entities (OPCI) and entities whose real estate assets -or rights- held directly or indirectly, are inferior to 100,000 € or to 5% of the fair market value of the French real estate assets and established in France or in UE or in a country having signed a tax treaty with France providing either for administrative assistance or containing non-discrimination clauses.

In case of indirect holding, entities must yearly (before May 15) reveal the identity of the shareholders owning more than 1% of the capital. If they don't, they will be taxed on the part of the undisclosed shareholders.

Example



3% tax: (assumption: French real property is the only French asset in the chain)

- FrenchCo: Exempted from 3% tax if undertaking made
- SwissCo: Exempted from 3% tax if information is declared or undertaking made
- Individuals: outside the scope of 3% tax
- LuxCo: Exempted from 3% tax if information is declared
- UKCo: Exempted from 3% tax if information is declared or undertaking made
- USCo 1: Exempted from 3% tax if information is declared
- USCo 2: Exempted from 3% tax if information is declared
- JerseyCo: 3% tax is due. Amount = fair value of French real estate property * 3% * (70% * 70% * 60%)

3.3.4. Business tax

Individuals and corporations are required to pay an annual local tax based on the rental value of the assets held for professional purpose. The tax rate depends on the decisions of the local governments that are beneficiaries of the tax (municipality, region) and can vary widely from one place to another. But the tax is capped on 3.5% to 4% of the added value produced by the undertaking.

As the tax is only due based on the rental value of the professional assets, individuals or companies are not liable for business tax if their only activity is the administration of the assets held. Thus, the holding and leasing of real estate does not trigger any business tax.

3.3.5. Land tax

Land tax and accessory taxes such as sweeping tax are due annually by the owner of the property on the 1st January of a given year.

The tax is assessed on a deemed rental value, as determined by the tax authorities, multiplied by the tax rate retained by the municipality, the department and the region.

3.3.6. Tax on office spaces in Paris

Office spaces located within the Paris city limits and in the Paris region are subject to an annual tax which amounts to 11.30 € per m² of office space.

4. Taxation of real estate funds

French tax law provides for the possibility to apply several specific regimes for real estate funds investing in France, each one having its own constraints and conditions.

4.1. Closed-end and open-end funds

4.1.1. Taxation of the company

- *Société Civile Immobilière (SCI)*

French civil law real estate companies (*SCI*) may be used as closed-end funds in certain cases. *SCI* are non-trading real estate investment companies.

They are basically look-through entities for income tax purposes. The taxable income is calculated at the level of the company according to the rules that apply to the different shareholders, and is then taxed at the level of the shareholders.

For example, if partners of a *SCI* are companies subject to CIT (or similar, for non-resident companies), the determination of the taxable income of the *SCI* will follow the same rules as for companies subject to CIT. Moreover, taxation will be triggered even if no distribution is actually made. Partners will be taxed in the proportion of their shareholding in the *SCI*. If the partners are not French residents, they will still be taxed even if they have no permanent establishment in France.

Same rules apply for *SNC* (French general partnerships).

One of the tax reasons for establishing such companies in the real estate sector is revealed when the asset is being sold. It is then preferable to dispose of the company itself if the latter is heavily indebted, in order to reduce in the same proportion the sale price, hence respectively the taxable capital gains and the registration fees.

It has to be noted that the *SCI* may be treated as a corporation if an according option is exercised. In this case, the taxable income is determined according to the corporate income tax rules and is subject to corporate income tax in the *SCI*'s name.

- *Société Civile de Placement Immobilier (SCPI)*

French *SCPI* are civil law real estate companies with a broad and changing investors circle and are therefore used as open-end funds vehicles.

They are look-through entities for income tax purposes. The taxable income is calculated at the level of the company according to the rules that apply to the different shareholders, and is then taxed at the level of the shareholders.

SCPI make public issues, and their corporate aim is limited to investment in real estate (acquisition and management, mainly leasing, of the real property, with possibilities to perform secondary activities related to the main aim of the company).

As from December 31st 2009, it will not be possible to set up *SCPI* anymore. However, pre-existing *SCPI* benefit from a determined period of time to turn into *OPCI*.

- *Organisme de Placement Collectif Immobilier (OPCI)*

OPCI are a new type of real estate investment vehicle, inspired by German open real estate investment funds. They are collective investment bodies with specific aims, which is the acquisition or the building of real estate in order to lease them, or the holding of companies who predominantly hold real estate.

OPCI may take the form either of *Sppicav* or *FPI*.

Sppicav are share corporations with variable capital (*Sociétés Anonymes à Capital Variable*). They are 100% exempted from CIT, subject to the compliance with distribution conditions.

FPI have no legal personality. Thus, they are legally excluded from the scope of CIT.

4.1.2. Taxation of the investors

The taxable income as determined by the *SCI* or *SCPI* is taxed at the level of the investors according to their tax status (personal income tax for private investors, corporate income tax for corporate

investors) in case no option for corporate income tax has been exercised. Income derived from members of Sppicav are taxed as dividends. Hence, this is an interesting vehicle for investment funds as it has the ability to turn income derived from real estate net of all tax into dividends. This latter point is particularly positive when members of the Sppicav are not French residents. Associated members of FPI are subject to taxation according to the nature of the income derived by the FPI itself if they are individuals. If they are corporate entities, income derived from the FPI will be included in their taxable profits. In both cases, taxation is triggered only if income is actually distributed by the FPI.

4.2. REITs (SIIC)

The *Société d'Investissements Immobiliers Cotée (SIIC)* is a listed real estate stock company having opted for a specific tax treatment, inspired by the one available for American REITs.

Upon choosing for the *SIIC* tax treatment, a 16.5% exit tax is levied on the deferred capital gains on real estate held by the company (exit tax is due per quarter on December 15th of the year of option and in the three following years).

Main conditions to benefit from the *SIIC* regime can be summarized as follows:

SIIC REGIME : MAIN CONDITIONS OF APPLICATION

- Minimum share capital: 15 million €
- Quotation on a French regulated market
- Main activity (but not exclusive): letting of real estate
- 85% of rental income and 50% of capital gains must be distributed
- 16.5% exit tax on deferred capital gains on the assets of the *SIIC* when option is elected
- Minimum period of application of the regime: 10 years

4.2.1. Taxation of the company

Profits of French *SIIC* are basically tax-exempted for their part providing from:

- rental income, providing at least 85% of this income is being distributed to the stockholders within a certain timeframe,
- capital gains realised on the disposal of real estate and similar rights, providing at least 50% of this income is being distributed to the stockholders within a certain timeframe,
- dividends derived from subsidiaries benefiting from the special tax regime, providing they are distributed to the stockholders within a certain timeframe.

4.2.2. Taxation of the investors

4.2.2.1. French resident shareholders

Dividends derived from *SIIC* stockholdings are subject to corporate income tax or income tax depending on the investor's tax status.

For French resident corporate investors, *SIIC* dividends do not qualify for the parent-subsidiary regime and are therefore taxable income.

For French resident private investors, *SIIC* dividends qualify as dividend income, hence only 60% of the income is taxable.

4.2.2.2. French non-residents shareholders

SIIC regime appears to be very attractive for foreign investors.

Dividends distributed by the *SIIC* are subject to a withholding tax of 25%, most of the times reduced by DTTs (however, the parent-subsidiary regime of the 1990 Directive can generally not apply).

No branch tax may apply (depending on DTTs) if the *SIIC* is set up under a French branch of a foreign listed company (also listed in Paris) having a PE in France that opts for the *SIIC* regime in relation to its French assets.

As from July 1st 2007, a 20% withholding tax has to be paid by the *SIICs* on distributions of exempted profits to corporate shareholders non taxable (or taxable at a low rate) on these distributions and holding at least 10% of the *SIIC*. However, from our point of view, in the case the DTTs taxation on dividends is lower than 20%, DDT's rate may prevail on French 20% withholding tax.

This makes the *SIIC* regime favorable each time the shareholder benefits from reduced taxation on dividends in its state of residence.

CONTACTS

MARCCUS PARTNERS

23 rue Balzac
75008 Paris

Tel: + (33) (0)1 53 53 02 80
Fax: + (33) (0)1 53 53 02 81

FOR LEGAL ASPECTS

Yann François
Avocat à la Cour,
International Partner
yann.francois@marccuspartners.com

Silke Nadolni
Rechtsanwältin,
National Partner
silke.nadolni@marccuspartners.com

FOR TAX ASPECTS

Jacques-Henry de Bourmont
Avocat à la Cour, Rechtsanwalt,
International Partner
jh.debourmont@marccuspartners.com

Guillaume Rubechi
Avocat à la Cour,
National Partner
guillaume.rubechi@marccuspartners.com

www.marccuspartners.com

www.mazars.com