French tax rates for high net worth individuals lowered

The French finance bill for 2019 adjusted the general 30% flat tax on financial incomes, the real estate wealth tax and the business transmission tax regime for high net worth individuals in a bid to keep more wealthy French at home. Benoît Couty, partner at Pichard & Associés, examines the changes

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The 30% flat taxation of financial incomes (flat tax) is the most significant tax measure that was adopted in 2018 after President Emmanuel Macron’s election in an effort to stop French high net wealth individuals (HNWI) relocating outside France.

The 30% flat tax consists of 12.8% income tax and 17.2% social contributions, which is much lower than the general bracket rates applicable otherwise (up to 45% on incomes exceeding €156,000 (£135,000) plus 17.2% social contributions).

The actual income tax rates (12.8% under the 30% flat tax or 45% under the standard bracket rates) will be increased, however, by 3% to 4% for high incomes (ie, exceeding €250,000 euros for single taxpayers or €500,000 euros for couples).

Because the 30% flat tax does not allow basis rebates that could otherwise apply to dividends (40% basis rebate) and capital gains (up to 85% basis rebate depending on holding period and nature of the business), the 30% flat rate can, in some specific cases, result in a higher tax burden.

Therefore, taxpayers can opt out of the 30% flat tax, in which case all their financial income is subject to the standard bracket rates after basis rebates. No cherry picking is allowed as the election is global for a given year.

Practically speaking, the 30% flat tax is almost always more favorable, save capital gains eligible for a 85% basis rebate, which only relate to shares held for at least eight years in certain EU SMEs.

The French tax administration has made some technical amendment in the 2019 finance bill to cover certain loopholes, clarify certain aspects and enlarge the scope of the new 30% Flat Tax, which in our view is clearly appealing, and may even prove to be competitive, at least within the UE.

Real estate wealth tax

Macron’s other significant tax gesture towards high net wealth inviduals was the suppression of the French wealth tax. However, this only targeted investments that contribute to the development of business activities. Non-business related real estate therefore remains subject to a wealth tax that is very similar to the former general wealth tax.

The rebranded real estate wealth tax hence applies to the fair market value of real estate owned as of 1 January of each year, reduced by the acquisition debt and real estate local tax. The same bracket rates as the former general wealth tax apply (progressive 0 to 1.5%) as well as the possibility to deduct the amount of the outstanding acquisition debt and to apply an automatic 30% rebate on the main residence remain.

The 2019 finance bill introduced several amendments to cover loopholes and clarify certain aspects of the new real estate wealth tax, notably to catch private properties that would be artificially connected to a business or debt that would be artificially allocated to real estate.

75% basis rebate applicable to transmission of businesses

This favourable regime is commonly referred to as 'Dutreil deed' after a lawmaker's name. It has been in place for a long time and is very popular as it allows significantly reducing the tax burden on the successor of a business when receiving shares from the previous owner (most often also founder).

Even though very technical and complex, it can be summarised as a 75% tax basis rebate on the fair market value of shares provided the initial owners collectively retain their shares for two years and the successors individually retain their shares for another four years following the end of the first-mentioned two-year period. The initial owners or the successors are also required to be official managers in the business for three years following the transmission and the holding commitment needs to represent at least 34% of the total number of voting rights (or 20% for listed companies).

The initial two-year collective holding period for the initial owners can be deemed completed at the time of the transmission, hence reducing the total holding commitment to four years by the successors.

The shares must qualify as active business themselves or as an interposed holding company owning shares in an underlying active business.

The 2019 finance bill brought significant improvement to this already well established tax regime, notably by allowing flexibility in post transmission restructuring and by softening the mandatory yearly compliance, previously considered tricky and burdensome.

When this 75% basis rebate is combined with other donation schemes like splitting ownership rights (and therefore share value) between 'bare ownership' (right to sell) and 'usufruct' (right to receive incomes) or the general €100,000 gift tax rebate per parent and per children, the taxation of business transmission can be reduced to acceptable levels.

About the author

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