



A Step-by-Step Guide to Purchasing a Home in France

When a client is considering the purchase of a home in France, or any other country, it is important to evaluate all the factors that may affect the purchase, ownership, inheritance, and taxes related to that new home.

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Originally published in *Estate Planning*, Vol. 36, No. 9., 2009 Thomson Reuters/RIA

September 2009

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As advances in technology, transportation systems, and the global economy have made it easier for people to live, work, and travel abroad, more and more people are looking outside the United States when purchasing their residences and vacation homes. Purchasing a home is always a major undertaking, but when that home is located abroad, the process becomes significantly more complex. The legal, tax, and ownership considerations that come into play whenever a home is purchased must, in an international transaction, be evaluated within the unfamiliar context of another country's laws. This article focuses on those considerations as they come into play when a U.S. person purchases a home in France.¹

The French Notaire

The French government actively regulates the purchase of real estate and has established the process by which real estate is purchased. As part of that regulation, the French government has designated "Notaires" as the only professionals in France authorized to finalize certain real estate transfer documents, and the professionals responsible for insuring good title. As a result, a Notaire is generally required for any transfer of French real estate.²

The training required to be a Notaire is rigorous. To be a Notaire, an individual must complete seven years of training in French real estate law, family law, and corporate law. Notaires can practice anywhere in France; they are not limited to a specific geographical area.

Because they are responsible for ensuring that the purchaser receives good title, Notaires are considered neutral parties who can act on behalf of both the buyer and the seller. Therefore, depending on the preference of each party and the circumstances between the parties, the buyer and seller may each engage their own Notaires or use the same Notaire. If both the buyer and seller engage their own Notaires, there is no additional cost. Notaire fees are fixed by law, and are divided between the Notaires working on a given transaction.

Notaires have personal liability for the real estate transactions that they coordinate. If a transaction goes awry and the Notaire does not have sufficient funds to make the parties whole, the Notaire association satisfies the difference. All Notaires are insured by a common fund. The Notaire's prescribed responsibilities and neutrality mean that real estate transactions are very rarely overturned or challenged in France.

The purchase process

The process involved in purchasing a home in France involves the following steps:

(1) *Setting of basic terms.* The buyer and the seller, and, if applicable, their respective Notaires and estate agents, negotiate and set the terms of the sale.

(2) *Compromise de vente (agreement of sale).* The Notaire (or, at this stage, it can be a lawyer or estate agent) prepares the compromise de vente. This is the key legal document in a real estate transaction. It is similar to the preliminary sales contract used in U.S. real estate transactions but is more important than the U.S. version because it sets forth all the future obligations of the parties. When the compromise de vente is signed, the buyer makes a down payment (usually 10% of the purchase price) to an account controlled by the Notaire.

(3) *Cooling off period.* After the compromise de vente has been signed and the down payment made, there is a mandatory seven-day cooling off period during which time the buyer can rescind the agreement and receive the down payment back. The seller cannot rescind the agreement once he or she has signed the compromise de vente.

(4) *Document preparation and execution.* After the seven-day cooling off period has expired, the Notaire collects and finalizes the documents needed to record the deed. Those documents attest to the legal competence of the parties and their authority to enter into the real estate transaction, and confirm that the real estate being purchased is free of liens, claims, asbestos, termites, and lead poisoning risks, and is in conformity with local regulations.³ It usually takes the Notaire 2-1/2 to three months to prepare and finalize these documents.

(5) *Closing.* The purchase is finalized at a closing that generally takes place in the Notaire's office. The balance of the purchase price is paid at the closing by having those funds wired directly into an account controlled by the Notaire. If a mortgage is involved, those proceeds also will be transferred into that account. The Notaire's fees are paid, along with various administrative costs and taxes, at the closing. Closing costs (including Notaire fees) usually range between 5% and 10% of the purchase price.

Ownership of the house

There are a variety of ways to hold title to a house in France.

Individual ownership. Before consulting with their advisors, many purchasers assume that they will own the property directly in their individual names. Such direct ownership, though, can cause complexities down the road. If an individual owns French real property, upon that individual's death, the property will be transferred pursuant to the French forced heirship laws. This is true even if the individual is not a resident of France.⁴ Under the French heirship laws, a fixed portion of the decedent's property must pass to the decedent's children, even if the

decedent's will provides otherwise. The portion that must pass to the decedent's children will be determined based on the number of the decedent's children, as follows: one child is entitled to one-half; two children are entitled to share two-thirds, and three or more children are entitled to share three-quarters. After application of the relevant fraction, the decedent is free to dispose of his or her remaining property under his or her will to anyone the decedent chooses, including the surviving spouse and descendants.

The best way to illustrate the impact of the French forced heirship laws is with an example. For instance, if the real estate owner has two children, the children are entitled to receive two-thirds of the property and the owner may leave only the remaining one-third to whomever he chooses, such as his surviving spouse. This result is true even if it means that children from a prior marriage take equally with the surviving spouse's children. Such a result can make it difficult for the surviving spouse to sell or mortgage the house if any of the decedent's children are minors because such actions require a court's approval when minor children are involved.

Universal Community. One way spouses may avoid the French forced heirship laws is to elect for the "Universal Community" regime to apply to them.⁵ Generally, this regime provides that all assets acquired by the spouses before or after marriage are the property of the community. It is possible for a U.S. couple to enter into a contract providing that the French Universal Community regime will apply to the couple's French property. If this regime applies, at the death of the first spouse to die, full ownership of the French property passes to the surviving spouse notwithstanding the forced heirship laws. The result of the application of the Universal Community regime is that essentially the same result is achieved as the U.S. concept of joint tenancy would achieve.

Trusts. Owning the real estate in a trust is not an option and therefore does not help with the forced heirship problem.⁶ French law does not recognize trusts and does not have the equivalent of legal and equitable estates in land. Accordingly, France will not permit splitting the ownership of land into legal and equitable interests. If property is registered in the name of a trust, France will view the property as being owned by the trustee and will disregard the beneficiary entirely.

Foreign entities. Non-French companies (i.e., foreign entities) may be used to own a residence in France, but they are frequently avoided due to their complications and often costly taxes, fees, and administration. The first hindrance to using a non-French company is the 3% annual tax on the market value of the French property that is assessed on non-French companies that are formed in

tax havens that do not have a treaty with France (e.g., Jersey, Panama). While the use of a company that is located in a jurisdiction that does have a double tax treaty with France (e.g., the U.S., United Kingdom) can avoid the special 3% tax, all non-French companies will still be subject to French corporation tax with respect to the French property.

A corporate tax will be imposed on any rental income from the French home and a capital gain tax will be imposed upon the disposition of the home owned by the company, which will be subject to a 33-1/3% withholding tax (which is limited to 16% if the entity is a resident of an EU Member State, Norway, or Iceland). In addition, there are various other fees and filing requirements that generally make non-French companies impracticable for owning a French home.

French entity. The most popular way to purchase a home in France is through a *société civile immobilière* ("SCI"). An SCI is a French business organization capable of owning real property. The organization is somewhat similar to a corporation, since it is under shareholder ownership and control, but is treated like a partnership for U.S. tax purposes.

There are several advantages to owning French property through an SCI. The most important one is that using an SCI allows the nonresident shareholders to avoid France's forced heirship laws. The reason is that shares in an SCI are considered moveables, and moveables owned by someone who is not a resident of France are distributed according to the laws of the decedent's country of residence rather than the laws of France. Accordingly, as long as the owner does not die a resident of France, the French forced heirship laws will not apply to his or her interests in the SCI.⁷

Another advantage of owning a French home through an SCI is that the SCI shares are generally easier to transfer for estate planning purposes than fractional pieces of the real estate. Transferring shares rather than the real estate itself also is less costly because it does not involve a Notaire and is subject to lower fees.

Similarly, it is generally easier to sell the real estate when the property is held in an SCI because the sale of shares does not require the preparation of a deed or the involvement of a Notaire. A sale of property through an SCI can be done in a couple of weeks while a sale of property owned directly usually takes several months.

Finally, owning property through an SCI also has the advantage of avoiding the annual tax on real estate (3% of fair market value), which otherwise would be due if the property was owned by a non-French entity.

The disadvantages to owning the property in an SCI are largely administrative in nature. An SCI must maintain accounts (using the French accounting system), hold an annual shareholders meeting, and maintain statutory records in the legal register. The accounting procedures are minimal and relatively inexpensive; however, if these requirements are not met, the SCI can be deemed not to exist. There seems to be no immediate penalty for failing to comply with the requirements beyond the nonrecognition of the SCI, but the property cannot be sold through the SCI if the SCI's accounting is not up-to-date. Accordingly, it is best to use a local company to handle the SCI's accounting and to make sure that requirement is satisfied.

The SCI also is required to file an annual tax return to report any income it receives and will be assessed a 3% tax if a return is required and not filed. However, for SCIs that do not have any income, the annual tax return is required only the first year.

The second disadvantage is that an SCI must have at least two shareholders. This multiple ownership requirement can be a problem for individuals who want to have 100% ownership of a property. In most cases, though, this requirement is not a difficult barrier to overcome as there is no minimum or maximum number of shares that each shareholder can or must own. Consequently, the second shareholder can own only one share (regardless of the percentage of ownership that share represents) if that is desired.

In addition, if only one member of an SCI remains for any reason (e.g., if all outstanding shares are transferred to one shareholder upon the death of the other), it is not necessary to bring in a new second shareholder to continue the organization unless an interested party so demands. An interested party is defined as any party, including the French Revenue Service, with a pecuniary interest in the SCI. Upon a demand for a second shareholder, the SCI has six months to either bring in another shareholder or dissolve the organization. (Another way to have a second shareholder without giving up control is to have a U.S. limited partnership ("LP") or limited liability company ("LLC") controlled by the first shareholder be the second shareholder.)

The third disadvantage to owning property through an SCI is that the SCI shareholders cannot claim a U.S. income tax deduction for any mortgage interest paid by the SCI. Under the U.S. income tax laws, a residence held in a business entity is not entitled to a tax deduction for mortgage interest unless it is owned by a co-op housing association, estate, or trust. SCIs do not fall into any of these exceptions.

Finally, using an SCI is often not appropriate if the house will be furnished and rented. Renting the house on an

unfurnished basis does not interfere with the partnership nature of the SCI, although it will necessitate the filing of annual income tax returns. However, renting the house on a furnished basis will cause the SCI to lose its flow-through nature and to become subject to corporate income taxes.

Financing considerations

The SCI shareholders, the SCI directly, or other owners of a French home can borrow money to make the purchase. In many cases, this loan will be set up as a mortgage with respect to the property. In addition to providing liquidity, borrowing can allow the ultimate owners of the property to minimize the wealth tax (discussed below) that will be assessed on the property. However, if the debt is to be a long-term solution to the wealth tax, it also must be long-term in nature. In addition, if an SCI owns the property and a bank loan is used, the SCI may need to charge rent to generate a cash flow to cover its loan payments to the bank. If the option exists, the SCI can borrow from a family trust that benefits one or more shareholders (although any such loan should not come from a shareholder's revocable trust to ensure that the loan will be respected as a loan).

In any event, interest should be paid on the loan. While this is not an issue in France since French tax law does not require that interest be charged, for U.S. tax purposes, the imputed interest rules will apply, so generally it is better to charge interest at a rate equal to at least the applicable federal rate. If the property is not held in an SCI but instead is owned directly, any mortgage interest will be deductible for U.S. income tax purposes.

Trust funds. Although France does not recognize trusts, the funds accumulated inside of a trust can be used to purchase the house. This can be accomplished by having the trust contribute those funds to a U.S. limited partnership or LLC and then having that LP or LLC contribute those funds as capital to the SCI.

French and U.S. taxes

There are several different taxes that must be considered.

Wealth tax. France imposes an annual wealth tax. For purposes of this tax, wealth is calculated for a family group (i.e., husband, wife, and dependent children) rather than for each person individually. As of 1/1/09, the wealth tax is imposed when the value of a household's assets (less debts) exceeds 790,000 euros (approximately \$1,010,000) as of January 1 of each year, and the tax rate ranges from 0.55% to 1.8%. For a resident of France, the wealth tax is assessed on the individual's assets wherever they are located, but for a nonresident, the wealth tax is assessed only on the person's assets that are physically located in France.

A person's assets subject to the wealth tax include land, buildings, bank accounts, and personal property (such as furniture, jewelry, and cars). In addition, an individual's SCI shares are taken into account for purposes of the wealth tax. The value of such shares is determined based on the value of any real estate, cash, furniture, and other property owned by the SCI; however, if the SCI borrows funds to purchase the real estate, the amount of that debt will reduce the value of its shares accordingly.

Death taxes. Both the U.S. and France assess some form of death tax. France has an inheritance tax that is paid by the recipient of property from a decedent. The rate of tax depends on the recipient's relationship to the decedent, with higher rates being assessed against nonfamily members. The U.S. has an estate tax that is paid out of the decedent's assets before they are distributed to the beneficiaries. Many of the separate states also assess an estate tax. While both the U.S. and France will tax the value of an interest in a French home (whether owned individually or through an entity), the U.S. will give a credit for the tax paid to France under the 1978 France-United States Estate and Gift Tax Treaty, as amended.

Registration duty. France charges a "registration duty" of between 4.8% and 7% of a property's market value when the property is purchased or transferred. This duty is charged each time the property is transferred even if the parties are related. Accordingly, purchasing the property individually and then transferring it to an SCI will result in an assessment of this registration duty both at the time of purchase and also when the property is transferred to the SCI. Therefore, if an SCI will be used to hold the property, it should be the initial purchaser.

Property taxes. Two kinds of local taxes are generally charged to French properties. Property tax is payable by the owner of the property, regardless of whether the owner resides in or uses the property. Dwelling tax is payable by the tenant of the property, regardless of whether the tenant owns the property. A U.S. person who purchases French property will therefore always pay property tax, and will also pay dwelling tax unless the U.S. person rents out the property to outside individuals.

Other considerations after the purchase

A U.S. person making a contribution to a foreign partnership, such as an SCI, must report such contribution on IRS Form 926 if, after such contribution, the individual's direct or indirect interest in the partnership's profits or capital exceeds 10% and the value of the property contributed, combined with the value of any other property transferred to the partnership in the preceding 12 months, exceeds \$100,000.

An individual owning a home in France should review his or her estate plan to make sure it correctly handles the disposition of the house. As previously discussed, SCI shares cannot be held in trust. Accordingly, in many situations, an individual's estate plan will need to be amended to provide for the outright disposition of the SCI shares (to avoid them passing to a marital trust or a family trust at the first spouse's death).

Conclusion

When a client is considering the purchase of a home in France, or any other country, it is important to evaluate all the factors that may affect the purchase, ownership, inheritance, and taxes related to that new home. While there is not a one-size-fits-all solution for a U.S. person owning a home in France, an SCI is a viable solution for many clients. Finally, as is the case for all international planning, it is always important to consult with an expert in the location of that new home to fully understand the nuances and specifics of that jurisdiction's rules.

Reference

¹ While an in-depth discussion of French law, including French property, corporate, and tax law, is beyond the scope of this article, the author found the following resources to be particularly helpful: de Rouffignac, "Buying Property in France," www.escapeartist.com/efam/90/art_France.html (Apr. 2007); Whitaker, and Tirard, "Des Américains en France," 146 Tr. & Est. 34 (Aug. 2007); Chesnais, Froment-Meurice, and Hazan, 961-3rd T.M. (BNA), *Business Operations in France*.

² While Notaires are required for real estate transfers in France, buyers and sellers may also use French estate agents to assist them in the buying and selling process. The fees of the estate agent(s) are typically paid by the seller from the proceeds of sale.

³ If there are any problems during this stage of the buying process, the Notaire will contact each of the parties to attempt to reach an agreement about the issue that arises. If no agreement can be reached, the sale may lapse. This is unusual, however, because a seller's agent typically does a thorough check of the property before agreeing to list it for sale.

⁴ The French heirship rules apply to all property of a decedent if he or she is a resident of France. However, if the decedent is not resident of France, the rules will apply only to the decedent's immovable property (i.e., land and buildings) located in France.

⁵ In the absence of an agreement, each spouse will be treated as owning one-half of the property acquired by the couple during marriage. Each spouse's one-half of the couple's property will pass pursuant to the French heirship laws, if applicable to the particular property, and the deceased spouse's will.

⁶ A U.S. trust, however, may be used to own French real property indirectly through ownership in one or more of the entities discussed below.

⁷ There are four ways that a U.S. person can become a resident of France for French tax purposes. One way is for the individual to have his or her "home" located in France. According to French law, an individual can have only one "home." This means that a French home purchased by a U.S. person will not be considered his or her "home" for residency purposes unless the U.S. person disposes of his or her prior home or otherwise elects to make the French residence his or her home. The second way for a U.S. person to be deemed a French resident is if the individual lives in France for 183 or more days in any given year. In this case, the U.S. person will be considered to have a "habitual place of abode" in France, and be a resident of France for that year. The third and fourth criteria for French residency are whether an individual's principal professional activity is in France, and whether the individual's center of economic interests is in France. Purchasing a French residence or property does not generally affect either of these criteria.

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