MRS EVELYNE POILLOT v THE DIRECTOR OF TAX SERVICES OF THE HAUTS DE SEINE NORD

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INTRODUCTION

Although French law does not contain any statutory provisions dealing specifically with the treatment of trusts for wealth tax purposes, on 4 May 2004 a French court[2] ruled for the first time that a French resident beneficiary of a discretionary trust is not subject to such tax.

This decision is very important, for two reasons. First, although the French courts have agreed in a number of cases to recognise the effects in France of foreign trusts for civil law purposes, this is the first time that a French court has decided a tax case involving trusts. Secondly, given the very high tax burden that wealth tax represents for high net worth French residents, the decision has considerable practical implications for French taxpayers.

Although the decision will not have surprised French tax lawyers who advise on the application of trusts in the planning arrangements established for French clients, it is clear that it is nonetheless preferable to have a court case in addition to the legal opinions of French tax lawyers. Nonetheless, it should be emphasised that the decision of 4 May 2004 is not a binding precedent and, as is explained in this article, the decision makes clear that the question whether or not the French resident beneficiary of an 'Anglo-Saxon' trust is subject to wealth tax depends on the circumstances of each case and, more particularly, on whether the French tax authorities are able to demonstrate that the French resident beneficiary of a trust holds rights which have a market value.

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[2] *Mrs Evelyne Poillot v the Director of Tax Services of the Hauts de Seine Nord*, TGI Nanterre, 4 May 2005 0303-950

SUMMARY OF THE DECISION

Madame Evelyne Poillot, a French national and resident, was the beneficiary of two trusts subject to US law created inter vires by her uncle and aunt, who were residents of the US. During the years for which Madame Poillot was the subject of an additional assessment for wealth tax, she had received distributions of income from the trusts in question, which she regularly reported on her income tax returns, and which were taxed accordingly. On the other hand, Madame Poillot did not report any assets for wealth tax purposes in relation to the trusts.

The tax authorities, however, took the view that Madame Poillot should have been subject to wealth tax by reason of her status as a beneficiary of the two American trusts. Consequently, the local tax office included in Madame Poillot's return for wealth tax a chargeable asset, calculated by capitalising at the rate of 3% the income that had been reported as being distributed from the trusts. Madame Poillot did not accept the proposed assessment, on the ground that she did not have any legal right or title to the principal of the trusts. The tax authorities in turn confirmed the assessment, on the ground that since Madame Poillot received annual income from the trusts, she was 'like the owner of a right of ownership of assets constituting intangible values'. The tax authorities also claimed that their position was supported by the provisions of Art 752 of the General Tax Code (CGI), which creates a presumption of ownership of shares, bonds, debts and other assests from which the taxpayer has received income. Although Art 752 of the CGI deals with inheritance tax matters, its provisions are also applicable in respect of wealth tax.[3]

THE NATURE OF FRENCH WEALTH TAX

Wealth tax (*impôt de solidarité sur la fortune* (ISF)) is an annual tax based on net worth. It is payable by individuals whose private wealth, after deductions, exceeds a certain amount, which is determined on 1 January each year.[4] French residents are subject to ISF on their property situated both in France and abroad.[5] Taxpayers resident outside France are subject to ISF only on property situated in France,[6] with the exception of their French financial investments.[7] In principle, all property is potentially subject to ISF. However, this general rule is subject to a significant exception concerning professional property.[8] Antiques and artworks are also exempt

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[3] CGI, Art 885S.

[4] €732,000 for the tax due on 1 January 2005.

[5] CGI, Art 885A1.

[6] CGI, Art 885A2.

[7] CGI, Art 885A3.

[8] CGI, Art 885N–885R defines the assets that are classified as professional property and exempt from ISF.

from ISF.[9] Article 885G of the CGI provides that property or rights encumbered by an usufruct (*usufruit*) are subject to wealth tax in the hands of the usufructuary (*usufruitier*) and have the same value as the rights attaching to full ownership, subject only to limited exceptions. The basis for wealth tax is measured by the net value on 1 January each year of the whole of the individual's property, rights and other taxable assets.[10] The net value must be reported for wealth tax purposes and is determined in accordance with the rules in force for inheritance tax.[11] The valuation rules are the same whether the property is situated in France or abroad. Inheritance tax – and consequently wealth tax – are in principle calculated on the market value at the date of death (inheritance tax) or on 1 January (wealth tax). The concept of market value is not defined by the legislation. However, both case-law and administrative doctrine confirm that it corresponds to the price that could have been obtained on the open market. Of particular interest for the facts of the present case are the specific rules which apply in determining the market value of property and receivables. So far as property is concerned, according to case-law, the market value must be determined through comparison with a sufficient number of intrinsically similar property sales, save in exceptional circumstances. Other methods of valuation (in particular by reference to income) may also be used, as was the case in the present circumstances.

The taxable base is subject to progressive taxation. The rates of tax to be applied for 2005 are as follows:

Fraction of the taxable net value of the patrimony (EUR)	**Applicable tariff (%)**
Up to 732,000	0
732,000–1,180,000	0.55
1,180,000–2,339,000	0.75
2,339,000–3,661,000	1
3,661,000–7,017,000	1.30
7,017,000–15,255,000	1.65
Over 15,255,000	1.80

[9] CGI, Art 885I.

[10] CGI, Art 885E.

[11] CGI, Art 885S.

THE FINDING OF THE FRENCH COURT

Although Madame Poillot did not contest that she was receiving regular distributions of income from the two trusts, the Tribunal de Grande Instance (TGI) decided that this was not enough to impose upon her a presumption of ownership of the assets held by the trusts. Furthermore, the court recognised that the 'trust' is an 'original institution under Anglo-Saxon law', of which there is no single legal definition, but which has numerous variations. It is interesting to note that in their decision the French judges gave the following description of the trust relationship:

> 'as a general rule, it [the trust] contemplates legal relationships created by one person – the settlor [*le "constituant"*] – by an instrument during his lifetime or upon death, where property is placed under the control of a trustee [the same word is used in French] for the benefit of a beneficiary [*"bénéficiaire"*] or for a given purpose. The rights of the beneficiaries can be varied by the deed establishing the trust.'

In the particular circumstances, the court found that the tax authorities had failed to prove that Madame Poillot, as a beneficiary of the two trusts in question, had property rights having a value in her estate therefore to be included in the taxable base for wealth tax purposes. It also follows from the judgment that, on the contrary, the trusts in question denied the beneficiary any property right or *'créance'* against the trustee or the assets in the trust fund, and even left to the trustee the discretionary power to determine how much income (if any) was to be distributed.

As a consequence of its failure to establish that Madame Poillot held any legal rights relating to these trusts, the court held that the tax authorities had not substantiated good grounds for imposing wealth tax on Madame Poillot by reason of her status as a beneficiary of the two trusts in question.

IMPLICATIONS OF THE CASE FOR FRENCH TAXPAYERS

Although the issue was not raised by the tax authorities and was therefore not considered by the court, it is worth mentioning that any analogy between the legal situation of the beneficiary of a trust and the position of the holder of a usufruct (*usufruit*) is inappropriate. The beneficiary, in contrast to the usufructary, does not possess any direct interest in the property held in trust, has no control over it, and more generally does not have any of the usufructuary's rights. In any case, it seems clear from the judgment of May 2004 that when a trust deed (whether it is subject to US law or to any other system of law) confers on the trustee a very wide discretion, the French resident beneficiaries are not subject to wealth tax in respect of the trust assets. Although they have the right to seek due and proper administration of the trust through the courts, they do not have any asset of economic value apart from

that. This is even more true when the trust deed provides that the trustee holds the trust property for the benefit of a wide class of beneficiaries and confers on the trustee a very wide discretion as to the choice of beneficiaries to whom income and/or capital should be paid. When the settlor chooses a class of potential beneficiaries and gives the trustees power to determine how much each beneficiary should receive, it is beyond doubt that the beneficiary has only expectations which do not have any market value and which consequently fall outside the scope of French wealth tax.

However, it would certainly be imprudent to conclude that French resident beneficiaries of any trust are always immune from wealth tax. For example, at the other extreme, a trust could be set up in the form of a 'bare trust', under which property is transferred by the settlor to a trustee, who holds that property for the absolute benefit of a single identified beneficiary. In such a case, the trustee is no more than a nominee for the beneficiary and will normally be bound to pay any income derived from the settled property to the beneficiary as it arises, and to transfer the trust property to the beneficiary at his demand. Where a trust of this kind is established and the beneficiary is a French resident, it is more than likely that he will be subject to wealth tax in respect of the trust property. Faced with an almost infinite variety of trust arrangements which could fall between these extremes, in my opinion a distinction should be drawn based on whether the beneficiary of a trust has a vested (unconditional) or contingent (conditional) interest – or an interest which, although vested, is subject to defeasance. Assume, for example, that a trust is established in favour of A for life and upon A's death in favour of B absolutely. A is then entitled, as of right, to the income produced by the trust assets for the rest of his lifetime. B, being identified in the trust instrument as having an absolute successive interest, has a vested interest in remainder. He is entitled to the capital of the trust upon A's death. In such a straightforward life interest trust, A has an indefeasible right to the trust income, which he is free to dispose of by sale. In my opinion, this means that A has a valuable interest which might be subject to wealth tax. B has a vested interest in remainder, which he may also dispose of by sale or gift. Such an interest also has a market value and the French tax authorities might argue that it is also subject to wealth tax. Obviously, the values of both the interests of A and B are likely to be significantly less than the current value of the trust property. On the other hand, if a gift held in trust is contingent upon the occurrence of a specified future event, then it is difficult to see on what grounds the French tax authorities could take the view that the beneficiary is subject to wealth tax, at least until the condition is met.

CONCLUSION

As a conclusion, it would be prudent to assume that the only type of trust that offers full protection against French wealth tax is the discretionary trust, as this has now been confirmed by a French court. On the other hand, in the case of a life interest or interest in possession trust, it is only if the interest is precarious or can be defeated by the discretion of the trustee that the view may reasonably be taken that it is not subject to wealth tax. In my opinion, the main test to decide whether or not a French resident beneficiary of a trust is subject to wealth tax depends on the ability of the beneficiary to sell or assign his interest. It is only when he has such an ability that the interest in question has a market value which gives rise to wealth tax. When this is the case, the taxable value corresponds to the price that the beneficiary could obtain if he sold his interest. In all other cases, the French resident beneficiary of a trust is not subject to wealth tax.

Finally, as confirmed by the decision of 4 May 2004, the burden of proof whether or not the French resident beneficiary of a trust owns anything having a monetary value for French tax purposes is on the French tax authorities.

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