

## **Wealth Tax, Tax Shield and Exit Tax**

On October 28<sup>th</sup>, the European Commission asked France to amend its legislation regarding the tax shield and the limitations to the wealth tax, which is regarded as contrary to European law.

Indeed, the government wished to exclude from the benefit of these regulations foreign residents despite the fact that they perceived most of their income in France and that they were primarily taxable in France. According to the European Commission, such limitations constitute a violation to the principle of freedom of movement of persons.

If the Budget Minister, François Baroin, has announced tax reforms, the question is whether the government will take into account the opinion of the European Commission. The answer is twofold.

First, the Budget Ministry put an end to the tax shield which purpose was to cap the direct tax to 50% of the income. Therefore, French residents will now be under the same tax system as non residents since no one will benefit any longer from such shield. The European Commission's advice has therefore been complied with in this regard.

Further, the conditions under which the wealth tax reform will take place have been disclosed. The rate of this tax will be decreased, but not suppressed. The tax threshold will now be of €1,300,000 instead of €800,000 and there will be two tax brackets: 0.25% between €1,300,000 and €3,000,000 and 0.5% above €3,000,000. The tax rate has therefore largely diminished while, in the mean time, its threshold has considerably increased. However, its tax basis is much wider as the tax will be applicable from the first Euro,

and not from the threshold as it was the case until now.

This tax reform would nevertheless allow 300,000 tax payers to escape from the wealth tax.

Moreover, François Baroin has announced that he wishes this tax reform to be applicable as of 2011. For this reason, the Budget Ministry wants to shift the dates of submission of the tax returns to 15<sup>th</sup> September, which also implies a shift of the 15<sup>th</sup> June deadline in order to pay such tax. It is unquestionable that this tax reform is proposed in view of the presidential elections in 2012 so that tax payers may benefit from such changes before the said elections.

However, nothing in the proposed amendments suggests that this decrease will apply to French residents as well as non residents, as per the advice of the European Commission. We will need to wait until next June for clarifications, i.e. when the project of law will be submitted to the Parliament.

Finally, the government announced its will to put back in place the Exit tax, which aim is to tax the realized capital gains (and not the unrealized ones) in case of transfer of the tax residence outside of France. This taxation will now occur once the shares are sold, without taking into consideration the place of residence of the seller. However, in principle, the capital gains of non residents based in France are exonerated from taxation according to double taxation avoidance treaties.

France had already been convicted for a similar case in 2004. However, the taxation

had occurred on unrealized capital gains and not on the realized ones.

Is this Exit Tax going to be considered as a restriction to the freedom of establishment? Will the European Commission question this Exit tax as it did for the shield tax and

the limitation to the wealth tax? Will France be convicted as it was in 2004? Finally, would such Exit tax not be contrary to most of the double taxation avoidance treaties?

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