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CLIENT UPDATE

AMENDMENT TO FRANCE-LUXEMBOURG TAX TREATY AFFECTS FRENCH REAL ESTATE HOLDING COMPANY STRUCTURES

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On September 5, 2014, the French and Luxembourg ministries of finance signed an amendment to the France-Luxembourg tax treaty (the "Treaty") that affects the taxation of Luxembourg structures holding French real estate and the structuring of future French real estate investments by foreign investors. As a result of the amendment, Luxembourg companies will no longer benefit from the Treaty's exemption from French tax for gains from the sale of shares of an entity that predominantly holds French real estate assets. As discussed below, investors holding French real estate assets through a Luxembourg structure should evaluate whether to realize gains or restructure their investments before the amendment to the Treaty becomes effective, in order take advantage of the existing Treaty.

Under the current Treaty, contrary to France's usual tax treaty practice, capital gains from the sale of shares in a company holding real estate are taxable only in the country of the seller, and not in the country where the real estate is located. As a result, capital gains realized by a Luxembourg resident from the sale of shares of a company holding French real estate are not taxable in France, even if those gains are exempt from tax in Luxembourg under its domestic tax rules. This provision of the Treaty, taken together with favorable domestic rules applying in Luxembourg to the taxation of gains derived from real estate companies, made Luxembourg a jurisdiction of choice to structure investments into French real estate.

The amendment changes the current favorable rule and allows France to tax capital gains derived by a Luxembourg resident from a sale of shares or other rights in any type of entity if more than 50% of its value derives directly or indirectly from French real estate assets. Real estate assets used by an entity for its own business activity (*e.g.*, a hotel owned by a company engaged in the hotel business) are not taken into account for the purposes of this provision.

The amendment will enter into force at the beginning of the calendar year following ratification by both countries, and therefore could be effective as early as January 1, 2015. Existing structures are not grandfathered. Therefore, investors holding French real estate assets through a Luxembourg structure should consider realizing their gains or restructuring the ownership of these assets to take advantage of the existing Treaty.

The amendment will likely prompt an increased use by investors of French OPCIs (*Organismes de Placement Collectif Immobilier*, or "collective real estate investment schemes"). OPCIs are exempt from French corporation tax on real estate profits and gains, subject to certain distribution requirements, but they result in a more burdensome structure. OPCIs are regulated investment vehicles, which are subject to the control and supervision of the AMF (the financial markets authority). Among other regulatory requirements, OPCIs must be managed by a regulated portfolio management company, which requires a license from the AMF.

Structuring alternatives through jurisdictions other than Luxembourg may also be available, but they generally would involve more complex structuring than under the current Treaty, and may not be as efficient from a tax perspective.

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Please do not hesitate to contact us with any questions.

September 12, 2014