

Séminaire Ferrara

« Personal capital income taxation: the case for capital gain in France »

Introduction:

Capital gains are generally understood as gains from the sale of movable or immovable property or even shares.

To determine this added value, it is necessary to carry out a preliminary step. Indeed, it is necessary to determine the sale price, which will be reduced by the acquisition price.

What is the sale price? It means the price stipulated in the deed of transfer. It may be increased by all the charges and indemnities stipulated for the benefit of the transferor.

It may be reduced by transfer costs.

What is the acquisition price? It means the price actually paid by the transferor, as stipulated in the deed.

It may be reduced, in particular for real estate capital gains, by the costs relating to the acquisition. These can, in the absence of supporting documents, be assessed on a flat-rate basis at the rate of 7.5%.

A reduction for construction expenses can also be applied, after 5 years, up to 15%.

I. Capital gain on movable property

A) Notion & regime: article 150 UA CGI

Capital gains made by individuals on the sale of movable property, as part of the management of their private assets, are subject to income tax at the rate of 19%, plus social levies.

But, in practice, this taxation is scarcely applied when:

- intangible movable property is subjected to a different taxation regimen of capital gains (securities, shares and digital assets)
- capital gains made on the sale of precious metals, jewellery, works of art, collectibles or antiques are subject to a flat rate tax

Taxable persons are natural persons and partnerships subject to personal income tax

Taxpayers not domiciled in France for tax purposes still escape taxation.

Taxable property is movable property and rights relating to movable property, except for:

- furniture, household appliances and motor vehicles (unless they are works of art, collectibles or antiques placed on option under the capital gains on movable property taxation);
- goods, other than precious metals, that were sold for €5,000 or less.

The most common cases of taxation result from the sale of pleasure craft, wines or spirits received in payment for rent or race and sport horses.

Calculation of the capital gain:

The rules for determining the capital gain are the same as for real estate capital gains, subject to the following clarifications.

Acquisition, restoration and repair costs increasing the acquisition price must always be considered for their real amount.

The amount of the capital gain is reduced by an allowance, at the rate of 5% per year beyond the second year of ownership, resulting in total exemption of the capital gain after twenty-two years of ownership.

The capital gain realized is taxed at the rate of 19%, to which are added social security contributions.

Capital losses are not considered.

For each asset sold, taxpayers must obtain and voluntarily submit to the tax department of their tax residence the declaration no. 2048-M within 1 month of the sale. The declaration is accompanied by the payment of duties. When the capital gain is not taxable, the declaration does not have to be submitted.

B) Tax on precious objects and metals

Transfers for consideration and exports of precious metals, jewellery, works of art, collectibles or antiques are subject to a flat rate tax proportional to the transfer price (or the customs value), in lieu of capital gains tax.

The seller or the exporter may, however, opt for the general taxation for capital gains on movable property, if he can prove the date and price of acquisition of the property or that the property has been held for more than 22 years. This option is irrevocable.

The tax is calculated on the amount of the sale of the object or, in the case of export, its customs value. It is due to the rate of:

- 11% for precious metals;
- 6% for jewellery, works of art, collectibles or antiques.

If the seller or the exporter is a French tax resident, the CRDS at the rate of 0.5% is also applicable.

II. Property capital gains

A) Notion & Regime: art 150 U à 150 VH CGI

Capital gains made by individuals on the sale of real estate or rights relating to such properties are subject to income tax at the rate of 19% (plus social security contributions: 17,2%). The capital gain is declared, and the tax is paid during the transfer, most often through the notary.

Note: Special taxes may also for capital gains exceeding €50,000.

The private real estate capital gains taxation applies to capital gains realized by natural persons in the context of the management of their private assets, either directly or through partnerships subject to personal income tax.

Most of the international tax treaties concluded by France provide that the capital gains realized on the sale of buildings are taxable, with an exclusive right or not, in the State where the buildings are located. This is how private individuals that are not French tax resident are generally taxable in France on the sale of their real estate located in France.

Only capital gains realized on the occasion of transfers for consideration are taxable. It is about:

- sales regardless of the form, nature and terms of payment of the price (which may consist in particular of a life annuity);
- exchanges, even without payment;
- company contributions.

Exemptions: The scope of the taxation of real estate capital gains is significantly reduced by a number of exemptions.

- **Main residence:** The capital gain realized on the sale of a main residence is exempt, regardless of the type of housing (detached house or apartment).

Only buildings (or parts of buildings) which constitute the habitual and effective residence of the owner on the day of the transfer are entitled to exemption. Buildings rented out or occupied free of charge by members of the owner's family or third parties cannot therefore benefit from it.

- **Sale amounts to less than €15 000:** Capital gains on the sale of real estate properties are exempt when the sale price is less than or equal to €15,000. This threshold is assessed property by property and not annually.

Again, for the calculation of **the taxable capital gain**, it is equal to the difference between the sale price and the acquisition price of the building.

The **transfer** price means the price stipulated in the deed, increased, when applicable, of the charges and indemnities stipulated in the sales contract for the benefit of the seller and reduced by the transfer costs.

The **acquisition** price corresponds to the price actually paid upon purchase of the property as stipulated in the deed, increased of the charges and indemnities stipulated for the benefit of the transferor (if a concealment of the price is established, the price included in the deed must be increased by the amount of this dissimulation).

The acquisition price is increased by a flat rate of 7.5% to take account of acquisition costs. The seller may, however, choose to substitute for this package the actual amount of those costs, duly justified: contract costs (in particular notary fees and intermediary commissions), registration fees or VAT.

The acquisition price can also be increased by the expenses of works.

In the event of acquisition by inheritance or donation, the acquisition price means the value retained for the liquidation of the rights of inheritance or donation or, failing that, the real market value on the date of this acquisition.

This value is increased by the acquisition costs retained for their real and justified amount.

Allowance for holding period: When the property sold has been owned for more than 5 years, the capital gain is reduced by an allowance for the duration of the ownership, the amount of which differs depending on whether it is a question of calculating income tax or social security contributions.

- For the determination of the amount subject to income tax, the allowance is:
 - 6% for each year of ownership beyond the fifth and up to the 21st;
 - 4% for the 22nd year of ownership.

The income tax exemption is thus acquired after 22 years of detention. For example, a capital gain realized on June 1st, 2021 is exempt if the building was acquired before June 1st 1999.

- To determine the amount subject to social security contributions, the allowance is different:
 - 1.65% for each year of ownership beyond the fifth and up to the 21st;
 - 1.60% for the 22nd year of ownership;
 - 9% for each year beyond the 22nd.
- Exemption from social contributions is thus granted after 30 years of ownership and, between 23 and 30 years of ownership, capital gains are only subject to social contributions.

Capital loss: When a real estate sale generates a capital loss, this cannot be attributed either to capital gains of the same nature, except in the case of a block sale of a building acquired in successive fractions, or to overall income.

B) Reflexion

We can wonder about the duration of detention, which allow a total exemption of taxation on the capital gain of the real estate sold after 30 years of detention.

Some may consider this to be too long, others may feel that it is not long enough.

What is certain, is that this holding period allowance mechanism discourages successive resales in a relatively short time.

It encourages individuals to hold on to real estate for a significant period of their lives.

It is also an instrument that will allow the state to recover important tax revenues, the optimum holding being difficult to reach.

III. Capital gains on securities and shares

A) Notion

Art. 150-0 A du Code général des impôts : *net gains from sales for valuable consideration, made directly, through an intermediary or through a trust, of securities and shares, mentioned in 1° of article 118 and in 6° and 7° of article 120, of rights relating to securities or shares or of securities representing the same shares or securities*

Art. 118, 1° du Code général des impôts : *interest, arrears and all other proceeds from bonds, participating securities, public bills and all other negotiable debt securities issued by the French State,*

departments, municipalities and public establishments, associations of any kind and any French financial, industrial, commercial or civil companies, corporations or enterprises

Art. 120, 6° et 7° du Code général des impôts : 6° Interest, arrears and all other income from the bonds of the companies and enterprises designated in 1° and 2°, and the income attached to capitalisation bonds or contracts as well as to investments of the same nature subscribed with insurance companies established outside France, at the time of the settlement of the contract, and the gains from the sale of these same investments; [...]

7° Interest, arrears and all other income from annuities, bonds and other public instruments of foreign governments as well as foreign corporations, cities, provinces and any other foreign public establishment

B) Regime

Scope:

Are not concerned by this taxation the private individuals that make capital gains on the sale of shares of certain real estate companies or funds. They undergo property capital gains taxation.

Are also not concerned the individuals that make a genuine profit-making business from the sale of unlisted securities or carry out stock exchange transactions under similar conditions to those of professionals. Those transactions are taxed under non-commercial profits (art. 92 du Code general des impôts).

Are therefore concerned the private individuals that are tax resident of the French State and are acting in the context of private wealth management.

Private individuals that are not French tax resident but realize capital gains on the sale of French securities are exempted from taxation (art. 244 bis C).

Calculation of the capital gain:

The French tax administration computes the capital gain as follows:

Sale amount:

For unlisted securities: actual price agreed between the parties

For listed securities: stock exchange price at which the transaction is concluded.

This sale amount includes all charges and indemnities stipulated that benefit the transferor or a third party as remuneration for the transaction.

It is also reduced of the fees (intermediary commissions, value assessment...) and taxes paid by the transferor.

△ The additional consideration that derives from an earn-out clause is taxed for the year in which it is received.

△ Liabilities guarantee clause that would lead to the transferor owing the transferee and as such a decrease of the sale amount initially received. In this case, the transferor can request, with a contentious claim, a tax deduction. The capital gain is recalculated taking into account the repayment made by the transferor.

Purchase amount:

The price the transferor paid initially, or the value used to determine transfer duties.

Are also included the acquisition costs that mark up the purchase amount. It covers brokerage fees, commissions, value assessment, registration fees, transfer duties, deed costs...

△ If securities of the same company were acquired at different purchase amounts, the purchase price to be used is the weighted average of the different purchase amounts

△ For shares in partnerships, the purchase amount must be subjected to in order to avoid double counting of profits and social deficits that have already been taxed by the seller or deducted from his income

Deduction of capital loss:

Capital losses are offset on the capital gains on securities that are made during the tax year. Capital gain/loss on financial future instruments are taken into account in this general compensation, as they are considered of the same nature.

If it amounts to an annual capital loss, they can be carried forward on the following ten years, waiting to be offset on an annual capital gain.

Tax treatment:

French taxpayers may choose between two methods of taxation (art. 200 A du Code general des impôts).

The Flat-rate method:

Called the *Prélèvement forfaitaire unique* (PFU), it is a flat rate (proportional tax) of 12.8 % relating to personal income tax.

The option for taxation according to the progressive income tax scale:

By derogation, the taxpayer can opt for an inclusion of his capital gain the sum of his personal incomes, that is after subjected to the progressive income tax scale (from 0 % (less than €10,225 of total income) to 45 %).

It is a comprehensive, express and irrevocable option. Comprehensive because it applies to all incomes in the scope of the *Prélèvement forfaitaire unique*. Express because it must be voiced by the taxpayer. And irrevocable because it is definitive for the income of the tax year in which it is taken.

This option is interesting because it allows for the application of allowances based on the duration of ownership (art. 150-0 D du Code general des impôts). 2 different proportional allowances can be applied alternatively, provided that the securities were acquired or subscribed before 1 January 2018:

➤ The general allowance:

The allowance amounts to :

- 50% of the net gains when the securities have been held for at least 2 years and less than 8 years on the date of the sale or distribution;
- 65% of the net gains when the securities have been held for at least 8 years.

➤ The increased allowance from the sale of shares in SMEs under 10 years old:

As it is more generous allowance, strict conditions have to be met. The company must be an SME within the meaning of European Union law (règl. 651/2014 ann. I), created less than 10 years ago at the date of acquisition or subscription by the transferor, subjected to corporate income tax or an equivalent tax, having its head office inside of the European Economic Area (EEA) and carrying out a exercising a business, industrial, handcrafted, professional or agricultural activity.

There is a third allowance that can be applied, but unlike the previous two, it can be applied also if the taxpayer chose the flat rate taxation (art. 150-0 D ter du Code general des impôts).

➤ Fixed allowance on gains from the sale of shares by retiring executives:

This fixed allowance amounts to €500,000 per company sold. It is also very generous and therefore strict conditions have to be met regarding the transferor (exercise of executive functions, holding of at least 25% of the shares...), the company (EU SME, inside the EEA, subject to corporate income tax...) but also the sold shares (at least holded for 1 year, retirement within 2 years of the sale, sale on the entirety of the shares holded).

Reporting requirements:

In addition to the general income tax return n° 2042, there is a special return n° 2074 to provide.

Intermediaries are subject to more requirements.

C) Reflexion

This generous flat rate was introduced by the *Loi de finances pour 2018* (Budget Act). Stated in the campaign manifesto of Emmanuel Macron, he wanted to put an end to the alignment of the taxation of capital income with the taxation of labor income, which had irritated company directors and holders of intangible movable assets cringe.

Indeed, between 2013 and 2018, capital gains were subjected to the progressive income tax scale. The system was nonetheless enhanced by increased allowances and other generosities to alleviate the displeased crowd.

It is this persistence that we observe in the allowances that are still prevailing when the option for the progressive income tax scale is formulated.

Nevertheless, it should be noted that this perpetuation will not be infinite. The option for the scale is only interesting, in almost every situation, for the application of the allowance for the length of the holding period. However, these only apply to the sale of securities that were acquired prior to 2018. Even if this option is still of interest as of now, its disappearance in the foreseeable future is certain.

In a response of the Ministry to a member of parliament (*Rép. Rabault: AN 25-2-2020 n° 24560*), it was decided, for the 2019 income reporting campaign and specifically income reporting, that if the taxpayer has not spontaneously opted the progressive income tax scale, a calculation is automatically made by simulating the option and a message explicitly invites the taxpayer to opt if the option is more favorable. The Government made sure that the transition between the previous system and the flat rate was smooth, as the first year under this new system led to a few hiccups.

The actual taxation on securities and shares with this flat rate is the most lenient it ever was. Before 2013, there was also a flat rate, but it was of 15 %. This shift in tax policy reflects the current

president's desire to make our system more attractive to investors and translates a liberal approach to the French economy.

IV. Capital gains on financial future instruments

A) Notion

Art. 150 ter du Code général des impôts: *net profits realised, directly, through an intermediary or through a trust, on the settlement or transfer for consideration of financial contracts, also referred to as "financial futures", mentioned in III of Art. L 211-1 of the Code monétaire et financier*

Art. L. 211-1 du Code monétaire et financier: *Financial contracts, also referred to as "financial futures", are futures contracts that appear on a list established by decree → Art. D. 211-1 A du CMF*

(BOI-RPPM-PVBMI-70-10 n° 30) In practice, this includes:

- forward transactions carried out on financial futures markets;
- transactions carried out on negotiable options markets (MONEP);
- Transactions on option certificates.

B) Regime

Scope:

Are not concerned the settlements or transfers for consideration of financial contracts carried out on a regular basis. Those transactions are taxed under non-commercial profits (art. 92 du Code general des impôts).

Are also not concerned the professional traders that are taxed under industrial and commercial profits.

Are therefore concerned the private individuals that are tax resident of the French State and who carry out transactions on an occasional basis as part of managing their private assets, regardless of the location of the operation.

Calculation of the profits:

The profit (or loss) is equal, for each financial contract, to the difference between the sums received and the sums paid, raised or reduced,

When the contract is terminated by the delivery of a financial instrument or commodity, the profit or loss shall be increased or decreased by the difference between the purchase or sale price of that financial instrument or commodity and its value on the day of delivery.

When contracts with the same characteristics have resulted in purchases or sales at different prices, the profit or loss is calculated on the weighted average price of the transactions.

The profit is net of deductible taxes and expenses.

Deductible expenses: commissions paid to the clearing house, trading commissions, brokerage fees...

Deductible taxes: VAT due on brokerage and commissions.

Tax treatment:

Art. 150 ter du Code général des impôts refers to art. 200 A, 1. & 2.

As so, the taxation on financial future instruments is the same than on shares and securities.

The general system is the flat rate taxation of 12.8%, and the derogation is an inclusion of the profit to the overall income with a subjection to the progressive income tax scale.

There is another derogation to the general system when the account holder or co-contractor is a tax resident of an uncooperative State or territory (art. 238-0 A), the profit made is taxed at the punitive flat rate of 50%. But the losses made can still offset the profits under normal conditions. However, there is a safeguard clause for taxpayers that demonstrate that the transactions correspond to real transactions which have neither the goal nor the effect of enabling them to be in such a State or territory for the purpose of tax fraud.

Reporting requirements:

In addition to the general income tax return n° 2042, there is a special return n° 2074 to provide.

Intermediaries are subject to more requirements, as for the capital gains on shares and securities.

V. Capital gains on digital assets

A) Notion

Art. 150 VH bis: *capital gains realised on the sale for consideration of digital assets mentioned in article L. 54-10-1 of the Monetary and Financial Code or rights relating to them.*

Art. L. 54-10-1 du CMF: *1° The tokens mentioned in art. L. 552-2, excluding those that meet the characteristics of financial instruments mentioned in art. L. 211-1 and the savings bonds mentioned in Art. L. 223-1 ;*

2° Any digital representation of a value that is not issued or guaranteed by a central bank or public authority, that is not necessarily attached to a legal tender and that does not have the legal status of a currency, but that is accepted by natural or legal persons as a means of exchange and that can be transferred, stored or exchanged electronically.

BOI-RPPM-PVBMC-30-10 §60: *According to Art. L. 552-2, a token is any intangible asset representing, in digital form, one or more rights, which can be issued, registered, retained or transferred by means of a shared electronic recording device enabling the owner of the asset to be identified, directly or indirectly. In practice, this includes tokens resulting from fundraising operations (ICO: Initial Coin Offering), carried out through a distributed registry technology (blockchain) to finance a new or innovative company.*

B) Regime

Scope:

The Code général des impôts provides in its articles 150 VH bis and 200 C a taxation for capital gains on the sale of digital assets.

Are concerned by this taxation the capital gains realised on an occasional basis by French resident individuals, directly or through an intermediary, on the sale for consideration of digital assets, and in particular cryptocurrencies

If the gains on digital assets are resulting from a purchase-resale activity carried out on a regular basis, they are taxable under industrial and commercial profits (BOI-RPPM-PVBMC-30-10 n° 70).

The capital gains on digital assets obtained through data mining are taxable under non-commercial profits (BOI-RPPM-PVBMC-30-10 n° 70).

Calculation of the capital gain:

Gross capital gain/loss = sale amount – [total purchase amount of the entire digital assets' portfolio x (sale amount / total value of the portfolio)]

Sale amount = actual price received or the value of the consideration, minus the costs incurred borne by the transferor.

Total purchase amount of the digital assets' portfolio = all prices paid in legal tender at the time of their purchase and the value of the consideration for these acquisitions (excluding exchange transactions that benefited from a tax deferral).

Overall value of the digital asset portfolio = all the values of the digital assets held by the transferor before transferring the assets.

Capital losses can only be offset on gross capital gains of the same nature (digital assets) realised in the same year.

Tax treatment :

The capital gain made by taxpayers is subjected to income tax at a rate of 12.8%, to which are added social security contributions at a rate of 17.2%. They are therefore subject to the French flat tax.

Taxpayers are exempt from taxation when the sum of the sale prices, excluding tax deferred exchange transactions, does not exceed €305 per tax year.

Exchange transactions without a cash balance benefit from a tax deferral.

Reporting requirements:

Capital gains must be declared on the tax return n° 2086 which mentions and evaluates all the capital gains and losses realised on each taxable transfer made during the year or the prices of each exempt transfer.

Exchanges without a cash balance benefiting from the tax deferral do not commission for a tax return (BOI-RPPM-PVBMC-30 n° 20).

Taxpayers are also required to declare the references of digital asset accounts opened, held, used or closed with companies, legal persons, institutions or organisations established abroad. They are liable to a fine of €750 per undeclared account, or €125 per omission or inaccuracy, up to a limit of €10,000 per declaration, increased to €1,500 and €250 respectively when the value of the accounts exceeds €50,000 at any time during the year.

C) Reflexion

The decision of the Conseil d'Etat (highest administrative jurisdiction) of the 26 April 2018, M. de Rycke is the first decision that ties the taxation of capital gains on cryptocurrencies in with the taxation of capital gains on movable property when they are realized on an occasional basis, and not to the taxation of non-commercial profits (which was previously ordained by administrative comments). It is in 2019 that the legislator, considering that the law was not coherent, intervened in favor of a specific taxation for virtual currencies (art. 150 VH bis).

There was a recent legislative development. The *Loi de finances pour 2022* changes the taxation of capital gains on digital assets realized by individuals by introducing an option to be taxed on the progressive income tax scale, as of 1 January 2023. This demonstrates a desire to bring the taxation of capital gains on digital assets closer to that of securities.

The next element to decipher for the taxation of digital assets is the non-fungible tokens (NFT). This type of digital assets has not yet been legally defined, and thus its affiliation to an established taxation has not been clear-cut. At least 2 written questions from member of parliaments have been asked to the French minister of Economy and Finance (Louwagie, n° 43760, 25/01/2022 and Bascher, n° 22200, 15/04/2021), but they went unheeded up until now. Mr Pierre Person and 45 other MPs brought forward an amendment at the end of September 2021 proposing a definition of NFTs and the creation of an ad hoc regime in an Article 150 VH ter, with a taxation based on their underlying assets. This amendment was not adopted as part of the *Loi de finances pour 2022*. These tokens could either be seen in the light of digital assets, works of art or movable property (like cryptocurrencies were before the intervention of the legislator). As of now, the American and British tax systems have not yet produced a framework for NFTs.