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Recent US & French Tax Developments

With the arrival of a new French president in May 2007 and that of a still unknown US president in less than a year from now, major changes affecting taxpayers on both sides of the Atlantic seem to be on the horizon.

Already in France, and less than three months after taking office, Nicolas Sarkozy implemented a series of wide ranging tax breaks and incentives known informally as the *paquet fiscal* and officially as the *Loi TEPA* ("*Travail, emploi, pouvoir d'achat*"). These changes include substantially increased abatements affecting gift and inheritance taxes, an overhauling of wealth tax (ISF) regulations including reductions for charitable donations or investments in small businesses, and a mortgage interest tax credit for interest paid on loans used to purchase a principal residence. Two additional pieces of legislation – the *Loi de finances rectificative pour 2007* and the *Loi de finances 2008*, both passed late in December 2007 - include additional changes to income and ISF tax rates.

With a US economy rattled by this summer's subprime mortgage crisis and an upcoming – and at this point completely open-ended – presidential election, Congress was hesitant to pass any major tax legislation towards the close of 2007. However, one important law voted in quickly before year-end was the Tax Increase Prevention Act of 2007, also known as the "AMT patch", because it will extend Alternative Minimum Tax relief for an additional one-year period to low and middle income taxpayers who might otherwise be hit with this burdensome income tax. Another major bill – The Heroes Earnings and Assistance Relief Tax (HEART) Act of 2007 – which is still pending at this time, includes a revenue raising provision that will apply an "exit tax" to the net assets (above a certain threshold) of US citizens who renounce their US citizenship. We will be following closely the evolution of this and other proposed laws as the year goes on.

You will find below a summary of the provisions we think will have the greatest effect on our clients, although we of course cannot include all of the various changes and their consequences. For further information we would recommend that you contact us to discuss.

French Tax Developments

Increased Gift and Estate Tax Abatements (i.e. credits or reductions)

Following is a summary of the increased French tax abatements that will apply to gifts or estate transfers made as of January 1, 2008. The abatements depend on the relationship between the donor and the donee in the case of gifts, and the decedent and beneficiary in the case of estates:

Gifts or estate transfers made to:	Abatement available until August 22, 2007	New abatement as of January 1, 2008
direct descendants	€50,000	€151,950
brothers or sisters	€5,000	€15,195
nephews or nieces	€5,000	€7,598

Note that with regards to gifts, the abatement is renewable every six years, and applies to each gift made by each separate parent to a child or relative. Therefore, in the case of a married couple with two children, each spouse can give tax-free up to €303,900 to each one of their children (€151,950 per child), allowing for a total tax-free transfer every six years of €607,800 (note that "tax-free" applies to the French gift tax – keep in mind that depending on their situation, US citizens may still be subject to US gift tax on such transfers).

Special Exemption on Cash Gifts

As of January 1, 2008, a special exemption from French gift tax is available for gifts of cash made to direct descendants (children, grandchildren, great-grand children), and if there are no direct descendants, for gifts made to nieces and nephews or grandnieces and grandnephews. The exemption is limited to €30,390 and applies only once. In order to qualify for the exemption, the donor must be at least 65 years old at the time of the gift, and the donee at least 18 years old. The gift must be officially registered with the local tax office within one month of the transfer.

Exemption on Estate Transfers at Death between Spouses or PACS partners

As of August 22, 2007, estate transfers at death from decedents to their surviving spouses or PACS partners are exempt from French estate tax. This major change now aligns French estate tax law with US estate tax law, where a 100% marital deduction on inheritances between spouses (as long as both are US citizens) has already existed for several decades. There are two important points to however keep in mind about this new law: Firstly, although French estate taxes are no longer due, a 1.1% French transfer tax will be due in the case of spouses married under a community property regime, since the community must be liquidated and the property split up at the time of death. Secondly, spouses who beforehand changed their marital regimes from separate to universal community property may no longer need to do so to avoid French estate taxes. However, they may choose to do so for other reasons under French civil law, involving such issues as the hereditary reserve (i.e. legal provisions with respect to the devolution of assets.)

Major Adjustments to French Wealth Tax (ISF)

The recent changes to the French Wealth Tax (ISF) are definitely the most significant to take place in more than a decade. Below is a brief explanation of new provisions that will take effect as of the 2008 ISF declaration (due for French residents on June 15, 2008):

- The principal residence exemption has been increased from 20% to 30%.
- The minimum threshold for taxation has been increased from €760,000 to €770,000 and the corresponding tax brackets adjusted by 1.30%.
- A new ISF tax reduction is available for taxpayers who opt to either invest funds in a PME ("*Petite et moyenne enterprise*") or else to make a donation to a charitable organization. The reduction is limited to 75% of the investment, within a limit of €50,000. In the case of a PME investment, the PME must be an active company (commercial, industrial, agricultural or financial), and the shares received in exchange for the investment must be held for a minimum period of five years. In the case of charitable donations, the recipient organizations must normally be charitable associations that already qualify for French income tax charitable deductions. In both cases, investments or donations must be made before the June 15th filing deadline in order to qualify for the ISF tax reduction on the 2008 declaration.
  Note that this is indeed a major adjustment: For example, a taxpayer who beforehand paid an annual ISF tax of €7,500 can, as of 2008, decide to make a

€10,000 donation to his or her favorite charity (hospital, university, museum, etc.,) or else invest in a PME start up, and will then have no ISF tax due for 2008 !

- The famous *bouclier fiscal* ("fiscal shield") which allows taxpayers to be refunded the portion of the combined income, wealth and real estate taxes (for the principal residence) when such combined taxes exceed 60% of one's income, has been adjusted to a new threshold of 50%. Furthermore, starting in 2008 the *contributions sociales* (CSG/CRDS) of 11% will from now on be included in the formula.

New Income and Withholding Tax Rates on French Investment Income

On the downside, starting January 1, 2008, a new withholding tax rate of 18% (up from 16%) will apply to dividend and other fixed income distributions for which taxpayers opt for a *prélèvement libératoire* (whereby taxes are automatically withheld by the bank upon each distribution of income). Combined with the *contributions sociales* (CSG/CRDS) of 11% that will also be automatically withheld by the French banks, this results in a total withholding rate of 29% (up from 27%).

In the case of dividends, taxpayers will now be able to choose between a fixed 29% withholding regime and a regular income tax regime whose maximum rate for 2008 is 51% (both including CSG/CRDS), although in the latter case taxpayers are entitled to an abatement equal to 40% of the distributed dividend. Since such an option for the *prélèvement libératoire* is, in the case of dividends, irrevocable, it is recommended to discuss such options with your French banker and tax preparer before making a decision.

Note also that the new 29% rate shall apply to qualifying French capital gains. Furthermore, such capital gains are now only taxable if the total sales exceed €25,000 in the year (up from €20,000 in 2007).

French Home Mortgage Interest Tax Credit

Last but not least, a home mortgage interest tax credit for interest paid on loans which are used to acquire a principal residence in France will be available starting with 2007 French income tax returns. The credit is available for loans used to acquire property after May 6, 2007, and is limited to 20% (but 40% for the first year of acquisition) of the amount of interest paid, within a limit of €3,750 of interest for single individuals and €7,500 of interest for couples, plus €500 for each qualifying dependent. Thus, the total available tax credit for home mortgage interest for 2007 returns will be €750 (or €1,500 if it's the first year of acquisition) for single individuals, and €1,500 (or €3,000) for couples filing jointly.

US Tax Developments

Alternative Minimum Tax (AMT) "Patch"

Just as time was running out on a year which saw few major changes in US tax law, the House and Senate acted quickly to pass a last minute bill (HR 3996: Tax Increase Prevention Act of 2007) that will provide a "patch" to prevent millions of low to middle income taxpayers from being subjected to Alternative Minimum Tax (AMT) on their 2007 returns. The bill will increase - for tax year 2007 only - the exemption amounts above which taxpayers fall under the AMT regime: in the case of single taxpayers the exemption increases from $42,500 to $44,350; in the case of married couples filing jointly the increase is from $62,550 to $66,250. Note that without this last ditch effort,

the 2007 exemption amounts would have reverted to the pre-2001 levels of $33,750 and $45,000 respectively. As this is only a one-year temporary patch, the exemption amounts will again revert to pre-2001 levels in 2008, although we believe that Congress will act beforehand to avoid such an AMT disaster.

Adjustments to Foreign Housing Exclusion

As promised by the IRS, the annual excludable foreign **housing expense** amounts available to US taxpayers working overseas have been adjusted to better reflect realistic living standards abroad. In the case of France, the 2007 maximum amounts for certain cities have been adjusted as follows:

City	Garches	Le Havre	Lyon	Marseille	Montpellier	Paris	Sèvres	Suresnes	Versailles
Amount	$87,200	$38,500	$54,500	$51,000	$45,200	$87,200	$87,200	$87,200	$87,200

Note that if you live in France but not in any of the above-listed cities, then the maximum amount of expenses available for the housing exclusion in 2007 is limited to $25,710.

Otherwise, the section 911 Foreign Earned Income Exclusion amount for 2007 returns is $85,700.

“Exit Tax” on the horizon

Although as of this writing it is yet to have been signed into law by the President, another bill passed by Congress last year (HR 3997: Heroes and Earnings Assistance and Relief Tax) includes a revenue-raising provision that will apply a special “exit tax” to certain US citizens who renounce their US citizenship, or long-term residents (“green card” holders) who relinquish their residency status. The tax, at the current long-term capital gains rate of 15%, will apply to the value of net assets which exceeds $600,000 (to be adjusted for inflation) at the time of expatriation. The new law will also tax gifts made by such former US citizens or long-term residents to US citizen or resident recipients at the highest possible gift tax rate (45% in 2007 and 2008, to increase to 55% in 2011).

To stay in tune with these and other tax law changes (such as those that may be found in the upcoming US recession stimulus package), we strongly recommend that you visit our new website: www.cabinetsimonard.com

From all of us at Cabinet Simonard, we wish you a safe and happy (and hopefully not too recessive) 2008 !!!

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