SIMONARD & SOREL
AVOCATS

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Tax Talk 2014 ©

US Tax Law Developments

FATCA and France

It's been almost four years since The Foreign Account Tax Compliance Act (FATCA) was enacted, and the effect on US reporting requirements (Form 8938, Statement of Specified Foreign Financial Assets) has been an inconvenient, but as of yet pain-free transition. The next-phase of the legislation was completed on November 14, 2013 when France and the United States signed a bilateral agreement to implement FATCA.

Contrary to what was feared, the agreement has actually provided guidance. The French banks and other financial institutions now have a framework through which they must first identify potential "US-reportable accounts" and contact the account holder to confirm their US status and finally report the income and value of the account to the US. There are many types of specifically excluded accounts (Livret A, PEL, PEP, Madelin, PERP, PEE, PEI, etc), and the thresholds for accounts opened before the effective date of June 30th, 2014 ($50,000 for bank accounts and $250,000 for cash-value insurance or annuity contracts) will prevent the account from being identified at all. Please note that all new accounts will be reviewed for US connections, regardless of value. If you would like further details on what information will lead to the identification of a US-reportable account, please let us know.

French banks and financial institutions have already begun identifying and contacting their US clients to prepare for reporting. Do not be alarmed if you receive such an inquiry and have been reporting your income and accounts on your tax return and form TDF 90-22.1, Report of Foreign Bank and Financial Accounts (whose filing threshold remains $10,000). If you have not been reporting all or some of your French accounts, please contact us as soon as possible to discuss how to rectify the situation.

Income Tax Rate

For 2013, prior year's income tax brackets are still in effect for lower to middle-income taxpayers. However, there is a new highest marginal income tax rate of 39.6% for taxable incomes above $450,000 for married filing jointly, $425,000 for heads of households, $400,000 for single, and $225,000 for married filing separately.

Qualified Dividends and Long-Term Capital Gains Tax Rate

As with the income tax rates, long-term capital gains will continue to be taxed at a maximum 15% provided the taxpayer is below the 39.6% tax bracket for taxable income. If the taxpayer is in this tax bracket, the maximum tax rate for qualified dividends and long-term capital gains is 20%. This does not include the new NIIT that could also be applied.

NEW TAXES:

Net Investment Income Tax (NIIT)

Starting with income received after January 1st, 2013 by individuals, estates, and trusts, there is an additional tax of 3.8% on Net Investment Income (interest, dividends, annuities, rents, royalties, capital gains, and income from passive activities). This tax is imposed after the lower of the Net Investment Income or the excess modified adjusted gross income (MAGI) exceeds certain amounts. For income received in 2013 these amounts are $200,000 for single and head of household filers, $250,000 for married filing jointly and surviving spouses, and $125,000 for married filing separately. It should be noted that the MAGI calculation increases taxable income for the foreign earned income exclusion. Further, most US-qualified retirement benefits are excluded from Net Investment Income.

This tax was previously known as the unearned income Medicare contribution tax, but has been renamed so as to be an income tax instead of a Medicare contribution. The change of name prevents a situation of much concern to many of our clients who would normally be exempt from Medicare contributions by way of the US-France Social Security Totalization Agreement and who are exempt in France from social charges on their US investments.

Additional .9% Medicare Tax

For tax years 2013 and forward, there is an additional .9% Medicare Tax for self-employed individuals with income from self-employment above $200,000 for single and head of household, $250,000 for married filing jointly and surviving spouse, and $125,000 for married filing separately. If you are self-employed and believe we should adjust your estimated tax payments, please contact us as soon as possible.

Estate and Gift Taxes

The American Taxpayer Relief Act of 2012 has solidified the Estate and Gift Tax exemptions and rates for the near future. The exemption from Estate and Gift Tax is now $5.34 million for 2014 with a maximum tax rate of 40%. The annual exclusion for gifts from each taxpayer has been increased to $14,000; this allows a married couple to gift each year to each person $28,000 tax-free and have an estate of up to $10.68 million before paying any estate or gift taxes to the US. Please contact us before making any large gifts as there could be other (French or state-level) tax consequences.

Foreign Earned Income Exclusion

The Foreign Earned Income Exclusion has been inflation adjusted for the 2013 and 2014 income tax years to allow maximum exclusions of $97,600 and $99,200, respectively, of Earned Income for those who are considered tax residents of a foreign country under either the Bona Fide Residence Test or the Physical Presence Test.

The IRS

The IRS was closed in the government shut down last year, and has seen annual budget cuts. The IRS is trying to keep up with the questions, calls, and letters they receive in a timely manner, but its means are limited. We've noticed a decrease in the amount of new audits being opened, however IRS notices are being generated as often as before and many have been poorly worded or incorrect. We urge you to let us know as soon as you receive a notice so we can promptly respond.

FRENCH TAX NEWS

From a tax perspective, in France, as the years go on the more they look the same. 2014 seems to follow the same pattern, tax changes that raise taxation on households, heavily impacting their purchasing power.

- **Income Tax rate**

There is an increase in the tax rates and how quickly income goes through the brackets. The tax bands and rates for 2014 (for income earned in 2013) are as follows:

- Up to €6,011 : 0%
- €6,011 to €11,991 : 5.5%
- €11,991 to €26,631 : 14%
- €26,631 to €71,397 : 30%
- €71,397 to €151,200 : 41%
- From €151,200: 45%

- **Contribution exceptionnelle sur les hauts revenus and 75% tax rate**

In addition to the income tax, there are two supplementary taxes on high income earners:

-The first, introduced last year, is the "contribution exceptionnelle sur les hauts revenus" with a rate of 3% on income between €250,001 and €500,000,and 4% on income above €500,000.

- The second is the new 75% tax rate that has been recently approved by the French Constitutional Court. The initial proposal to tax individual incomes was ruled unconstitutional by the Constitutional Court almost exactly one year ago. But the government modified it to make employers liable for the 75% tax on salaries exceeding 1 million Euros. The levy will last for two years, affecting income earned in 2013 and in 2014.

- **Social charges**

On investment income the rates remain the same, 15.5%

- **VAT**

Starting January 1, 2014, the standard rate of value-added tax (VAT) in France rose from 19.6 percent to 20 percent.

- **Capital gains from the sale of shares**

There are changes to individual tax on capital gains on shares (retroactively applied to sales occurring from the beginning of 2013). Capital gains will remain taxable under the progressive income tax rates (of up to 45%), they will also benefit from a "tax allowance" which would vary depending on the length of time that the individual held the shares (a holding period rule):

•50% reduction if the shares were held between two years and eight years
•65% reduction if the shares were held for eight years or longer

An incentive regime will be established with respect to capital gains derived from the sale of shares by managers of small and medium enterprises. The gains on such sales will benefit from an enhanced tax allowance at the following rates:

•50% if the shares were held between one year and four years
•65% if the shares were held between four years and eight years
•85% if the shares were held for eight years or longer

Finally, an existing mechanism that allows for tax deferral of amounts realized on the sale of shares if the sales proceeds are reinvested has been repealed.

- **Capital Gains Tax on real estate**

A reduction in the holding period from 30 years to 22 years over which complete exemption from the tax is granted, with relief starting from the 6th year of ownership with a discount of 6%, and 4% in the final 22nd year. For example, a property owned for 10 years would be eligible for a 30% discount on the tax, and one held for 15 years would be granted a 60% discount.

- **Social Charges (Prélèvements Sociaux) on capital gains from real estate**

By contrast, there has been no change in the period over which complete exemption from social charges is granted on the sale of real property, which remains at 30 years. The annual discount on the taxable gain is 1.65% per year from the 6th to 21st year of ownership, 1.6% for the 22nd year, and 9% for the 23rd to the 30th year. For example, a property owned for 10 years would be eligible for an 8.25% discount on the social charges, and one held for 15 years would receive a 16.5% discount.

Additional Discount

An additional supplementary discount of 25% for properties sold between 1st September 2013 and 31st August 2014. The discount applies to both capital gains tax and the social charges. The above dates relate to signing of the deed of sale (*acte authentique*), not the sale and purchase contract. So a sale and purchase contract signed before the 1st of September 2013, but completed after this date would fall within the new rule.

Supplementary Capital Gains Tax

This tax will continue to apply to gains over €50,000, although it will also be eligible for the 25% discount. In addition, calculation of liability for the tax will depend on the number of owners, with the total gain being divided between the owners. Accordingly, two joint owners who make a €99,000 capital gain would not pay the supplementary tax.

- **Changes are proposed to the exemption from capital gains tax granted to certain former residents of France.**

Although only the main residence in France is exempt from capital gains tax, there is also a specific exemption for certain non-residents who were previously residents.

This exemption is currently subject to three conditions:

- That you are a national of the European Union, or a country of the wider Economic European Area, having concluded an appropriate tax treaty with the EEA and France

- That you were previously a tax resident in France for at least two years

- That the property had been freely available for your use since the 1st of January in the year preceding the sale.

The main change to the existing rules concerns the disposition requiring that the property was 'freely available' for your occupation. This clause effectively means that if you rent out the property it ceases to be at your disposal, so in order to be eligible the property would need to remain unoccupied. Free use of the property to, say, members of your family or close friends would be permitted. The current exemption also applies even though the property may not be furnished; it merely requires that it is 'freely available'.

The new rule, which applies on all **sales starting on the 1st of January 2014,** provides that the condition relating to the property being freely available will **no longer be required** if the sale transfer takes place within **5 years of your departure** from France. However, by way of restricting the scope of this concession, the exemption from capital gains tax will be **a maximum of €150,000.** This maximum threshold is net of allowances. That is to say it arises after deduction of allowances for duration of ownership, deductible costs and any other discounts, such as the current 25% discount that applies for sales that are concluded prior to 31st August 2014.

- **US/French tax agreement: France has signed a bilateral information exchange agreement with the USA.**

The Foreign Account Tax Compliance Act (FATCA) introduced in the United States in March 2010, aims at combating off-shore tax evasion by US taxpayers. It requires that banks and financial institutions worldwide identify US account holders amongst their clients, and that they automatically send information to the Internal Revenue Service (IRS) about their accounts. Banks will be obliged to disclose names and addresses, as well as balances, receipts, and withdrawals.

The main requirements for non-US institutions enter into force on 1st of July 2014, prior to which the procedure involves the signing of bilateral agreements with the IRS. Five European countries, including France and the United Kingdom, have initiated a common system of bilateral cooperation with the United States on the basis of an automatic exchange of tax information. Accordingly, French and UK banks will now collect data and transmit them to their tax authorities, who in turn will forward it to the IRS. The same procedure will apply in reverse, with the IRS providing tax information on French and UK taxpayers holding assets in the United States.

The net is cast wide in terms of the information that is captured by the agreement. It includes most types of income, such as interest, dividends, royalties, bonuses, proceeds of sale, as well as most types of account holders (individuals, companies, and partnerships etc) and financial institutions (banks, insurance companies, dealers, brokers, trusts, and funds). Failing a bilateral agreement, the US authorities are entitled to apply a withholding tax of 30% on all US source income of foreign financial institutions in the United States. The implications of this law for foreign financial institutions are huge, and the complexity of the law, coupled with the financial penalties for non-compliance, have led some European banks to drop US customer accounts.

- **Estate planning**

Thanks to a European legal change, non-French people living in France can now choose to have the law of their nationality apply to the whole of their estate. This rule, which will apply from August 17, 2015, means that it is now possible to bypass the restrictive French inheritance rules. However, it is important to note that inheritance tax will not change.

ECONOMIC PREDICTIONS FOR 2014

As much as the New Year may imply change, where economic fundamentals are concerned such change is largely limited to a single digit in the calendar date. For three such consecutive calendar changes we at Simonard and Sorel have accurately forecasted tightened tax collecting driven by an anemic global economy. Last year we called the bursting of the BRIC bubble, and emphasized that governments were in no position to relax on taxes. This year we're sticking to our guns and repeating these calls because the change to a single digit on a calendar is cosmetic compared to the permanence of underlying dynamics.

While we're good at grasping trend for both the economy and tax collecting, the details are of course beyond our reach. No one could have anticipated that the most important tax development of 2013 would come from "Offshore Leaks." Without disclosing its origin, the International Consortium of Investigative Journalists (ICIJ) has obtained a 200+ gigabyte database of secret account information from Caribbean banks. These have revealed that international bureaucrats the world over are hardened tax dodgers, Cahuzac in France and Canada's Tony Merchant being prime examples. Building on the momentum its revelations generated, in mid December the ICIJ attempted to draw media attention to publicly available lists of names of American citizens who have expatriated, implying that they did so in order to avoid taxes. Support from intergovernmental organizations such as the OECD has lent credibility to "Offshore Leaks," and newspaper coverage of prominent tax dodgers has improved tax disclosure in Atlantic rim countries. An internationally consolidated position on the sharing of tax information with even the likes of Switzerland, China and Russia joining the effort, has emerged.

It is regretful that the ICIJ's concerns with tax avoidance are not accompanied by concerns for the intricacies of tax laws at the very root of poor tax compliance. The costs of agreements such as FATCA are always passed down to taxpayers, both in the form of greater diligence required in reporting, and via an expanded tax mandate ironically paid for by their own money. Government enthusiasm for the work of the ICJI indicates that 2014 could see the first steps towards a global tax framework developed in parallel with, or on the basis of FATCA. The American model of taxing citizens abroad is unique, and countries joining FATCA might want to debate the merits of treaties which reinforce US jurisdiction on their territory. The expansion of state power that's presumed should require the acquiescence of those most effected by it, but top-down-consultations are not standard bureaucratic practice when job numbers indicate reduced labor pool participation, and thus less taxable income.

While the costs for transportation, education, and medical care are steadily increasing, experts fret about the effects cheaper goods will have on business activity. They call it deflation, and hearing them speak about it, they conflate it with the reality consumer's face when seeing their doctor, attending school, or paying for train tickets; it's as if saving on hats bought in H&M translated into cheaper housing!

In 2013 we correctly foresaw turbulence in the developing world. Contrary to popular delusions, developing countries are in no position to effectively deal with external shocks, and they remain the dependants in the international system. The universal dream of export driven recovery is as at home in Wyoming, as it is in Sichuan, Recife, or Cape Town. The EU, America, and East Asia are locked in a one way struggle for export dominance, without thinking about the subsequent tension this imposes on the international system. The US Treasury chastises Germany for its trade surplus, and pesters the Chinese about the need to float their currency. Detroit has sent unambiguous signals to Japan's Prime Minister, not to cross the threshold of currency manipulation. Domestic demand, reforming labor markets, and streamlining tax law are not on anyone's agenda. The world is facing a Texas hold'em where nearly every player sees their economic failings resolved by penetrating another's markets.

SIMONARD SOREL S.E.L.A.R.L. au capital de 7.622 €- Toque L0184 - N° de TVA : FR82391172764
18 Avenue George V, 75008 Paris, France - R.S.C. Paris: 39117276400048 A.P.E. 6910Z
Telephone: +33 1 53 23 94 20 - Fax: +33 1 40 70 16 08 - contact@simonardsorel.com

Brussels paid lip service to deeper and more efficient domestic markets by conceiving a supranational banking union. Lacking a fund to bail out its members in case of trouble, it is effectively a sham. The situation with Dexia reminds us why. Pursued in court by 400 municipalities across France seeking to recover a mere 10 billion of junk loans, Paris is incapable of resolving Dexia's liabilities. If a rich state can't deal with the only bank it has nationalized, what can one expect at the continental level? A level at which everyone is encouraged to follow the German centered Eastern European manufacturing model, blissfully oblivious to the Malthusian competition for export markets this imposes on China and America?

In its third plenum China promised all the necessary steps to increasing domestic consumption, and took precisely none of them. Its policies amount to no more than a continued laundering of America's dollar flood into useless housing and construction. Like Germany, Beijing has no intentions of foregoing the export markets it requires to finance its growth, and it has no intentions of creating market based institutions which would impose political costs on its corrupt and unaccountable Communist politburo.

In an open trade model, comparative advantage leads to optimal international productivity such that the allocation of resources translates into global economic growth. Rising GDP is nothing but an abstraction of the transition from mud-huts to brick-and-mortar condominiums. It requires skills and resource mobilization, and is expressed as rising standards of living. It is driven by increased consumption of transportation, housing, education, and all other goods and services in an economy. What is holding the world back from this Utopian model of global interaction? Young people are passionate about social entrepreneurship, but it's people's consumer habits that drive global living standards, not self-proclaimed ideals. Millennials will not be reassured when it finally dawns on them that the jobs of their dreams depend on whether or not poor countries can increase their consumption to the levels of developed economies. To spot a utopian bubble, like its economic counterpart, it first has to burst.

Whether real estate prices in Korea, Japan, and China are in bubble territory, is as hard to answer as whether commodities from Africa, Brazil, Australia, Russia, and Canada, suffer the same. Do moneys pouring into shale gas and the US stock market represent speculative flows? Monetary policy conundrums, and significantly divergent institutional frameworks across the world, make any straightforward answers limited to hindsight, not forecasting.

The governments in advanced economies rely on the wealthy as their single biggest source of income based revenue. The social mantra in that the rich must give more because they have more, implying that taking more of their wealth will make everyone who is poor, wealthier. The question of how the rich created their wealth in the first place, is simply ignored. Focusing on how to make a minority poorer at the expense of the majority requires less intellectual effort than focusing on conditions in which the majority can join the minority in its wealth. It is easy for politicians whose salaries are paid by our taxes to bribe journalists with tax exemptions and skew the public debate in their favor.

The question should be about the ability of all individuals to contribute to their general well being, via investment in their own financial literacy, skills, employability, self-regulating behavior and cultural development. Redistribution is a zero sum game. Economic growth is by definition a net positive. On the face of it we're witnessing tiny increment to VAT and marginal increases on various asset classes. When viewed in light of the fractional increases to baseline taxes combined with galloping rise in "cotisations," the tax burden favors reckless government spending at the cost of overall economic productivity. It's the tax burden which is eroding the tax base by destroying economic productivity. Poor GDP indicators are the result, not the cause, of economic stagnation.