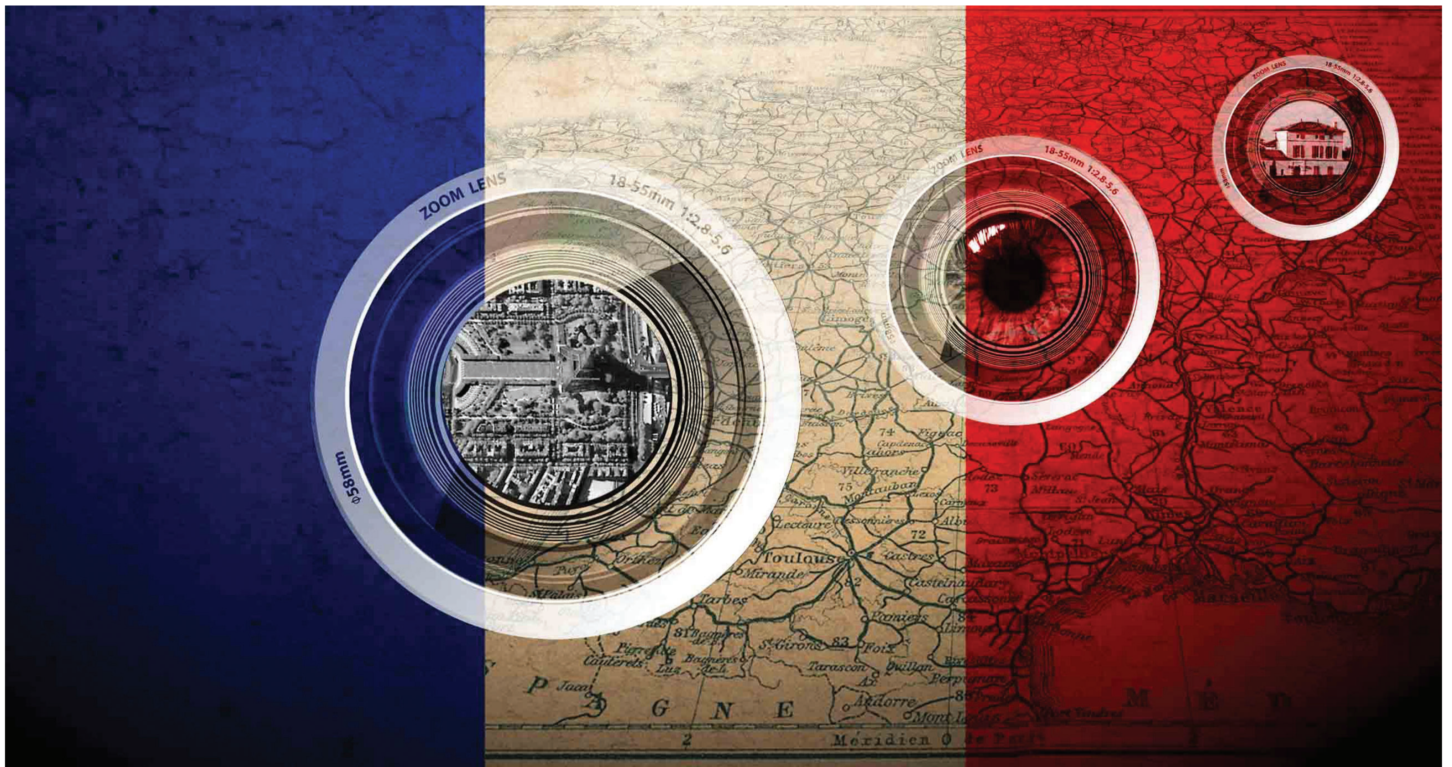
Bearing fruit

In the latest in our series on international probate, **Chris Cumberbatch** looks at the French concept of *usufruit*, its similarities with a UK life interest, and how private client solicitors can support clients with assets in France when an *usufruit* arises



It is well established that French succession laws are different to our own; previous editions of *PS* have looked at ways of helping clients avoid the potential pitfalls of a move across the channel or an investment in the French property market. This article, however, seeks to shed some light on one area of similarity between our private law and that of our Gallic cousins – that of the *usufruit*, or life interest – and to provide some practical points to clarify the opportunities for and limitations of its use in estate planning.

THE BASICS

As with a trust, an *usufruit* arises when the rights to a property are divided, not by percentage or share, but by class of proprietary right. In France, this is known as *le démembrement de propriété*, and, in certain respects, is comparable to the separation of "legal" and "beneficial" interests here. On the creation of an *usufruit*, the title to the property (*la pleine propriété*) is shared between two parties: the *usufruitier*, whose rights are similar to those of a "life tenant"; and the *nu-propriétaire*, whose rights resemble those of a "remainderman". As with a life interest trust, a common way for an *usufruit* to be created is by will or intestacy, following the death of a spouse, where it enables the surviving spouse to take an interest in the property without infringing the French forced heirship rights of the deceased's children. Effectively, the surviving spouse is entitled to the "use" of property, which is simultaneously vested in the name of the child or children, who, as the *nu-propriétaire*, will normally not be entitled to take ownership until the death of the *usufruitier*. It is worth adding that it is possible to have an *usufruit* in other assets, such as a portfolio of shares, a second home, or even a life policy.

Following the intestate death of a spouse co-owning a French property or assets, the survivor is given two options: take one-quarter of the succession outright, and three-quarters in *usufruit*; or take an *usufruit* in the entire estate, so long as any surviving children agree. If no choice is made, the survivor is presumed to have opted for the full *usufruit*. In the case of a married couple, no inheritance tax on the *usufruit* will be payable by the surviving spouse, as there is no tax on transfers to spouses under French law. However, the *nu-propriétaire* will be liable to pay tax on their *nu-propriété*. Given that they may not have the capital to do so while the property remains unsold, it is possible for annual instalments (and interest) to be paid up until the death of the *usufruitier*.

LEGAL OBLIGATIONS – THE *USUFRUITIER*

The *usufruitier* is obliged to maintain the property in the condition in which it was received by him, so that when the *nu-propriétaire* receives it, it will be in this same condition – arguably, all properly drafted life tenancies have the same effect under English law. As such, the *usufruitier* is responsible for ensuring that all necessary maintenance works are carried out. Article 606 of the *Code Civil*, which sets this requirement, does not offer a precise definition of what this might comprise, but in practice, the works are likely to include a wide range of repairs: to plumbing, tiling, minor walls, floors, ceilings, internal paint and decor, plastering, central heating, windows and doors. Plainly, these obligations are much more onerous than those imposed on a mere tenant, and accord with the substantial rights to the property that the *usufruitier* possesses. That said, there is no obligation for them to undertake works that are necessary at the beginning of their *usufruit*; they simply have to give the property to the *nu-propriétaire* in the condition that it was in when the *usufruit* began.

For this reason, it makes sense to obtain a structural survey of property left on *usufruit* by the first spouse, shortly after their death, especially where there are children from prior relationships.

If the *usufruitier* fails to carry out the necessary works, the penalties can be severe. The *nu-propriétaire* has the right to demand that they carry out the maintenance works required and, if this does not take place, article 618 of the *Code Civil* provides for the *usufruitier* to be ordered to undertake the necessary works and / or pay damages to the *nu-propriétaire* and, in extreme cases, for the *usufruit* to be voided by judicial order. Note that it is possible for the *nu-propriétaire* to exempt the *usufruitier* from this obligation and to take it on themselves.

Other obligations include the payment of the *taxe foncière* and *taxe d'habitation*, the local property and residence taxes. They will also be liable to pay the *impôt de solidarité sur la fortune*, except in certain circumstances, including where they have received the *usufruit* by virtue of the *Code Civil* (that is, on an intestacy), but not under a will.

LEGAL OBLIGATIONS – THE *NU-PROPRIÉTAIRE*

The *usufruitier* is not responsible for major building works (*grosses reparations*), such as structural work to the roof, supporting walls or foundations. It is the *nu-propriétaire* who must do these repairs. However, there is no enforcement remedy available to the *usufruitier* against the *nu-propriétaire* who fails to complete major works, unless this has been specifically agreed in advance. All that exists is a remedy for after the completion of repairs, where the *usufruitier* has expended monies on major works, which enables their beneficiaries to claim reimbursement from the gain in value that arose by dint of their execution. This right can only be claimed on the expiry of the *usufruit* – in other words, on the death of the *usufruitier*. Alternatively, the *usufruitier* can release the *nu-propriétaire* from their obligation to pay for such works. Such agreements can be made privately ("*sous seing privé*") or by *acte notariale*.

SELLING

The principal concern for a surviving spouse, particularly where the French property is their main residence or investment, will be the ability to sell. Unlike under a life interest trust, where the appointed trustees will commonly be the surviving spouse plus one or more children, the right of sale will be purely in the hands of the *nu-propriétaire*. By themselves, the *usufruitier* only has the right to sell the *usufruit*, for which there would be a limited market. The only comfort they have is the knowledge that, unless they are in breach of the conditions set out above, a sale will not be possible without their consent (article 815-5 of the *Code Civil*). If they do agree, then, on a sale of the property, there are two methods for valuing the *usufruit*.

The first method, the "financial" method, takes into account the current market value of the property and the life expectancy of the *usufruitier*. In much the same way as the Intestate Succession (Interest and Capitalisation Order 1977) (as amended) provides an index and percentage multiplier to value a life interest based (in part) upon the age of the life tenant, article 669 of the *Code General des Impots* contains a "*barème d'évaluation fiscale de l'usufruit*" which calculates the value of the *usufruit* according to the age of the life tenant at the date that the property is sold. The older the *usufruitier*, the lower the value of the *usufruit*; it is valued at just 10% if they are over the age of 90, but as much as 90% if they are under 21. For instance, a widow aged 71, entitled to a life interest in her husband's half share of their property worth €500,000 under the intestacy rules, will be entitled to €75,000 from his half, together with her €250,000, on a sale at this price.

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The second "economic" method is available only in limited circumstances, and only provided the *usufruitier* and the *nu-propriétaire* agree. Essentially, this enables both parties to agree to ignore the *barème* and instead rely on any of a number of factors (of which age is just one) to determine the value of their rights in the property themselves.

Either way, the *notaire* handling the sale will normally demand both parties' agreement on the division of monies prior to the sale, to enable them to transfer funds thereafter.

REPURCHASE OR RENTAL

If all parties are agreed, the property can be sold and a new property purchased, into which they can assign their respective rights, just as with the sale and purchase of property within most life interest trusts, where the new property is held on identical trusts. If a sale is not in issue, but instead perhaps a move to different accommodation, or a change of tenant, note that the *Code Civil* (at article 595) confirms that the property can be rented without the consent of the *nu-propriétaire*. In doing so, the *usufruitier* has most of the powers of a full legal owner in granting a tenancy. They can determine the amount of rent, permit a rental break to the tenant, and permit the tenant to carry out works. It should be noted, however, that a lease from an *usufruitier* should not be longer than nine years, and that they will need consent where the *usufruit* consists of agricultural or commercial property.

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This means that owners of rental property in France should be able to ensure a continuation of their survivor's investment income, without being prevented from managing the asset by the presence of minor children.

MOVABLE PROPERTY

An *usufruit* may also apply to movable assets, such as bank accounts or shareholdings. The *usufruitier* benefits from all interest and dividends paid on these movable assets, but, as with most life interest trusts, cannot use the capital. But who manages the funds? It was established by the French Supreme Court in 1998 that, within a share portfolio, the *usufruitier* is able to dispose of shares without the consent of the *nu-propriétaire*, so long as they replace existing shares with other shareholdings. In managing a portfolio, their obligation is to "*conserver la substance*" of the holdings, and as one might suspect, the exact meaning of this duty has been the subject of several tribunal decisions. As with life interest trusts, an inherent conflict of interest is a risk of the arrangement; the *usufruitier* may wish to

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maximise income, which calls for a riskier investment strategy, while the *nu-propriétaire* often seeks capital protection and growth. Under article 618 of the *Code Civil*, if the *nu-propriétaire* has reason to believe that the *usufruitier* is mismanaging funds or placing their interests at too great a risk, they can bring proceedings to obtain a guarantee, a charge, or even an end to the life interest. To support this right, the Supreme Court has established that if the *nu-propriétaire* requests information on a portfolio, the *usufruitier* has a duty to provide it.

If any capital gains tax ("*l'impôt de plus values*") is payable on gains made while managing an investment, this is, in principal, the liability of the *nu-propriétaire*. However, where the *usufruit* arises from an estate, the "*fisc*" (the equivalent of HM Revenue and Customs) will accept that the *usufruitier* is liable, so long as it receives a formal request to that effect from both parties.

The same principles apply to bank accounts, but note the danger of double taxation on joint accounts, where the *usufruitier* has had an *usufruit* for several years. French inheritance tax ("*droits de succession*") is paid on the first death, on the value of the *nu-propriété*, but it is not unknown for it to be paid again, because the entire balance is improperly included in the estate of the survivor, as the existence of an *usufruit* has been overlooked or is not understood.

INHERITANCE TAX

As the *usufruit* is extinguished on the death of the *usufruitier*, there is no value to transfer to beneficiaries, and consequently, there are few formalities to complete and no capital gains or inheritance taxes to be paid.

Of course, presuming that one-half of the property was owned by the surviving spouse outright, that half will be subject to *droits de succession*. In France, each child benefits from a tax allowance of €159,325 per inheritance. Therefore, by inheriting half of the *nu-propriété* on the first death and the rest on the second death, the children will benefit twice from their tax allowances, instead of once had they inherited only after the death of the surviving spouse. They will also have paid a reduced inheritance tax bill on the value of the *nu-propriété* on the first death, and on the second, will simply have to pay a registration fee of €75 to "reunite" the *usufruit* and the *nu-propriété*.

However, bear in mind that if the *usufruitier* is resident in the UK, inheritance tax (IHT) here would be payable on the French property on their death, under section 49(1) of the Inheritance Tax Act 1984, which treats the half share held on *usufruit* as theirs for IHT purposes. The effect of this is that inheritance tax may be payable twice on the value of the French property: first in France on the first death; and then again in the UK on the second. Much depends on the value of the estates in both jurisdictions, and the number of children. With two children inheriting on both deaths, properties worth up to approximately €640,000 will be exempt from *droits de succession* provided they inherit the *nu-propriété* on the first death. If tax is then paid in the UK, this will not be double taxation. For properties of greater value, however, or fewer beneficiaries, one should consider ensuring that the *droits de succession* arise on the same event as the UK charge to IHT – that is, on the second death. This is so that the beneficiaries will be entitled to relief from double taxation under the UK / France Double Taxation Convention, which states that the charge to tax must arise from the same taxable occasion. Establishing a matrimonial property regime in France is one way to do this, as, in such a regime, the property will pass to the survivor outright, and then on the second death, to the children, with no *droits de succession* payable on the first death; this means that the tax liability arises on the second death, as in the UK. Although this results in higher French taxation, the benefit of double tax relief may outweigh this.

RECOGNITION

Despite the many practical similarities between the life interest trust and the *usufruit*, official recognition is one-sided. It is widely known that HM Revenue and Customs will treat an *usufruit* as a life interest, but the French *Direction de la Législation Fiscale* maintains that a life interest trust will not be treated as an *usufruit*.

Perhaps, despite appearances to the contrary (such as our reluctance to harmonise EU succession laws), we are no more protective of our common law than our continental cousins are of their *Code Civil*.

At any rate, it has been shown that the two arrangements have things in common, and where they differ, the rules applicable are, for the most part, logical. Of course, there will be traps for the unwary, but our system of taxation is hardly straightforward in its own right! ■

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