

# ARTICLES

## FRANCE TRIES A WEALTH TAX

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### 1. INTRODUCTION

Despite my best advice,<sup>1</sup> the French National Assembly enacted an annual tax on individual net wealth, *impôt sur les grandes fortunes*, ("IGF")<sup>2</sup> on October 30, 1981.<sup>3</sup> The tax went into effect on January 1, 1982<sup>4</sup> and was repealed on July 11, 1986.<sup>5</sup> A new annual tax on indi-

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<sup>1</sup> An article published in 1980, written by the author, examined the forms a French wealth tax might take in light of studies within France and French fiscal history, as well as the experience of other countries with such a tax. See Verbit, *Taxing Wealth: Recent Proposals from the United States, France, and the United Kingdom*, 60 B.U.L. REV. 1 (1980).

<sup>2</sup> The name for the tax has a polemical quality. It has been variously referred to in the literature as the tax on patrimony (*patrimoine*), a wealth (*richesse*) tax, and a tax on capital. See Grosclaude, *L'Impôt Sur les Grandes Fortunes*, 15 FASCICULE para. 3 (1986).

<sup>3</sup> Loi No. 81-1160 du 30 Decembre 1981, De finances pour 1982, 1981 J.O. 3539, 1982 D.S.L. 22 [hereinafter 1982 Finance Law].

<sup>4</sup> Detailed regulations implementing the law were issued on May 11, 1982 and May 19, 1982. See INSTRUCTION DU 11 MAI 1982: IMPÔT SUR LES GRANDES FORTUNES (Bulletin Officiel de la Direction Générale des Impôts No. 7 R-1-82) [hereinafter INSTRUCTION DU 11 MAI 1982]; IMPÔT SUR LES GRANDES FORTUNES: COMPLÉMENTS DÉTAILLÉS À L'INSTRUCTION GÉNÉRALE ET EXEMPLES PRATIQUES, para. 1, at 12 (Bulletin Officiel de la Direction Générale des Impôts No. 7 R-2-82, May 19, 1982) [hereinafter COMPLÉMENTS DÉTAILLÉS]. These were "*prise de position*," administrative interpretations, as defined by the French Rules of Tax Procedure. See LIVRE DES PROCEDURES FISCALES, art. L. 80 (Fr.). See also CONSEIL DES IMPÔTS, HUITIÈME RAPPORT AU PRÉSIDENT DE LA RÉPUBLIQUE: RELATIF À L'IMPOSITION DU CAPITAL NO. 4063 101 (1986) [hereinafter HUITIÈME RAPPORT]. These *compléments détaillés* and *exemples pratiques* were incorporated by reference in the reenacted wealth tax. See INSTRUCTION DU 28 AVRIL 1989, para. 3 (Bulletin Officiel de la Direction Générale des Impôts No. 7 R-1-89) [hereinafter INSTRUCTION DU 28 AVRIL 1989].

<sup>5</sup> Article 24 of the corrected Finance Law of 1986 repeals the wealth tax. See Loi No. 86-824 du 11 Juillet 1986, De finances rectificative pour 1986, 1986 J.O. 8688, 1986 D.S.L. 400. This tax repeal occurred despite the previous administration's claim that the tax was approved by a "large majority of French citizens in its fifth year in

vidual net wealth, *impôt de solidarité sur la fortune*, came into effect on January 1, 1989<sup>6</sup> and remains in effect.

The purpose of this article is to examine the available data to evaluate how the wealth tax worked during the period in which it was in force. Part 2 presents a brief outline of the tax as it was enacted, and part 3 discusses the wealth distribution effects of the tax. Part 4 then examines some of the more troubling aspects of the IGF. In addition to this historical exercise of examining what went right, what went wrong and how these errors can be avoided in the future, this article will close with a view of the *new* wealth tax enacted in 1988. The 1988 wealth tax is in many respects identical to the IGF. Substantial differences between the old wealth tax and the new wealth tax are discussed in Part 5 of this article.<sup>7</sup>

## 2. OUTLINE OF THE WEALTH TAX

### 2.1. *Property Included in the Tax Base*

The taxable unit of the wealth tax is the family—husband, wife and minor children.<sup>8</sup> The tax applies to the property, wherever located, of those families domiciled in France.<sup>9</sup> It also applies to the property of non-residents that is located in France.<sup>10</sup>

force.” Ministère de l’Economie, des Finances et du Budget, *Impôt sur les Grandes Fortunes* (Jan. 22, 1986) (Press Release SI/7950) [hereinafter Press Release].

<sup>6</sup> See *infra* note 139.

<sup>7</sup> See *infra* notes 155-76 and accompanying text.

<sup>8</sup> 1982 Finance Law, *supra* note 3, at art. 3. Assets are treated individually when couples are separated. Alternatively, and uniquely, an unmarried couple is treated as a taxable household, if there is stability and continuity in the relationship and the individuals hold themselves out as husband and wife, *concubinage notoire*. See INSTRUCTION DU 11 MAI 1982, *supra* note 4, at 4. See also R. BLANCHER, *L’IMPÔT SUR LES GRANDES FORTUNES* 14-20; P. COURTOIS, *L’IMPÔT SUR LES GRANDES FORTUNES* 33 (1982). The inclusion of this concept was first proposed by opposition members in the National Assembly. See 1981 J.O. 2740, 2741 (Oct. 29, 1981) (National Assembly Debates). It was presented formally as an amendment in the Senate in the name of the Commission of Finances. See 1981 J.O. 3073 (Nov. 24, 1981) (Senate Debates). See also II G. TIXIER & D. LALANNE-BERDOUIT, *L’IMPÔT SUR LES GRANDES FORTUNES* 44-45, 48-49 (1982) [hereinafter TIXIER]. The purpose was to prevent couples from divorcing and separately assessing their individual property in order to minimize the tax.

If one of the parties to the *concubinage notoire* is married, *concubinage adulterin*, his or her property is assessed together with that of his marriage partner for purposes of the tax, *foyer legal*. See INSTRUCTION DU 11 MAI 1982, *supra* note 4, at 32; MEMENTO PRATIQUE FRANCIS LEFEBVRE FISCAL 875 (1986); TIXIER, *supra*, at 53.

The definition of *concubinage notoire* does not include homosexual couples. See LE FIGARO ECONOMIE, Dossier Special, Apr. 17, 1989, at 5 (Ministerial Response to this question posed in the National Assembly, Mar. 28, 1983).

<sup>9</sup> For a definition of domicile for French tax purposes, see C. CIV. art. 102 (Fr.).

<sup>10</sup> To encourage continued investment in France by foreigners various investment

The property that is subject to the tax is defined rather broadly.<sup>11</sup> In addition to property normally considered to be owned by the taxpayer, ownership extended to property "belonging to," *appartenant*, taxpayers in the following senses: (1) Assets that appear to belong to the taxpayer from a third party's point of view (i.e. assets held by the taxpayer as nominee and assets acquired by the taxpayer subject to a condition precedent or a condition subsequent); (2) assets in the taxpayer's possession, other than temporarily; (3) property attached or clearly related to an asset that belongs to the taxpayer; and (4) assets that the taxpayer is presumed to own by a special provision of the French Tax Code (i.e. shares on which the taxpayer receives dividends or which he votes and real estate on which he pays property tax).<sup>12</sup>

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instruments, *placements financiers*, held by non-residents are specifically exempted by article 5 of the IGF. 1982 Finance Law, *supra* note 3, at art. 5. There are two principal exceptions to this exemption. The first exception applies when a non-resident obtains a sufficient number of holdings in an enterprise such that the non-resident may exercise influence over the management and direction of the enterprise. Thus, the exemption would not apply if the non-resident's equity holdings are more than 10 percent of the enterprise's capital and the cost exceeds Fr 10 million. *See COMPLÉMENTS DÉTAILLÉS, supra* note 4, para. 36, at 16. The second exception relates to shares in companies whose principal assets are real estate. *See* 1982 Finance Law, *supra* note 3, at art. 5. *See also* I TIXIER, *supra* note 8, at 49-50.

The first exception creates a situation which even the French Parliament considered "curious." If the non-resident owns less than 10 percent of the shares in a company, she is not subject to the IGF. If the shares held by the non-resident represent between 10 percent and 25 percent of the outstanding shares of a company, the shares are subject to the IGF since such a large shareholding would permit the non-resident to exercise influence over the management. However, if the shares held by the non-resident were more than 25 percent of the company's outstanding shares, and the non-resident was a senior executive in the company (admittedly an unlikely event for a non-resident), the holding would be exempt from the tax as "business property." *See ASSEMBLÉE NATIONALE RAPPORT FAIT AU NOM DE LA COMMISSION DES FINANCES, DE L'ÉCONOMIE GÉNÉRALE ET DU PLAN (1) SUR LE PROJET DE LOI (NO. 147) RELATIF À L'IMPÔT DE SOLIDARITÉ SUR LA FORTUNE, NO. 158, Première Session Ordinaire de 1988-1989, at 78* [hereinafter *ASSEMBLÉE NATIONALE NO. 158*]. For a discussion of shareholdings as "business property" *see infra* notes 99-110 and accompanying text.

<sup>11</sup> *See* INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at paras. 30-31; *COMPLÉMENTS DÉTAILLÉS, supra* note 4, paras. 70-96, at 22-28.

<sup>12</sup> *See* *COMPLÉMENTS DÉTAILLÉS, supra* note 4, paras. 70-96, at 22-28. There are also special provisions for life insurance. *See* *COMPLÉMENTS DÉTAILLÉS, supra* note 4, para. 98, at 27. *See also* 1982 Finance Law, *supra* note 3, at art. 5. Insurance policies are subject to the IGF, if the amount of premiums due over a four year period represent less than three-quarters of the policy face amount and the insured is 66 years old or less at the time the policy is issued. For details of this provision, *see* INSTRUCTION DU 20 AOÛT 1981 (Bulletin Officiel de la Direction Générale des Impôts No. 7 G-9-81).

For purposes of the IGF, the value of the premiums paid is included in the tax base, not the guaranteed cash value. *See* *COMPLÉMENTS DÉTAILLÉS, supra* note 4, para. 98, at 29. For other life insurance policies, *see id.* paras. 99-101, at 29. *See also* INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at para. 34. Since pensions cannot be given away either during life or at death, they also are not considered part of a taxpayer's wealth for tax purposes. *See* *COMPLÉMENTS DÉTAILLÉS, supra* note 4, para.

## 2.2. Exemptions

Numerous types of property were exempt from the IGF. One such exemption was for objects of art.<sup>13</sup> This category specifically included<sup>14</sup> antiques over 100 years old, rugs, tapestries, hand-drawn paintings, drawings and sketches, original engravings, prints and lithographs, original statuary and sculpture,<sup>15</sup> stamp collections, zoological, biologi-

107, at 30.

Proceeds received for personal injury are exempt from the tax. See INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at para. 35; COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 102, at 29. In addition, if these proceeds are invested in property, the property is exempt. Moreover, in valuing the exempt property its value is increased annually by the interest rate payable on passbook savings accounts. Thus, in the example given in the regulations, where the taxpayer received compensation of Fr 500,000 in 1979 for injuries suffered in an automobile accident, the value of the deduction as of January 1, 1982 was Fr 627,500, or Fr 500,000 times 3 years times 8.5 percent. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 103, at 30.

<sup>13</sup> 1982 Finance Law, *supra* note 3, at art. 3; COMPLÉMENTS DÉTAILLÉS, *supra* note 4, paras. 131-42, at 35-37. See also INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at para. 146. This exception was not in the original bill but was added as a result of debate in the National Assembly. See 1981 J.O. 2746-47 (Oct. 29, 1981) (National Assembly Debates); P. COURTOIS, *supra* note 8, at 64. This was apparently the only amendment of importance adopted in the National Assembly, and it was introduced by the government itself. See Grosclaude, *supra* note 2, at para. 31. The exemption is attributed in part to the intervention of President Mitterrand who feared "precious paintings and antiques would be shipped out of the country for sale abroad." *French Wealth Tax the Pips Won't Squeak*, *ECONOMIST*, Nov. 7, 1981, at 88. President Mitterrand was also interested in encouraging the purchase of contemporary art. See Melikian, *Taxes and Art in France*, *Int'l Herald Trib.*, Nov. 10, 1981, at 7, col. 1. In response, Marc Chagall telegraphed Mitterrand "Bravo, la France!" Eder, *Socialist Test: Taxing Riches of the French*, *N.Y. Times*, Nov. 2, 1981, at A5. The IGF was amended again by the National Assembly to provide that a work of art sold abroad after obtaining an official export license would not be exempt. See Melikian, *supra*.

To compensate for the exemption of art objects from the IGF, the sales tax on art was raised to 4 percent for works sold at auction and 6 percent for works sold through galleries. See R. BLANCHER, *supra* note 8, at 27. See also 1981 J.O. 2735 (Oct. 29, 1981) (National Assembly Debates); TIXIER, *supra* note 8, at 59, 69-70.

The regulations required that all payments for jewelry, works of art, paintings, etc. of a value in excess of Fr 10,000 be by check. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 5, at 12 (citing 1982 Finance Law, *supra* note 3, at art. 96-I). See also R. BLANCHER, *supra* note 8, at 27; Allaed, *Impôt sur la Fortune: Vos Bijoux Aussi*, *Figaro*, Oct. 28, 1981, at 4, col. 1.

In addition, insurers were required to furnish the tax authorities with a list of persons who insured jewelry, objects of art or antiques for a value in excess of Fr 100,000. COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 5, at 12 (citing, 1982 Finance Law, *supra* note 3, at art. 96-II).

<sup>14</sup> The Finance Ministry decided to adopt the definitions used for customs purposes in the common external tariff of the European Economic Community. The relevant tariff numbers are: 58-01 and 58-03 (carpets), 99-01 (paintings and drawings), 99-02 (prints), 99-03 (sculpture), 99-04 (postage stamps), 99-05 (collections of historic, archeological, and scientific interest), and 99-06 (antiques of more than 100 years of age). See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 131, at 35. See also P. COURTOIS, *supra* note 8, at 64.

<sup>15</sup> The regulations require that the number of castings of a sculpture be limited

cal, mineralogical and anatomical specimens and collections of objects having historical, archeological, paleontological, orthological or numismatic interest.<sup>16</sup> Jewelry over 100 years old was not exempt unless its value was derived from age and workmanship rather than from the value of the stones and precious metals.<sup>17</sup>

Also excluded from the IGF was rural property subject to a long-term lease<sup>18</sup> and stocks of wine and brandy.<sup>19</sup> Up to three-fourths of

and within the control of the artist. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 135, at 36.

<sup>16</sup> See R. BLANCHER, *supra* note 8, at 50-54. The regulations encompass collections of books over 100 years old. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 142 at 37.

<sup>17</sup> See R. BLANCHER, *supra* note 8, at 54. So as not to discriminate between different forms of art, the Finance Law Corrections Act added copyrights to the list of exempt property. See Loi No. 82-540 du 28 Juin 1982, De finances Rectificative pour 1982, 1982 J.O. 2038, 1982 D.S.L. 296. See also COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 142 *bis*, at 37.

<sup>18</sup> See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, paras. 302-14, at 67-68. The lease had to be for a minimum of eighteen years. *Id.*, para. 302, at 67. This exemption is attributed to the strength of the landowners' lobby. See Grosclaude, *supra* note 2, at para. 31 (quoting A. TCHEKAY, L'ÉLABORATION DE L'IMPÔT SUR LES GRANDES FORTUNES, POUVOIRS 51 n.23 (1982)).

Article 19-VI of the Finance Law of 1984 exempted all business property from the IGF. Loi No. 83-1179 du 29 Decembre 1983, De Finances pour 1984, 1983 J.O. 3799, 1984 D.S.L. 63 [hereinafter 1984 Finance Law]. See *infra* note 73. It therefore became necessary to redefine agricultural land on long-term lease for the purposes of the IGF, since such land initially qualified as business property. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, paras. 302-14, at 67-68. However, after January 1, 1984 only such land as was leased to the wife of the lessor, the ascendants or descendants of the lessor or to siblings of the lessor would be considered business property. See INSTRUCTION DU 9 MAI 1984: IMPÔT SUR LES GRANDES FORTUNES, LOI DE FINANCES POUR 1984, ART. 2-VIII, ART. 19-VI ET 20 (Bulletin Officiel de la Direction Générale des Impôts No. 7 R-5-84) [hereinafter INSTRUCTION DU 9 MAI 1984]. Agricultural land subject to long-term lease that was not classified as business property was exempt from the wealth tax for three-fourths of its value up to a limit of Fr 500,000. Above that amount, only half the value was exempt. *Id.* at 13.

As an illustration of how the new system would work, the regulations posit a rural landholding of 500 hectares, 100 hectares of which is leased on long-term lease to the taxpayer-lessor's son, B, and 400 hectares are similarly leased to a third party, X. The father has 1,500 parts of the property. Each part is estimated to have a fair market value of Fr 1,000. In calculating the father's IGF he would multiply the value of his shares, i.e. 1,500 times Fr 1,000, by a fraction the numerator of which is the total land on long-term lease to his relatives, i.e. his son B, and the denominator is the total landholding, i.e. 500 hectares. Fr 1,500,000 times  $1/5 =$  Fr 300,000 which is the amount of the father's exemption. As to his Fr 1.2 million of land on long-term lease to the third party, he is entitled to a three-fourths exemption on the first Fr 500,000 and a one-half exemption on the remaining Fr 700,000 of value, for a total reportable value of Fr 475,000.

The lessor's son, B, also owns 1,000 parts in the property. He must report Fr 1 million times  $1/5$  or Fr 200,000 exemption. For his remaining Fr 800,000 of value, B reports  $3/4$  of the value up to Fr 500,000, or Fr 125,000, and  $1/2$  of the remaining Fr 300,000, or Fr 150,000, for a total of Fr 275,000. *Id.* Annexe II, at 16-17.

<sup>19</sup> This exemption was also added as an amendment in the National Assembly.

the value of agricultural land and forests was excluded.<sup>20</sup> Finally, but most importantly, there was in the IGF an exemption for Fr 2 million of business property, *biens professionnels*.<sup>21</sup>

In addition to these exemptions for particular kinds of property, every taxpayer was given an exemption of Fr 3 million (at the time approximately \$500,000).<sup>22</sup> Thus, the statute defined a "rich" family as one whose property exceeded a value of \$500,000.

### 2.3. Valuation of Property

Valuation issues are dealt with by incorporating existing rules and policies as they apply to death duties.<sup>23</sup> There are three instances in which individuals are required to report the full value of the property as part of their personal wealth: (1) holders of life estates, *usufruitiers*,

See 1981 J.O. 2761 (Oct. 29, 1981) (National Assembly Debates). The purpose was "to avoid penalizing businesses which must hold large inventories and whose value increases over time." *Id.*

<sup>20</sup> See 1981 J.O. 2844-46 (Oct. 29, 1981) (National Assembly Debates). There were two conditions attached to the exemption: first, an undertaking that the woodlands would be exploited in a normal fashion by the proprietor and his heirs for at least 30 years; and second, that an agreement to such effect would be entered into with the local government agricultural body. MEMENTO PRATIQUE FRANCIS LEFEBVRE FISCAL, 879 (1986).

Article 19-III of the Finance Law of 1984 reduced by half the exemption available for agricultural and timber land for amounts in excess of Fr 500,000. See HUITIÈME RAPPORT, *supra* note 4, at 44 citing 1984 Finance Law, *supra* note 18, at art. 19-III. For other exemptions see HUITIÈME RAPPORT, *supra* note 4, at 44-47.

The exemption on rural landholdings may be seen as a tax provision favoring families with large landholdings. Such benefits had been a feature of the French tax system in earlier times. See Hoffman, *Taxes and Agrarian Lands in Early Modern France: Land Sales, 1570-1730*, 46 J. ECON. HIST. 37 (1986).

<sup>21</sup> See 1982 Finance Law, *supra* note 3, at art. 3. For a discussion of business property see *infra* notes 73-123 and accompanying text.

Anonymous sales of gold were outlawed. Decree No. 81,888 of Sept. 30, 1981. See I TIXIER *supra* note 8, at 132.

<sup>22</sup> "Exemptions. . . have whittled down the 'revolutionary tax' to a shadow of what was heralded as a first move to redistribute wealth in France." *French Wealth Tax the Pips Won't Squeak*, ECONOMIST, Nov. 7, 1981, at 88.

The government originally considered an exemption of Fr 3 million per person but realized that a Fr 6 million exemption per married couple would eliminate any chance of the tax being significant. The government instead chose to exempt Fr 3 million per family with an exemption of half that amount for a single person filing alone. See 1981 J.O. 2734 (Oct. 29, 1981) (National Assembly Debates).

The separate exemptions for personal and business property could create a situation where taxpayers holding equal amounts of wealth were taxed differently. For example, if one had Fr 4 million of business property and Fr 1 million of personal property, there was no tax. But if one had Fr 4 million of personal property and Fr 1 million of business property, Fr 1 million was subject to the tax. See RAPPORT DE LA COMMISSION DES FINANCES DE L'ASSEMBLÉE NATIONALE, NO. 470, 1st Session Ordinaire, 40 (1981) [hereinafter FINANCE COMMISSION REPORT].

<sup>23</sup> 1982 Finance Law, *supra* note 3, at art. 3.

(2) holders of rights of use, *usage*, and (3) holders of occupancy, *habitation*.<sup>24</sup>

The regulations issued by the tax authorities pay particular attention to the valuation of tangible personal property. As a general proposition, the value of personal property is determined by the values established at public sales of the property within two years of the valuation date.<sup>25</sup> In the absence of such recent sales, the value is based on assessments made for inheritance tax purposes.<sup>26</sup> The assessment procedures were simplified in the regulations. For IGF purposes, an appraisal could be made, notarized and sworn to be true by the taxpayer himself.<sup>27</sup> This assessment would be considered good for three years.<sup>28</sup> If neither of these methods worked, then the taxpayer was to use the 5 percent method. The 5 percent method mandated that the taxpayer total the net value of all her assets excluding tangible personal property and property exempt from the IGF. Five percent of this total was used as the value of the tangible personal property.<sup>29</sup> In addition to these requirements, jewelry again received special treatment. Jewelry could not be valued at less than 60 percent of the value at which the jewelry was insured within the period of ten years preceding the valuation date.<sup>30</sup>

There were penalties for undervaluation similar to those utilized in regard to death taxes.<sup>31</sup> For an undervaluation that exceeded 10 percent of the tax base the penalty was 10 percent for the first month and 1 percent for each month thereafter.<sup>32</sup>

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<sup>24</sup> INSTRUCTION DU 11 MAI 1982, *supra* note 4, at 7-8. This provision did not apply to life estates where the division of the property was created by a sale of the fee or required by the Civil Code. *Id.* at 8.

This provision had a substantial impact since a typical testamentary disposition left the surviving spouse the usufruct interest. For an insight into the problems caused by this provision and the reasons for it, see 1988 J.O. 1171-72 (Oct. 21, 1988) (National Assembly Debates).

<sup>25</sup> COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 365, at 72.

<sup>26</sup> C. PR. CIV. art. 943 (Fr.).

<sup>27</sup> COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 367, at 73.

<sup>28</sup> *Id.* para. 368, at 73.

<sup>29</sup> This is the system used in the administration of the transfer taxes. See CODE GÉNÉRAL DES IMPÔTS art. 764-I-3 (Fr.).

<sup>30</sup> COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 371, at 73.

<sup>31</sup> *Id.* para. 670, at 125.

<sup>32</sup> See 1982 Finance Law, *supra* note 3, at art. 8-III; COMPLÉMENTS DÉTAILLÉS, *supra* note 4, paras. 670-71, at 125-26. See also *Le Figaro économie, Dossier Spécial*, Apr. 17, 1989, at 3 (citing, *Cour de Cassation*, Judgment of Dec. 15, 1987). Another safeguard against undervaluation is the provision in the eminent domain law that the judge, in fixing compensation, take into account the value of property in the wealth tax declaration. See CODE DE L'EXPROPRIATION art. L 13-16, 3e (Fr.). See also F. LEFEBVRE, IMPÔT DE SOLIDARITÉ SUR LA FORTUNE 81-82 (undated).

#### 2.4. *Timing for Determining Net Wealth*

Property is to be valued as of January 1 of each year. This date was chosen for convenience as it is the closing date for most business accounts.<sup>33</sup> Returns are due on June 15.

Since the tax was a tax on net wealth, certain deductions for debts payable on January 1 of each year were allowed. Although in general the law again incorporates the provisions covering death duties in the tax code,<sup>34</sup> the annual nature of the wealth tax led to some changes in procedure. In particular, where the existence of a debt was known on January 1, but the exact amount was in question (i.e. income taxes or property taxes), the taxpayer on his IGF return filed in June was permitted to substitute the actual taxes due for the January 1 estimated values.<sup>35</sup> Nonetheless, since the income tax is not due until July 15 of each year, a bookkeeping problem was created. Thus, a taxpayer was allowed to deduct the income tax paid in 1982 on his 1983 IGF return because the 1983 income tax amount was not fixed until after the June 15 IGF return filing date for 1983. For example, if his actual income tax in 1982 were Fr 360,000 and in 1983 were Fr 450,000, then his 1984 IGF return would reflect the following deductions: Fr 450,000 for the actual income tax paid in 1983 and Fr 90,000 representing the amount that should have been deducted in 1983 had he known the true amount of his 1982 income taxes at the time he filed his 1983 IGF return. Then on his 1985 IGF return, the taxpayer would deduct the actual amount of income tax paid in 1984 (Fr 390,000) reduced by Fr 60,000. The Fr 60,000 represents the amount that actual income tax paid in 1984 (Fr 390,000) was less than the estimate (Fr 450,000), which was based on his previous (1983) year's income tax.<sup>36</sup>

#### 2.5. *IGF Rates*

The tax rate was initially set at 0.5 percent for taxable property between Fr 3 million and Fr 5 million, 1 percent for taxable property between Fr 5 million and Fr 10 million, and 1.5 percent on taxable property above Fr 10 million (approximately \$1.8 million).<sup>37</sup> While nominally low, the rate schedule needs to be viewed against the revenues generated by the asset taxed. For a non-income producing asset,

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<sup>33</sup> COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 235, at 53. For companies which do not keep their books on a calendar year basis, an alternative procedure is proposed. COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 236, at 53.

<sup>34</sup> See CODE GÉNÉRAL DES IMPÔTS, art. 768 (Fr.).

<sup>35</sup> COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 384, at 76.

<sup>36</sup> *Id.*, *supra* note 4, para. 384, at 77.

<sup>37</sup> 1982 Finance Law, *supra* note 3, at art. 6.



jewelry for example, the rate might be quite burdensome. The tax on agricultural land was similarly burdensome because typically the yield is 1-2 percent on current market value.<sup>38</sup>

## 2.6. *An Example*

For an illustration of how the tax works, take the case of Mr. Bernard, a lawyer residing in Paris. He is married to Elizabeth, an accountant. The couple has three children. As of January 1, 1984, Mr. Bernard owned an apartment in Paris, which served as his principal residence and also as his office (Fr 1,359,000), a vacation home in Avallon (Fr 1,100,000), and a farm under lease for eighteen years (Fr 875,000). Mrs. Bernard has a life estate, *usufruct*, in an apartment in Paris inherited from her father. Finally, Mr. Bernard has 100 units in a group that owns timberland in Avallon.

In their current accounts Mr. Bernard has Fr 48,500 in a checking account and Fr 28,300 in a postal checking account. Mrs. Bernard has Fr 456,000 in a Belgian bank and Fr 75,000 in a Paris account. Mr. Bernard has Fr 82,000 in French government bonds. Mr. Bernard has Fr 375,000 and Mrs. Bernard has Fr 154,000 worth of listed securities. Mr. Bernard is also president of a corporation named "Audit" of which he owns 30 percent of the shares. They hold IOU's of Fr 35,000, Fr 12,000 and Fr 10,000. Mr. Bernard has an insurance policy with a current value of Fr 72,000. Mrs. Bernard has jewelry worth Fr 80,000 in her safe deposit box in Brussels. Mr. Bernard has two gold bars in his safe deposit box in Paris worth Fr 206,000. Mr. Bernard has an automobile worth Fr 25,000. Their furnishings are worth about Fr 32,000. This personal property totals Fr 2,107,600.

On their return the Bernards list their principal residence at a value of Fr 1,359,000, the vacation home at Fr 1,100,000, other real estate (the life estate) at Fr 1,000,000, timber land at Fr 17,500, rural land on long-term lease at Fr 875,000, and miscellaneous other land at Fr 252,120. Thus, there is a total for real property of Fr 4,603,620. Intangibles are listed as cash of Fr 82,600, securities, etc. at Fr 1,762,000, and other property at Fr 263,000. Personal property therefore totals Fr 2,107,600. The total for all property is Fr 6,711,220. From this amount the Bernards can deduct the amount due on their 1983 income tax, Fr 875,000, as well as other local taxes, for a total

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<sup>38</sup> Tax payments can be made in the usual ways and also in a way unique to the French system - by works of art. This is in accordance with the system for paying inheritance taxes in kind. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 632, at 120. For the current code provision allowing payments in kind see CODE GÉNÉRALE DES IMPÔTS art. 1716 *bis* (Fr.)

deduction of Fr 917,069. This leaves a tax base of Fr 5,794,151. For 1984 the first Fr 3,400,000 was exempt. The amount between Fr 3.4 and Fr 5.6 million was taxable at 0.5 percent, or Fr 11,000. Then, the amount in excess of Fr 5.6 million was taxed at 1 percent ( $194,151 \times .01 = 1,942$ ). So their total IGF bill was Fr 12,942.<sup>39</sup>

For someone with a net worth of about \$1,000,000 an annual tax of \$2,000 does not seem too large. In fact, the compliance cost involved in assembling the information and filing the return may well equal or exceed the amount of the tax. Moreover, where almost 70 percent of the Bernards' net worth is real estate — as we shall see, a typical profile — the wealth tax could well be characterized as a property tax surcharge. To test this proposition, as well as others about the tax, we will move from the case of this hypothetical individual to the actual results of the tax.

### 3. EXPERIENCE WITH THE TAX

One of the purposes of the wealth tax was to redistribute wealth. Therefore, the tax must be considered against the following pattern of wealth distribution in France: 1 percent of the families own 33 percent of total wealth, 10 percent of the families own 57.5 percent of total wealth, 20 percent of the families own 75 percent of total wealth, and 50 percent of the families own 95 percent of total wealth. This distribution leaves half the French families owning only 5 percent of the total wealth.<sup>40</sup>

The government's initial estimate was that there would be about 200,000 IGF taxpayers.<sup>41</sup> In fact, the number of filed returns was significantly lower than expected: 116,713 returns in 1982, 109,217 returns in 1983, 95,815 returns in 1984, 97,216 returns in 1985, and 84,717 returns in 1986.<sup>42</sup> No explanation has been uncovered for the

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<sup>39</sup> The amount of the IGF itself is deductible as a debt. See ASSEMBLÉE NATIONALE No. 158, *supra* note 10, at 92.

<sup>40</sup> See FINANCE COMMISSION REPORT, *supra* note 22, at 42 (quoting a 1978 study done by the *Centre de Recherches Economique sur L'Epargne*). See also HUITIÈME RAPPORT, *supra* note 4, at 17-18. The disparities were explained mainly by three factors: age, social class and inheritance. See Babeau, *Le Patrimoine des Ménages, PROBLÈMES ECONOMIQUES*, July 16, 1986, at 20, 25 [hereinafter Babeau, *PROBLÈMES ECONOMIQUES*]. There is no data in France for changes in concentration over time. *Id.*

<sup>41</sup> FINANCE COMMISSION REPORT, *supra* note 22, at 7. In 1982, there were an estimated 19.8 million families in France. See A. BABEAU, *LE PATRIMOINE AUJOURD'HUI* 284 (1988).

<sup>42</sup> See A. BABEAU, *supra* note 41, at 206. For 1982 the official number was 104,000. See *L'Impôt sur les grandes fortunes Premiers résultats*, LES NOTES BLEUES, May 23-29, 1983, at 2. The estimate had been 132,000. *Id.*

overestimate in the number of potential filers. The decrease in the number of returns between 1982 and 1983 was attributed to a decline in the value of real estate during that period.<sup>43</sup> The decline in 1984 and subsequent years was due to an expansion in the exemption for business property from Fr 2 million to an unlimited amount. In other words, business property was eliminated from the tax base beginning in the 1984 tax year.<sup>44</sup>

The initial estimate of the tax base was Fr 8,600 billion. This tax base was broken down into primary residences valued at Fr 2,400 billion (27.9%), vacation homes valued at Fr 550 billion (6.4%), developed real estate valued at Fr 1,350 billion (15.7%), agricultural land valued at Fr 1,250 billion (14.5%), business property valued at Fr 650 billion (7.6%), cash and cash equivalents valued at Fr 1,700 billion (19.8%), stocks valued at Fr 500 billion (5.8%), and bonds valued at Fr 200 billion (2.3%).<sup>45</sup>

The returns indicated a tax base in 1982 of Fr 7,016 billion of which Fr 1,181 billion was business property. In 1983, the total tax base was Fr 6,697 billion with business property constituting Fr 1,354 billion. For 1984 and 1985, when business property was no longer a part of the tax base, the tax bases were Fr 6,129 billion and Fr 6,284 billion, respectively.<sup>46</sup>

The actual IGF returns indicate the following patterns of wealth holding. Real estate constituted between 52.5 and 61.3 percent of the total tax base for the years 1982 through 1985. Twenty percent of the real estate was residential with the split in value being 2 to 1 principal residence versus vacation residence. About one-third of the real estate was in developed investment real estate. Less than 1 percent of the real estate was in the form of woods and forests.<sup>47</sup> The value of agricultural land ranged between 4.9 and 7.2 percent of total real estate value.<sup>48</sup>

Seventy-five percent of the personal property was in shares and about 15 percent in cash or cash equivalents. Note that this latter

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<sup>43</sup> See HUITIÈME RAPPORT, *supra* note 4, at 120.

<sup>44</sup> See *infra* note 73.

<sup>45</sup> FINANCE COMMISSION REPORT, *supra* note 22, at 41. This tax base can be compared to the distribution of assets in 1970: real estate was 51.9 percent of total assets, securities 23.9 percent and cash and cash equivalents 24.2 percent. In 1977 the respective figures were 46.8 percent, 18.2 percent and 35 percent. See Babeau, *PROBLÈMES ECONOMIQUES*, *supra* note 40, at 25. See also Babeau, *Le patrimoine des ménages*, LES CAHIERS FRANÇAIS, Apr. 1989, at 63, 66 [hereinafter LES CAHIERS FRANÇAIS].

<sup>46</sup> See HUITIÈME RAPPORT, *supra* note 4, at 121, Table 133.

<sup>47</sup> This pattern held true for all but the wealthiest filers, the over Fr 100 million group, 83 percent of whose wealth was in the form of shares. See A. BABEAU, *supra* note 41, at 128.

<sup>48</sup> See HUITIÈME RAPPORT, *supra* note 4, at 124, Table 136.

breakdown of personal property is far different from the original projections.<sup>49</sup> The difference may reflect an increased inclination to invest in the securities markets rather than keeping cash in the mattress. An alternative explanation is that cash and cash equivalents are more easily concealed than securities. The figures also reveal a trend of increasing value in personal property, particularly securities, relative to real property over the four year period the IGF was in effect. The ratio of personal property to real property in 1982 was 44.7/61.3 and in 1985 the ratio was 53.4/52.5.<sup>50</sup> This change is attributed primarily to the increased value of shares during the period,<sup>51</sup> but that shift may in fact be an effect of the tax. The IGF made real estate the least desirable type of asset from a tax point of view, since real estate was subject to real property taxes as well as the IGF. In addition, real estate is the least concealable form of wealth.

The IGF did not remain in effect long enough to demonstrate significant changes in asset composition among the wealthy. Nor was such a change among the government's articulated purposes for the tax. Nonetheless, it is possible to theorize about the impact the tax might have had — or might have in the future — on asset holdings. For example, the Tax Council (Conseil des Impôts) estimated the level of three types of taxes on various forms of assets for the year 1984. The three taxes were the IGF, real estate taxes and death taxes (calculated on an annualized basis).<sup>52</sup> For an individual with wealth totalling Fr 5 million, the combined tax rate would have been 1.6 percent on agricultural land, 1.23 percent on her residence and 0.77 percent on her securities holdings. For an individual with a fortune of Fr 50 million, the respective rates on each type of property were 3.43 percent, 3.06 percent and 2.60 percent. The element of progressivity present is due to the IGF and death taxes because the real estate taxes are at a flat rate. Thus, even though some have argued that the IGF was essentially another real estate tax, its significance is this added element of progressivity.

In another set of hypothetical calculations, the Council estimated the effect of capital taxes in 1984 on various size fortunes. Assuming that the distribution of assets was constant, the effective capital tax rate was 2.17 percent on a fortune of Fr 20 million and 2.69 percent on a fortune of Fr 50 million. Taking into account what is actually known

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<sup>49</sup> See *supra* note 45 and accompanying text. See also Babeau, LES CAHIERS FRANÇAIS, *supra* note 45; Babeau, PROBLÈMES ECONOMIQUES, *supra* note 40, at 23.

<sup>50</sup> *Huitième Rapport*, *supra* note 4, Table 136, at 124.

<sup>51</sup> See *id.* at 125.

<sup>52</sup> *Id.* at 196, 246; A. BABEAU, *supra* note 41, at 231.

about the asset composition of fortunes of these magnitudes, the rates were 2.08 percent and 2.58 percent, respectively.<sup>53</sup>

The same calculation was done without the IGF. The effective rates for the average asset distribution were 1.24 percent on a fortune of Fr 20 million and 1.48 percent on a fortune of Fr 50 million. For the actual asset distributions these rates were 1.17 percent and 1.39 percent. Thus the effective tax rates were cut almost in half by eliminating the IGF. What is perhaps more interesting is that the Council worked under the assumption that over the long run the gross return on capital assets is in the 3-3.5 percent range.<sup>54</sup> Thus a Fr 50 million fortune, which yielded 3 percent per annum, but was subject to an effective annual tax of 2.58 percent, was in effect being subjected to income tax at a rate of 86 percent. Without the IGF, however, where the tax rate was 1.39 percent, the effective income tax rate was reduced to 46 percent.

Thus, while one cannot point to changes in wealth distribution in France due to the existence of the IGF, the tax did have a substantial impact on the returns from capital. In fact, if one added to the capital taxes the effect of the income tax, the return on agricultural land was negative under the above assumptions. In addition, for those individuals with fortunes of Fr 50 million, the returns from rental property and securities were also rendered negative because of the existence of the IGF.<sup>55</sup>

The IGF was projected to generate revenue of Fr 5,000 million (\$1 million) per year.<sup>56</sup> The tax actually produced the following revenue: Fr 2,765 million in 1982,<sup>57</sup> Fr 2,876 million in 1983,<sup>58</sup> Fr 3,516 million in 1984, Fr 3,917 million in 1985,<sup>59</sup> and Fr 4,201 million in 1986.<sup>60</sup> Though large in absolute amounts, these figures were rather

<sup>53</sup> See HUITIÈME RAPPORT, *supra* note 4, at 293; A. BABEAU, *supra* note 41, at 233.

<sup>54</sup> See A. BABEAU, *supra* note 41, at 232.

<sup>55</sup> See HUITIÈME RAPPORT, *supra* note 4, Tables 220-21, at 201, 250 & Tables 274-75; A. BABEAU, *supra* note 41, at 238.

<sup>56</sup> See FINANCE COMMISSION REPORT, *supra* note 22, at 8.

<sup>57</sup> *But see L'Impôt sur les grandes fortunes Premiers résultats*, LES NOTES BLEUES, May 23-29, 1983, at 2 (1982 collections were Fr 3,756 million).

<sup>58</sup> In 1983, this was slightly more than 3 percent of the tax revenues on personal capital, which included: capital gains taxes, real estate taxes, transfer taxes, and motor vehicle taxes. See Babeau, *LE CAHIERS FRANÇAIS*, *supra* note 45, at 74-75.

<sup>59</sup> See HUITIÈME RAPPORT, *supra* note 4, Table 147, at 130.

<sup>60</sup> ASSEMBLÉE NATIONALE NO. 158, *supra* note 10, at 24. If the tax on bearer bonds is included, the figures of the Ministry of Finance show the following receipts (in millions of francs): Fr 3,756 in 1982, Fr 3,912 in 1983, Fr 4,768 in 1984, Fr 5,522 in 1985 and Fr 5,893 in 1986. See *Les statistiques de la Direction Générale des Impôts pour 1985 et 1986*, LES NOTES BLEUES, June 1988, at 10. The tax on bearer bonds produced revenues of Fr 991 million in 1982, Fr 1,040 million in 1983, Fr 1,251

small in terms of total French government revenues.<sup>61</sup> In 1984, for example, the IGF produced about 5 percent of the revenue from taxes on capital, which in turn represented only 12.4 percent of government tax receipts.<sup>62</sup> For a comparison, gift and inheritance taxes produced Fr 10 billion in revenue that same year.

A breakdown of taxpayers indicates that in 1982, 58,889 families (57.8 percent of filers) declared wealth of less than Fr 5 million. They paid an average of Fr 4,273 each and in total they contributed 8.7 percent of the total collections. Those taxpayers whose taxable wealth was under Fr 10 million constituted 89.8 percent of the filers and their total contribution was 36 percent of the total collections. The very wealthy, on the other hand, the 141 families (0.1% of the filers) whose declared wealth exceeded Fr 100 million, paid an average of Fr 2,708,511 each.

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million in 1984, Fr 1,596 million in 1985 and Fr 1,688 million in 1986. See ASSEMBLÉE NATIONALE NO. 158, *supra* note 10, at 34.

Bearer bonds are widely held in France. Their principal advantage is anonymity of ownership. If these bonds had to be included in an IGF declaration, that advantage would be lost. Therefore, the statute provided that bearer bonds could be excluded from the wealth tax return. If this option was selected, however, the owner had to pay a special tax of 1.5 percent (raised to 2% in 1984) of the face value of the bond when the annual interest was collected. See 1982 Finance Law, *supra* note 3, at art. 10. To the extent that the bondholder did not have net taxable wealth of Fr 3 million, this provision put him in the dilemma of either paying this new tax or surrendering his bearer bonds. In the parliamentary debate, it was pointed out that despite the government's statement that it was not trying to penalize bearer bonds, particularly since many of them were issued by government agencies, it needed some means of including them in the wealth tax. The effect, however, was to penalize bearer bonds not held by persons subject to the wealth tax. See FINANCE COMMISSION REPORT, *supra* note 22, at 59. As one might have expected, a "large proportion" of holders of bearer bonds "transformed" them into registered bonds. See I TIXIER, *supra* note 8, at 132-35.

Despite the significant decrease in the tax base for 1984 and 1985 due to the elimination of business property from the tax base, IGF revenues increased in those years. This anomaly needs some explanation. The answer is not increased taxpayer compliance or increased efficiency in collection, but rather that an 8 percent surtax, *majoration conjoncturelle*, was imposed in 1984. The revenue produced by this tax increased 42 percent between 1982 and 1985 mainly due to the 1984 8% surcharge and the introduction of a 2 percent top bracket in 1985. A. BABEAU, *supra* note 41, at 207.

The government claims the cost of collecting the tax was less than 1 percent of the yield. See Press Release, *supra* note 5. The Tax Council, however, estimated the cost of collection in 1984 at Fr 95 million, about 2.7 percent of the yield. See ASSEMBLÉE NATIONALE NO. 158, *supra* note 10, at 35. See also Lazare, *De l'impôt sur les Grandes Fortunes à l'Impôt de Solidarité sur la Fortune*, 146 REGARDS SUR L'ACTUALITÉ 34, 44 (1989) (criticizing the lack of information on the cost of administering the IGF).

<sup>61</sup> The Organization for Economic Cooperation and Development ("OECD") indicated that the revenue collected from the wealth tax represented 0.26 percent of the total tax revenue in 1985. ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, TAXATION OF NET WEALTH, CAPITAL TRANSFERS AND CAPITAL GAINS OF INDIVIDUALS 27 (1988).

<sup>62</sup> See A. BABEAU, *supra* note 41, at 195, 203 (citing HUITIÈME RAPPORT, *supra* note 4).

It is here that we begin to see the real bite of the IGF. Taxpayers with a net taxable wealth of at least \$20,000,000 were now paying an additional \$500,000 per year in taxes.<sup>63</sup>

For each tax year subsequent to 1982, the tax brackets were adjusted to reflect inflation.<sup>64</sup> Thus in 1983, the cut-off was increased to 3.2 million francs,<sup>65</sup> the 0.5 percent bracket became Fr 3.2 to 5.3 million, the 1 percent bracket was adjusted to Fr 5.3 to 10.6 million and the 1.5 percent bracket was increased to amounts in excess of Fr 10.6 million.<sup>66</sup>

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<sup>63</sup> In 1986 the government claimed that the richest 10 percent of French families paid 66 percent of the tax. See Press Release, *supra* note 5.

At the same time that the government introduced the net wealth tax, it also tightened up on death duties, partly by increasing their rates and partly by eliminating exemptions. For a summary description of French transfer taxes see 24 EUROPEAN TAXATION 224 (1984). Tax rates for large bequests to children were also increased considerably in 1984. For taxable bequests of a value between Fr 3.4 million and Fr 5.6 million, the tax increased from 20 percent to 30 percent. For bequests in the Fr 5.6 million to Fr 11.2 million range, the tax increased from 20 percent to 35 percent. And for the largest gifts, above Fr 11.2 million, the rate increased from 20 percent to 40 percent. See *id.* at 51 & Table 51; 1984 Finance Law, *supra* note 18, at art. 19-II. Similar increases were effected for gifts between spouses, which remain taxable in France. See *id.* at 51 & Table 52. The Finance Law of 1984 also eliminated business property from the wealth tax base—the two measures are probably related. TIXIER, *supra* note 8, at 19 (Supp. 1984). Factoring in death duties with the wealth tax indicates that for the richest families who left property valued in excess of Fr 20 million to two children, the wealth tax rate exceeded the nominal 2 percent and rose to 2.96 percent for those whose holdings were valued at Fr 500,000,000. HUITIÈME RAPPORT, *supra* note 4, at 136 & Table 162.

<sup>64</sup> See HUITIÈME RAPPORT, *supra* note 4, at 114 & Table 120. When the tax was first introduced, there were numerous proposals to index the exemption amount. These were all rejected by the government. 1981 J.O. 2698-703 (Oct. 28, 1981) (National Assembly Debates).

<sup>65</sup> This increase may not have been of much benefit. See TIXIER, *supra* note 8, at 28-29 (Supp. 1984). When the original wealth tax was repealed in 1986, the tax on bearer securities was left in place. See 1987 J.O. 1960 (Apr. 6, 1987) (National Assembly Debates).

<sup>66</sup> In 1984 the brackets again increased such that the minimum taxable wealth became Fr 3.4 million. The 0.5 percent bracket was between Fr 3.4 and 5.6 million, the 1 percent bracket was between Fr 5.6 and 11.2 million, and the 1.5 percent bracket was for taxable wealth above Fr 11.2 million. See 1984 Finance Law, *supra* note 18, at art. 19-VI. In addition, an 8 percent surtax on the amount owed was added in 1984. See *id.* at art. 2-VIII. See also INSTRUCTION DU 9 MAI 1984, *supra* note 18, at 9. The surtax continued in effect until the law was repealed. In 1985 there were brackets of Fr 3.5 to 5.8 million at the 0.5 percent rate, Fr 5.8 to 11.5 million at the 1 percent rate, Fr 11.5 to 20 million at the 1.5 percent rate and a new 2 percent rate for wealth above Fr 20 million. See INSTRUCTION DU 11 MARS 1985: IMPOT SUR LES GRANDES FORTUNES, LOI DE FINANCES POUR 1985, ARTICLE 26 (Bulletin Officiel de la Direction Générale des Impôts No. 7 R-1-85). The new 2 percent rate was added to "appease Communist party critics" and the proceeds were supposed to be earmarked for unemployed persons over 50 years of age. Boston Globe, Oct. 21, 1984, at A9. In 1986 the cutoff was increased to Fr 3.6 million, the 0.5 percent bracket became Fr 3.6 to 6 million, the 1 percent rate applied to Fr 6 to 11.9 million, the 1.5 percent bracket became Fr 11.9 to 20.6 million and the 2 percent rate applied to wealth above Fr 20.6 million. See IN-

The result of this constant increase was that by 1985 the group occupying the lowest bracket, below Fr 5 million, constituted 46 percent of the filers, but produced only 4.3 percent of the total collections. Those in the top bracket in 1985 constituted only 0.2 percent of the filers and their contribution was almost 20 percent of total revenue, with each family paying an average of Fr 4,774,826.<sup>67</sup> This latter figure perhaps explains why for 567 families, their income tax plus their wealth tax exceeded 100% of their revenues.<sup>68</sup> This, of course, is precisely the group at whom a wealth tax is aimed — those whose revenues are low such that their income tax burden is relatively light, yet who have at their command capital resources which generally escape the tax net.<sup>69</sup>

Another purpose of the wealth tax was to function as a cross-check on the income tax.<sup>70</sup> Thus, available data indicating such cross-checks is of interest. It is somewhat surprising to find that 28.8 percent in 1982, and 31.1 percent in 1984, of wealth tax filers, i.e. people with a declared net worth of at least \$500,000, reported taxable incomes of between Fr 100,000 and Fr 200,000 (\$16,700 to \$33,000). In fact, 62.4 percent in 1982 and 66.2 percent in 1984 of wealth tax filers reported taxable income of less than Fr 300,000 (\$50,000).<sup>71</sup> On the other hand, the 118 families that reported wealth holdings in excess of Fr 100 million each reported an average income for income tax purposes of Fr 17,790,400.<sup>72</sup>

#### 4. BUSINESS PROPERTY

##### 4.1.

As originally enacted, the IGF exempted Fr 2 million of business

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STRUCTION DU 29 JANVIER 1986: IMPÔT SUR LES GRANDES FORTUNES (Bulletin Officiel de la Direction Générale des Impôts No. 7 R-2-86). See also HUITIÈME RAPPORT, *supra* note 4, Table 117, at 113. These bracket changes were roughly correlated to the average annual increase in the consumer price index.

<sup>67</sup> See HUITIÈME RAPPORT, *supra* note 4, at Table 151, at 132.

<sup>68</sup> See HUITIÈME RAPPORT, *supra* note 4, at 135 & Table 160-61. This select group largely consisted of those who declared income of less than Fr 100,000 yet who were subject to the wealth tax. *Id.* at Table 161.

<sup>69</sup> The tax returns also give an insight into the demographics of wealth distribution in France. The figures indicate that thirty percent of the families that filed returns were over 75 years of age, whereas this group made up about 10 percent of total French taxpayers. See HUITIÈME RAPPORT *supra* note 4, at 121 & Table 130. In fact, the average filer was over 65 years of age! For taxpayers in general, the median age was 40 to 49. *Id.*

<sup>70</sup> See Press Release, *supra* note 5.

<sup>71</sup> See HUITIÈME RAPPORT, *supra* note 4, at 127 & Table 140.

<sup>72</sup> See HUITIÈME RAPPORT, *supra* note 4, Table 142, at 127.



property, *biens professionnel*, from the tax base.<sup>73</sup> Thus the major method of minimizing the wealth tax was, and is,<sup>74</sup> to have property classified as "business property." The elaboration of the term "business property" is quite complicated, as it is a concept unique to the wealth tax and thus the draftsmen could not incorporate by reference existing jurisprudence from other parts of the tax law or the Civil Code.

#### 4.1.1. *Property Necessary for Principal Occupation*

The attempt to define "business property" began with article 4 of the IGF, which declared that "these are business property" followed by seven numbered subparagraphs of rather general descriptions.<sup>75</sup> The first and broadest category was property necessary for the practice of the principal occupation of the owner and his spouse, *concubin*. Four conditions were required for property to be considered "business property." The first condition was that the occupation could be classified as an industrial, commercial, artisanal or agricultural activity, or a liberal profession.<sup>76</sup> An occupation or a business activity is practiced in order to provide one a livelihood.<sup>77</sup> In determining the character of an activity, the authorities indicated that they would take into account, among other factors, education, membership in professional organizations, the usual characterization of the activity, and the existence of a clientele.<sup>78</sup>

In addition to the nature of the activity itself, the second condition requires that business property be used in a business actively managed by the owner of the business property or the owner's spouse.<sup>79</sup> This

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<sup>73</sup> In 1984 business property was totally exempted from the tax base. See 1984 Finance Law, *supra* note 18, at art. 19-VI. Among the reasons given for the exemption was that it was difficult to clearly define business property. The effect of the exemption is clear, when one appreciates that this type of property represented 16.8 percent of the tax base in 1982 and 15.1 percent in 1983. For the 97 percent of taxpayers whose reportable wealth was below Fr 30 million, business property ranged from 20 to 30 percent of their reportable wealth in 1982 and 1983. About 60 percent of this business property was in shares of closely-held companies.

<sup>74</sup> The definition of business property was extensively revised and embellished when the wealth tax was reinstated. See INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at paras. 40-136. See also *infra* notes 141-153 for a discussion of business property under the new IGF.

<sup>75</sup> See 1982 Finance Law, *supra* note 3, at art. 4.

<sup>76</sup> Salaried individuals could, however, include as business property items which were required by law to practice that occupation. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 70, at 41.

<sup>77</sup> This definition of occupation is presumably in contrast to an avocation. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 172, at 41. See also INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at para. 44; INSTRUCTION DU 11 MAI 1982, *supra* note 4, at 38.

<sup>78</sup> See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 173, at 42.

<sup>79</sup> See INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at para. 45; COMPLÉ-

requirement was designed to exclude from the definition of "business property" property that is rented out to others.<sup>80</sup> The exclusion seems to be aimed primarily at real estate because the renting of property such as boats, automobiles and televisions is considered a commercial enterprise and therefore such property is still classified as "business property."

The major exception is for real estate rented by a taxpayer to his own company, which the taxpayer manages as his principal occupation and which is necessary for the taxpayer's work. Thus, for example, if X rents a building to a company in which he holds 40 percent of the capital and his wife holds 15 percent of the capital and X manages the company as an occupation, then 55 percent of the building's value is "business property."<sup>81</sup>

On the other hand, suppose three shareholders, each owning one-third of the shares of a company, lease 3 different properties to their company. Shareholder A leases a building with a value of Fr 1 million; Shareholder B leases a building with a value of Fr 10 million, and Shareholder C leases a building with a value of Fr 4 million. The formula for deciding how much of the real estate is "business property" is the total value of the real estate leased by its owner multiplied by the proportion of the firm's capital owned by the taxpayer. Thus for A, one-third of Fr 15 million yields a figure of Fr 5 million. Since his real estate leased to the firm has a value of Fr 1 million, the entire Fr 1 million worth of real estate is considered business property. However for B, only Fr 5 million of the leased property is considered "business property."<sup>82</sup>

The third condition in the broad definition of "business property" is that the property be part of the principal business activity of the taxpayer. Although not normally presenting a problem, the regulations issued by the tax authorities attempt to distinguish between a taxpayer's business activities and a taxpayer's management of personal property.<sup>83</sup> For this reason the regulations try to distinguish between a primary occupation and other activities on the basis of their economic

MENTS DÉTAILLÉS, *supra* note 4, at para. 178 at 43.

<sup>80</sup> For a discussion of leasing see 1981 J.O. 3122 (Nov. 26, 1981) (Senate Debates). See also INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at para. 44; COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 174, at 42; I TIXIER, *supra* note 8, at 100.

<sup>81</sup> See INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at para. 51; COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 182, at 44.

<sup>82</sup> COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 184, at 44-45.

<sup>83</sup> See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 194, at 46. See also FINANCE COMMISSION REPORT, *supra* note 22, at 25-26.

importance.<sup>84</sup> Yet the definition must account for the possibility that a full time physician or lawyer may still have rents or capital gains as the principal source of income. Moreover, because the taxable unit is the family and the husband and wife may have separate professions, the issue arises whether the taxable unit is limited to the property used in one principal occupation.<sup>85</sup> And what about one item of property that is used by the taxpayer in two different business activities?<sup>86</sup>

While the idea of separating business and personal activities is simple enough and is fundamental to most tax systems, the phrasing of the statute — principal occupation, *titre principal*, — compelled the authorities to distinguish between primary and secondary business activities.<sup>87</sup>

To highlight the arbitrariness of the system, one commentator proposed the example of a certified public accountant (“CPA”) who also offered computer services to the public. In terms of assets, goodwill (value of the client base) was estimated at Fr 500,000. This value was equally divided between the CPA practice, *activité libérale*, and the sales of computer services, *activité commerciale*. Other assets required for the CPA practice had a value of Fr 100,000, but computer assets had a value of Fr 1,000,000. If his principal occupation is considered a CPA, then “business property” is Fr 350,000. However, if his principal occupation is the computer business, then “business property” is Fr 1,250,000. Furthermore, if his wife joined him in his enterprise, either as an accountant or as the provider of computer services, then the total business property would be Fr 1,600,000.<sup>88</sup>

The fourth condition in the statute for categorization as “business property” is that the property be *essential* for the conduct of the business.<sup>89</sup> The legislature believed that existing law was not sufficient to

<sup>84</sup> Legislative history indicates that the definition of a taxpayer’s principal activity would be determined by considering a number of factors including: sources of income, time spent on each activity, and classification for social security purposes. See 1981 J.O. 2776 (Oct. 29, 1981) (National Assembly Debates); FINANCE COMMISSION REPORT, *supra* note 22, at 26.

<sup>85</sup> See COMPLÈMENTS DÉTAILLÉS, *supra* note 4, para. 192, at 46.

<sup>86</sup> See *id.* para. 193, at 46.

<sup>87</sup> In response to a proposal in the National Assembly to amend the statute to cover *all* business activities, the administration said that such a proposal would open the door to evasion of the tax by those subject to it. Such tax evasion could be accomplished when individuals organize their personal activities into many separate business enterprises. See 1981 J.O. 2774 (Oct. 29, 1981) (National Assembly Debates); FINANCE COMMISSION REPORT, *supra* note 22, at 30.

<sup>88</sup> See I TIXIER, *supra* note 8, at 95-96.

<sup>89</sup> One commentator has suggested that this “essentiality” requirement would solve the problem of taxpayer’s attempting to classify assets used in their personal affairs as business assets, thus obviating the need to decide which activity was one’s principal occupation. See I TIXIER, *supra* note 8, at 96.

prevent a taxpayer from including his home or vacation home within the category of "business assets." Therefore the "necessity" test was added.<sup>90</sup> One method to address this issue would have been to borrow from article 93 of the Income Tax Code, which uses the word "*af-fectes*" to distinguish between various business and non-business sources of income.<sup>91</sup> During the debates in the French Senate, the Budget Minister indicated that the reason for choosing "necessity" was that this term creates a more direct line between the occupation and the property, whereas the term "*affectation*" had been interpreted to permit companies to deduct yachts and vacation facilities as legitimate business expenses. The Minister did not want to see this interpretation applied to the IGF.<sup>92</sup> The government's understanding was that the law had been interpreted to require that if the business is one that normally produces a balance sheet, then that property appearing on the balance sheet was considered "business property." Under the "necessity" test, however, appearance on the balance sheet would operate as a *presumption* that the identified item is "business property."<sup>93</sup> Nevertheless, the regulations note that the jurisprudence of the *Conseil d'Etat* recognize that a businessman need not include all property he owns on his balance sheet.

Other assets, by their very nature, are presumed to be "business property."<sup>94</sup> This group includes factories, working farms, patents and other industrial property rights and inventory.<sup>95</sup> In addition, the tax authorities sought to include the value of doctors' and lawyers' client base.<sup>96</sup>

#### 4.1.2. Cash and Cash Equivalents

Liquid assets are considered "business property" only to the extent of "the normal needs" of the enterprise. This is because these assets can

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See also Rothschild, *Des PME pas comme les autres*, Le Monde, Dec. 29, 1981, at 24.

<sup>90</sup> See P. COURTOIS, *supra* note 8, at 87.

<sup>91</sup> See FINANCE COMMISSION REPORT, *supra* note 22, at 41.

<sup>92</sup> See 1981 J.O. 3122 (Nov. 26, 1981) (Senate Debates).

<sup>93</sup> See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 197, at 47. One commentator believes that the "necessity" requirement in the statute represents an abandonment of the theory of inclusion on the balance sheet. See P. COURTOIS, *supra* note 8, at 88.

<sup>94</sup> For a discussion of shares of stock, see 1981 J.O. 3127 (Nov. 26, 1981) (Senate Debates); 1981 J.O. 2789 (Oct. 31, 1981) (National Assembly Debates). See also P. COURTOIS, *supra* note 8, at 92.

<sup>95</sup> See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, paras. 203-07, at 48. Certain property is presumed to be non-business property, for example, real property which is rented out, yachts, vacation homes and expensive automobiles. *Id.* para. 209, at 49.

<sup>96</sup> *Id.* para. 226, at 51. See R. BLANCHER, *supra* note 8, at 74-75.

be the personal property of the proprietor. The regulations provide that current assets of an enterprise will be presumed business assets if current assets are less than current liabilities. If current assets exceed current liabilities, then the presumption will operate only to the extent of the value of the accounts receivable plus the difference between the current liabilities minus the accounts receivable. The regulations provide the following example.<sup>97</sup> A balance sheet shows the following:

Current Assets

accounts receivable	=	Fr 1,000,000
notes receivable	=	Fr 200,000
term balances	=	Fr 100,000
current bank accounts balances	=	Fr 50,000
cash	=	Fr 20,000
		TOTAL Fr 1,370,000

Current Liabilities

accounts payable	=	Fr 1,100,000
Bank overdraft	=	Fr 150,000
		TOTAL Fr 1,250,000

The amount of business property for wealth tax purposes is the amount of accounts receivable, Fr 1 million, plus the difference between the current liabilities and the accounts receivable, Fr 1.25 million - Fr 1 million = Fr 250,000. Total business assets are thus Fr 1.25 million. In other words, only the amount of the cash assets which, together with the accounts receivable, equal the current liabilities are presumed to be business assets. The rest of the liquid assets must be established to be business assets on a case by case basis.<sup>98</sup>

#### 4.1.3. *Stock as Business Property*

Shares of stock received special treatment in the IGF statute. This is because of the belief that one of the primary problems that would be encountered in administering the tax was in distinguishing between

<sup>97</sup> COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 208, at 48.

<sup>98</sup> From a taxpayer's business assets, a taxpayer is permitted to deduct his business debts. Examples are debts related to the acquisition of fixed assets or to finance the acquisition of business property. In general, if the debt is listed as a liability on the company's balance sheet and the interest on the debt is deductible for income tax purposes, it will be presumed to be a business debt. See Judgment of Mar. 29, 1989, Cass. civ. com., Fr. 1989 Bulletin des arrêts de la Cour de cassation, chambres civiles commerciale et financière [Bull. Civ. IV] 71 (holding that current assets are not business property).

shares held by a taxpayer for portfolio investment and shares related to the taxpayer's occupation. Shares in closely-held companies were considered "business property" if the family owned at least 25 percent<sup>99</sup> of the capital *and* actively managed the company.<sup>100</sup> In calculating the percentage of stock owned by the company's manager, the shareholdings of a spouse, or *concubin*, ascendants, descendants, and siblings and the ascendants, descendants, and siblings of the spouse are attributed to the manager.<sup>101</sup> The regulations define the management function in general and for the classic corporation, identify the positions of president and/or managing director.<sup>102</sup> Moreover, just as in the case of the individual entrepreneur, the taxpayer's management position must be his principal occupation.<sup>103</sup> Also, the company must be pursuing an activity that can be categorized as industrial, commercial, artisanal, agricultural, or as a liberal profession.<sup>104</sup> Finally, in calculating the value of the shares once they meet the tests of "business property," the book value of the shares is not taken into account. Only the pro rata value of the property actually required for the business is considered "business property." Without this valuation rule, it would be too easy for closely-held companies to transfer property into the corporation and claim it was business property.<sup>105</sup>

In a summary example, the regulations show how to determine the

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<sup>99</sup> The 25 percent refers to voting power. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 253, at 56.

<sup>100</sup> See 1982 Finance Law, *supra* note 3, at art. 4. The 25 percent figure was derived from a similar exemption in the capital gains tax. See CODE GÉNÉRAL DES IMPÔTS, art. 160 (Fr.). The Constitutional Council held that the figure was not obviously unreasonable. See Judgment of Dec. 29, 1983, Con. const., Fr. (LEXIS, Prive library, Cass file).

<sup>101</sup> See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 250, at 55. These attribution rules cover a broader group than the taxpayer's immediate family which is the taxable entity. See *id.* paras. 250-51, at 55-56.

<sup>102</sup> *Id.* para. 258, at 56. See Judgment of May 10, 1988 Cass. civ. com., Fr., 1988 Bull. Civ. IV 110 (upholding the denial of business property classification for shares on the ground that the taxpayer did not exercise managerial functions); see Judgment of July 15, 1987, Cass. civ. com., Fr. (LEXIS, Prive library, Cass file) (expounding upon the managerial responsibilities a taxpayer may exercise to enable his shareholding to constitute business property).

<sup>103</sup> See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 263, at 57.

<sup>104</sup> See *id.* para. 270, at 58.

<sup>105</sup> See *id.* para. 271, at 58. The relevant regulations are extremely cautious to specify in some detail the extent to which real estate rented to third parties can be counted as business property. *Id.* para. 275, at 59. The regulations provide an example of rentals between affiliates. Company A owns 25% of F1 and 40% of F2. A rents Building I to F1 and Building J to F2. A reserves ¼ of Building J for housing for its president. For Company A, 25% of the fair market value of Building I is presumed to be business property and 30% of (40% x ¾) the fair market value of Building J is presumed to be business property. *Id.* para. 276, at 59.

extent to which a shareholding is "business property."<sup>106</sup> Suppose a company has the following assets and debts:

<u>Assets</u> (in millions of francs)		
business real estate	=	100
non-business real estate	=	5
inventory	=	28
liquid investments	=	14
accounts receivable	=	3
		3
TOTAL		150
 <u>Debts</u>		
short term liabilities to trade creditors	=	11
long term debts:		
current indebtedness to		
principals in firm	=	2
mortgages on business property	=	52
mortgages on non-business property	=	1
		1
TOTAL:		66

The calculations are as follows. The net asset value of the company is Fr 84 million. Of this total, the non-business property has a net value of Fr 4.5 million: Fr 5 million non-business real estate, less 1 million in non-business debt, plus the part of the liquid assets considered non-business.<sup>107</sup> For illustrative purposes, it is assumed that Fr 500,000 is the portion of liquid assets not necessary to the business. Thus, the value of the business property held by the company is Fr 84 million less Fr 4.5 million, or Fr 79.5 million. This is 94.6 percent of the net asset value of the company. The company has 100,000 shares outstanding. The taxpayer, the president of the company, owns 30,000 shares. Each share has a market value of Fr 600.<sup>108</sup> Thus the fair market value of the taxpayer's shares is Fr 18 million. The fraction of this value which is considered business property for IGF purposes is 94.6

<sup>106</sup> See *id.* para. 281, at 60-61.

<sup>107</sup> Recall that liquid assets are presumed to be business property to the extent that the short term debt of the enterprise (Fr 11 million plus Fr 2 million) exceeds the accounts receivable (Fr 3 million), or Fr 10 million. The remaining Fr 4 million of liquid assets must be examined to assure that they do not represent private capital. See *supra* text accompanying note 88.

<sup>108</sup> A footnote in the regulations indicates that this value, which is apparently not based on the book value of the company (Fr 795 per share), may be based on the market value for listed securities or on a detailed analysis for closely-held companies. For illustrative purposes this value is assumed. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 281, at 61.

percent of Fr 18 million, or Fr 17,028,000.<sup>109</sup>

For a taxpayer owning shares in multiple layers of companies, determining which holdings constitute "business property" is even more complicated. For example, consider a case where 51 percent of the shares of Parent Company A are owned by the taxpayer, and 20 percent of such shares are owned by each of the taxpayer's two sons, F and G. Parent Company A controls 90 percent of Company B and 80 percent of Company C. Son F directly owns 9 percent of the shares of Company B and 10 percent of the shares of Company C. Son G owns 9 percent of the shares of Company C directly. The taxpayer is the chief executive of Parent Company A, his son F is the manager of Parent Company A, president of Company B, and director-general of Company C. Son G is commercial director (but not administrator) of Parent Company A and president of Company C.

For the taxpayer, the shares of A are business property. For son F, the shares of Parent Company A, and Companies B and C are also business property. This is because with respect to Company A, F, together with his father and brother, retains 91 percent of the capital and exercises the functions of management. The same persons also retain 90.9 percent of the capital of Company B and 91.8 percent of the capital of Company C; F is respectively the president and director/general of those companies. Finally, all three companies are connected. With respect to G, his shares in Company C are considered business property because, together with his father and brother, he retains 91.8 percent of the capital and he is also the president of Company C.<sup>110</sup>

The classification of shares as business property benefits entrepreneurs, particularly the owner-managers of closely-held businesses. The largest economically important group not covered by these provisions is executives of large companies whose shareholdings may be quite valuable, but which do not add up to 25 percent of the total voting power. Thus business executives were hit much harder by the tax than entrepreneurs.

#### 4.2. *Deduction for Net Investment*

Article 7 of the statute creating the IGF provided a deduction from the total of business property for net investment in business property for the taxable year.<sup>111</sup> That is, investment in excess of total deprecia-

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<sup>109</sup> *Id.*

<sup>110</sup> *Id.* para. 290, at 62-63.

<sup>111</sup> See 1982 Finance Law, *supra* note 3, at art. 7. See also 1981 J.O. 2828 (Oct. 30, 1981) (National Assembly Debates).



tion. The deduction is limited to the increase in the net worth of the business for the taxable year. To the extent the deduction is not used in any one year because of these limitations, it may be carried over for up to four years. This provision required extensive elaboration in the regulations.<sup>112</sup>

First, the investment had to be in depreciable business property. The term investment was defined as including property purchased for valuable consideration and excluded property received as a gift.<sup>113</sup> Second, because the deduction was for net investment, there were specifications for the calculation of the "disinvestment" amount for the relevant year. Disinvestment, generally, is property taken out of service. The value of the net investment was the value for depreciation purposes, except in the case of automobiles where costs in excess of Fr 35,000 could not be depreciated.<sup>114</sup> Next, the total amount of depreciation allowances for the relevant year and the increase in the net worth of the enterprise had to be calculated. Even "net worth," *capitaux propres*, was defined for purposes of the tax.<sup>115</sup> For enterprises that prepare a financial statement, "net worth" consisted of the par value of securities issued by the enterprise, plus specified types of reserves.<sup>116</sup> A shareholder's deduction was in proportion to his shareholdings in the enterprise.<sup>117</sup>

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<sup>112</sup> 1982 Finance Law, *supra* note 3, at art. 7.

<sup>113</sup> See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, paras. 451, 453, at 87.

<sup>114</sup> *Id.* paras. 464, 466, at 88.

<sup>115</sup> See 1981 J.O. 2826 (Oct. 30, 1981) (National Assembly Debates).

<sup>116</sup> A separate provision had to be made for enterprises that had a deficit year. This was apparently in response to a request from the C.N.P.F. See P. COURTOIS, *supra* note 8, at 220. See also 1981 J.O. 2821 (Oct. 31, 1981) (National Assembly Debates).

The regulations provided the following illustration of the calculations involved. Suppose that during the calendar year 1981 an enterprise had a net loss of Fr 1,000. Its balance sheet as of December 31, 1981 showed capital of Fr 10,000, reserves of Fr 2000, "provisions for eventualities diverses" (contingencies) of Fr 500, and retained earnings of Fr 200, for a total of Fr 12,700. On December 31, 1982 the accounts showed capital of Fr 11,500, reserves of Fr 2,000, "provisions for eventualities diverses" of Fr 630, and retained earnings of Fr -800, for a total of Fr 13,330. Subtracting the total at the beginning of the year, Fr 12,700, from the total at the end of the year, Fr 13,300, gives a change in the value of the net worth of the enterprise of Fr 630. The 1981 deficit of Fr 1000 must now be reduced by the amount of any depreciation not recognized by the tax law, assume Fr 100, and the increase in the "provision for eventualities diverses" of Fr 130. For purposes of the present calculation, the deficit is therefore adjusted to Fr 770. The increase in the net worth of the enterprise is 630 770, or Fr 1,400. If 1981 had resulted not in a loss but a net profit of Fr 900, the increase would have been Fr 2,530. The year-end figure for retained earnings would have been Fr 1100 rather than Fr -800. This would have given a total net worth of the end of 1982 of Fr 15,230. COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 516, at 94-95.

<sup>117</sup> COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 534, at 98.

To illustrate the entire calculation process for this deduction, take the case of Mr. X who is in the auto repair business.<sup>118</sup> In 1981, Mr. X made the following investments. He acquired a parcel of undeveloped land on January 15 for Fr 600,000. On the site, he constructed an office and garage at a cost of Fr 1.2 million. The work was completed on September 30 and had an estimated life of 20 years. Mr. X also built a facility for disposing of waste oil at a cost of Fr 250,000. This installation was completed on May 1 and had an estimated life of 15 years. He purchased, on August 14, a truck for Fr 200,000 and on October 1, an automobile for Fr 80,000. Each vehicle had an estimated life of 5 years. Finally, on March 16, he purchased a used computer for Fr 150,000 with an estimated life of six years.

During the same period, Mr. X disposed of the following investments. On June 30, he sold a truck for Fr 60,000, which he had purchased on July 1, 1979 for Fr 120,000. On September 30, he sold a building, which had been used as his office, for Fr 1.25 million. He had purchased the building on March 30, 1968 for Fr 500,000. The rate of depreciation used for the building was 4 percent. On December 31, he sold a piece of business equipment for Fr 20,000, which he had purchased for Fr 60,000 on January 1, 1979. The normal life of such equipment is ten years. In calculating the deduction for net investment, the purchase of the land is disregarded since it is not depreciable property. All other investments are calculated after reducing their cost for the amount of the value-added tax paid. Although the tax rate is 17.6 percent, to calculate the after-tax value the figure generally in use is 85 percent of the total price.<sup>119</sup> So the net investment for the new building is Fr 1.2 million multiplied by .85, or Fr 1.02 million. Using similar calculations, the investment in the oil disposal equipment is Fr 212,500 and the investment in the truck is Fr 170,000. Automobiles are only depreciable up to Fr 35,000 in value. There is no value-added tax on the purchase of used equipment, so the used computer is accounted for at Fr 150,000. Thus, the total of depreciable investments made by Mr. X in 1981 is Fr 1,587,500.

In calculating "disinvestment," that is, depreciable property disposed of during the year, the taxpayer reduces his sales proceeds by the amount of taxes paid on the sale. The taxpayer has a choice of two methods. The first, *déduction forfaitaire*, might be called the short-cut method. It involves simply reducing the sales proceeds by 25 percent. The other method, *l'impôt effectif*, takes into account the actual

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<sup>118</sup> See P. COURTOIS, *supra* note 8, Annexe III, at 277-82 for the example.

<sup>119</sup> See P. COURTOIS, *supra* note 8, at 278 & n.1.

amounts of depreciation and the actual capital gains tax paid. For purposes of the illustration, the short-cut method is used. The net sales proceeds are Fr 1.33 million; 25 percent of this sum is Fr 332,500. In addition, the taxpayer gets to deduct the amount of value-added tax *reverse* (reimbursed), which applies only in the case of the truck he sold, and amounts to Fr 7,500. The net value of the disinvestment is Fr 990,300 (Fr 1.33 million - Fr 332,500 - Fr 7,200). Thus, the net investment for 1981 is Fr 597,200 (Fr 1,587,500 - Fr 990,300).

The taxpayer must now calculate the depreciation allowances taken in 1981 on the new investment. The building had a net investment cost of Fr 1,020,000 and is depreciated at an annual rate of 5 percent (20 year estimated life). The building was in service beginning October 16, 1981, which is 75/360 of the year. This yields a depreciation figure of Fr 10,625 ( $1,020,000 \times 5\% \times 75/360$ ). The depreciation for the oil disposal facility is Fr 23,588 ( $Fr\ 212,500 \times 6.66\% \times 2.5^{120} \times 8/12$ ). The depreciation for the truck is Fr 28,333 ( $Fr\ 170,000 \times 20\% \times 2^{121} \times 5/12$ ); for the automobile it is Fr 1,750 ( $Fr\ 35,000 \times 20\% \times 90/360$ ); and for the computer it is Fr 19,784 ( $Fr\ 150,000 \times 16.66\% \times 285/360$ ). The total of depreciation taken in 1981 on the 1981 investments is Fr 84,080. Add this to the existing depreciation deductions (for pre-1981 property), assumed to be Fr 397,444, and the total is Fr 481,524. So the investment in depreciable property acquired in 1981 exceeds total depreciation deductions by Fr 115,676 (597,200 minus 481,524 = 115,676). Mr. X will get this amount as a deduction *if* the net worth of his enterprise increased during 1981 by at least this amount.<sup>122</sup>

To calculate the increase in the enterprise's net worth in the preceding year, it must initially be determined whether the form of the business is a corporation or an individual proprietorship. If it is a corporation, then the comparison is between the balance sheet accounts for capital and various forms of reserves at the beginning and end of the year. Eliminated from this calculation is only the "legal reevaluation" account, *écarts de réévaluation*, which is an increase in earned surplus for unrealized capital gains. For the unincorporated enterprise comparison of actual assets and liabilities at the beginning of the year and the end of the year must be made.<sup>123</sup>

<sup>120</sup> The depreciation method used is the fixed percentage of the declining balance method.

<sup>121</sup> The depreciation method used is the fixed percentage of the declining balance method.

<sup>122</sup> See P. COURTOIS, *supra* note 8, at 277-82.

<sup>123</sup> See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 528, at 96-97. For new investments made outside of France, a separate calculation must be made for each

### 4.3. Foreign Trusts Whose Beneficiaries Reside in France

A problem arose with regard to United States citizens who permanently resided in France and who were beneficiaries of trusts established in the United States.<sup>124</sup> The cause of the problem is that there is no institution similar to the trust in French law.<sup>125</sup> Thus, it was neces-

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country. That is, the amount of investment, disinvestment, depreciation and increase in net worth must be calculated on a country by country basis. See *id.* paras. 588-94, at 113-14.

<sup>124</sup> These issues were not covered in the U.S.-France Tax Treaty of July 28, 1967. See Income Tax Treaty Between France and the United States, July 28, 1967, United States-France, 19 U.S.T. 5280, T.I.A.S. No. 6518, amended by, Protocol of Oct. 12, 1970, 23 U.S.T. 20, T.I.A.S. No. 7270, Protocol of Nov. 24, 1978, 30 U.S.T. 5109, T.I.A.S. No. 9500, Protocol of Jan. 17, 1984, U.S.T. —, T.I.A.S. No. —, and Protocol of June 18, 1988, U.S.T. —, T.I.A.S. No. — [hereinafter U.S.-France Tax Treaty]. The attitude of the French authorities toward the IGF and the various tax treaties that France has entered into with other states has shifted periodically. Originally the government considered the IGF not covered by the treaties. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 44, at 17. However, critics pointed out that in about 20 of these bilateral agreements the other party specifically mentioned wealth taxes. Moreover, the claim that the treaties did not apply to the IGF meant that the determination of domicile for income tax purposes was under the treaty, but for IGF purposes this determination was governed by French domestic law. The Administration then reconsidered its position and announced in the Senate on January 27, 1983 that it would apply the treaty rules on domicile to the IGF. 1983 J.O. 111 (Jan. 20, 1983) (Senate Debates). Finally, in a case dealing with the rights of an Austrian national under the French-Austrian Tax Treaty of October 8, 1959, the court decided that to tax the Austrian domiciliary on shares held in French corporations under the IGF would amount to double taxation under the treaty because Austria had a wealth tax. Judgment of Jan. 17, 1985, Trib. gr. inst., Fr. As a result of this case, the Administration revised its view on the application of the treaties. See INSTRUCTION DU 21 NOVEMBRE 1985, No. 172 (Bulletin Officiel de la Direction Générale des Impôts No. 7 R-4-85).

The U.S.-France Treaty was amended on January 17, 1984 to cover the IGF. See U.S.-France Treaty, *supra*, at Protocol of Jan. 17, 1984, U.S.T. —, T.I.A.S. No. —. See also 1981 J.O. 1552, 1556 (Nov. 24, 1988) (Senate Debates); INSTRUCTION DU 21 JANVIER 1987, No. 10 (Bulletin Officiel de la Direction Générale des Impôts No. 14 B-1-87). As to treaties with countries other than the United States, see INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at paras. 14-28. There were approximately 26,000 United States citizens in France in 1988. See Document no. 480, Assemblée Nationale, 1988-1989, p. 5.

<sup>125</sup> The idea of the "trust" is unknown in French law. NOTE DU 25 MARS 1981, No. 59 (Bulletin Officiel de la Direction Générale des Impôts No. 14 B-2-81) (explains the July 28, 1967 Convention to Prevent Double Taxation between the United States and France). Thus it is not true that "the English trust has everywhere planted itself like a cuckoo in the nest of the civil law." Amos, *The Common Law and the Civil Law in the British Commonwealth of Nations*, 50 HARV. L. REV. 1249, 1263-64 (1937). And the Roman law institution of the *fiducia* "is virtually absent from France." A. DYER & H. VAN LOON, REPORT ON TRUSTS AND ANALOGOUS INSTITUTIONS, ACTS AND DOCUMENTS 37 (1982) (Hague Conference on Private International Law Pre. Doc. No. 1). The *fidescmissio* was prohibited in the French Civil Code of 1804. *Id.* at 39. This is not to say that the concept of the trust is entirely unknown to French law. Article 120 of the Tax Code includes in its definition of income "[t]he fruits of 'trusts' whatever be the substance of the property included in the trusts."

sary to resolve whether these residents were subject to the wealth tax on the trust property, and if so, in what way.

Article 3 of the IGF applied the tax property "belonging to," *appartenant*, residents.<sup>126</sup> Moreover, the regulations provided that those who held life estates, *usufruitiers*, or the lesser rights of use and occupancy were liable for the tax on the full value of the underlying property.<sup>127</sup> Needless to say, trust beneficiaries were not anxious to include on their wealth tax returns the full value of the trust corpus to which they may have had very little claim. To extricate themselves from the tax, the attorneys of the trust beneficiaries made the following argument.

The term "*appartenant*"<sup>128</sup> in the statute seems to encompass "ownership," *propriété*, within the meaning of article 543 of the Civil Code,<sup>129</sup> or "possession" as defined by article 2228 of the Civil Code.<sup>130</sup> According to article 544, ownership is the right to enjoy and to have the property without restriction.<sup>131</sup> This definition did not apply to the typical beneficiary of a trust. Furthermore, according to the treatise writers, "possession," within the meaning of article 2228, has two parts: (1) the fact of having the goods within your power so as to be able to use and change them; and (2) the mental state of considering oneself the

CODE GÉNÉRAL DES IMPÔTS art. 120(9) (Fr.). This provision has been part of French law since 1937 and was added to the Code in 1948. See Jeantot & LeGall, *L'application de l'impôt sur les grandes fortunes à certains trusts anglo-saxons*, J.C.P. (C & I) No. 49, ¶13896, at 569 (1982).

Article 2 of the Hague Convention on the Law Applicable to Trusts and On Their Recognition provides in part:

For purposes of this convention, the term 'trust' refers to the legal relationship created — *inter vivos* or on death — by a person, the settlor, when assets have been placed under the control of a trustee for the benefit of a beneficiary or for a specified purpose.

A trust has the following characteristics —

- a. the assets constitute a separate fund and are not a part of the trustee's own estate;
- b. title to the trust assets stands in the name of the trustee or in the name of another person on behalf of the trustee;
- c. the trustee has the power and the duty, in respect of which he is accountable, to manage, employ or dispose of the assets in accordance with the terms of the trust and the special duties imposed upon him by law.

<sup>126</sup> 1982 Finance Law, *supra* note 3, at art. 3.

<sup>127</sup> COMPLÉMENTS DÉTAILLÉS, *supra* note 4, para. 110, at 31.

<sup>128</sup> When the issue arose in 1970 with regard to the gift tax, the government decided that under the theory of "apparent ownership" the trustee was to be considered the owner of a trust. See Response of Minister Mouron, Oct. 8, 1970, *reprinted in*, J.C.P. 1971, II, 10083, cited in Jeantot & LeGall, *supra* note 125, at 570, 572.

<sup>129</sup> C. Civ. art. 543.

<sup>130</sup> C. Civ. art. 2228.

<sup>131</sup> C. Civ. art. 544.

owner of the property. Both elements must be present at the same time for "possession" to exist in this context.<sup>132</sup> For example, although a lessee may have use of property, she would not be considered the owner of such property. Likewise, a thief would not be the owner of stolen property.

In an irrevocable trust, who has the possession of the trust assets? In a simple trust, the beneficiary has the right to possess the revenues but not the corpus. In a discretionary trust, the beneficiary has neither of the elements of possession within the meaning of article 2228 of the Civil Code. If anyone has the right of possession it is the trustee.

Although the rights of resident trust beneficiaries seem inconsistent with ownership as defined in article 544 of the Civil Code and possession as defined in article 2228 of the Civil Code, such rights could be analogized to the rights of *usufruit*, *usage*, and *habitation*.<sup>133</sup> The right of *usufruit* is defined in section 578 of the Civil Code as the right to enjoy the property like the proprietor, except with a duty to preserve the corpus.<sup>134</sup> According to article 601, the person who has the right of *usufruit* has the obligation to actively manage the property, diligently and carefully, "as a good father should."<sup>135</sup> Even the beneficiary of a simple trust, who does have the right to the income of a property, does not fit within the definition of a *usufruit*. The beneficiary does not enjoy the benefits of the property in the same way as a proprietor because he does not and cannot manage the trust property. Therefore, the trust beneficiary does not have a right equivalent to that of *usufruit*.<sup>136</sup>

<sup>132</sup> 6 ENCYCLOPÉDIE DALLOZ (CIVIL), Possession, § 2, art. 1(15), art. 1 (17) (2d ed. 1990).

<sup>133</sup> See 1982 Finance Law, *supra* note 3, at art. 5-III. The right of *usufruit* is defined in article 578 of the Civil Code. C. Civ. art. 578. The right is similar to a life estate. The underlying fee interest is the *nue-propriété*. According to the regulations, the IGF seeks to levy the tax on the person with the taxable capacity; in the case where the ownership is split that capacity is in the hands of the owner of the present interest, since he or she receives the income from the property. Moreover, without a specific provision, it was believed that the tax could be easily evaded by dividing up property interests and transferring the fee to one's next of kin. For these reasons, article 5 of the statute provides that the holder of the *usufruit* interest will include the full value of the property in his or her tax return. The statute contains a limited number of exceptions. The provision does not apply if the underlying fee is sold to a third party rather than retained by a member of the family or where the division of the property is the result of the application of another statute. See COMPLÉMENTS DÉTAILLÉS, *supra* note 4, paras. 113-18, at 32.

For an American view of the differences between a right of usufruct and a life estate, see, e.g., Estate of Panzeca, 543 N.E.2d 161 (Ill. App. 1989).

<sup>134</sup> C. Civ. art. 578.

<sup>135</sup> C. Civ. art. 601.

<sup>136</sup> The beneficiary of a trust can have his right to income extinguished in many ways. Thus, it distinguishes his case from that of the holder of the right of *usufruit*. See C. Civ. art. 617 (listing five ways a *usufruit* may be extinguished).

The rights of *usage* and *habitation* are somewhat less than the right of *usufruit*. The right of *usage* is limited to the needs of the holder's family and is mainly found in rural areas or with foresters. The right of *habitation* is the right to use a particular house.

In conclusion, advocates representing trust beneficiaries residing in France made the following recommendations. In the case of irrevocable trusts, where the trustee has discretion to distribute income or principal, the beneficiary would declare nothing on her wealth tax return relative to the trust. An exception was made where the beneficiary received regular distributions of income from the trust for the immediately preceding five years. It was suggested that the average over the past five years be capitalized with the rate used for *rentes viagère*, with an abatement of 50 percent. In the case of a simple trust, where the income must be distributed, either of two methods were suggested as fair: (1) 75 percent of the value of the trust, or (2) capitalizing the five year average, as above, with a 25 percent abatement. And finally, in the case of grantor trusts, the grantor would be subject to the wealth tax because under the U.S.-France Tax Treaty of November 24, 1978<sup>137</sup> and the official explanation,<sup>138</sup> grantor trusts have no existence for tax purposes. Thus in the case of grantor trusts, it was recommended that the beneficiary not be required to include the trust on her IGF return.

## 5. THE NEW WEALTH TAX

The "Solidarity Tax on Wealth," *l'impôt de solidarité sur la fortune* (ISF),<sup>139</sup> came into effect on January 1, 1989. This reincarnation of the IGF imposes an annual tax on net wealth according to the fol-

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<sup>137</sup> See U.S.-France Tax Treaty, *supra* note 124.

<sup>138</sup> See NOTE DU 25 MARS 1981, No. 59, *supra* note 125.

<sup>139</sup> Loi No. 88-1149 du 23 Decembre 1988, De Finances pour 1989, 1988 J.O. 16, 320, 1989 D.S.L. 20, art. 26 [hereinafter 1988 Finance Law]. There was some discussion in the National Assembly on the style of the tax. The conservative opposition and the Communist group objected to the term "solidarity" on the ground that it was traditional to label tax laws so as to describe their content rather than the political motivation for their passage. See 1988 J.O. 1166 (Oct. 21, 1988) (National Assembly Debates). It was also alleged that there was legislation that prohibited earmarking of tax revenues for particular purposes. *Id.*

The proposal for restoration of the tax was adopted by the Council of Ministers on July 13, 1988. See Les centristes veulent 'tester' L'ouverture lors du débat sur l'impôt de solidarité. Le Monde, July 14, 1988, at 1, col. 3. The Commission on Finances of the National Assembly approved the proposal on September 21, 1988. See *Finances, économie Générale et Plan*, 1988 BULLETIN DES COMMISSIONS 325 (National Assembly). Regulations implementing the ISF were issued on April 28, 1989. INSTRUCTION DU 28 AVRIL 1989, *supra* note 4.

lowing schedule: (1) between Fr 4 million<sup>140</sup> and Fr 6.5 million (\$.645 - \$1 million) the rate is .5 percent; (2) between Fr 6.5 and Fr 12.9 million (\$1-\$2.15 million) the rate is 0.7 percent; (3) between Fr 12.9 million and Fr 20 million (\$2.15 - \$3.3 million) the rate is .9 percent; and (4) for assets above Fr 20 million (\$3.3 million) the rate is 1.1 percent.<sup>141</sup> This last bracket was probably added by the National Assembly<sup>142</sup> to placate "Socialist hard-liners"<sup>143</sup> disappointed with a rate schedule of half the rate of the old IGF.<sup>144</sup> Additionally, a 1.3 percent bracket for fortunes above Fr 40 million was added beginning in 1990.<sup>145</sup>

Unlike the IGF, the revenues generated by the new ISF are earmarked to fund a new minimum income, *revenue minimum d'insertion*,<sup>146</sup> for the poorest households.<sup>147</sup> As pointed out in the leg-

<sup>140</sup> 1988 Finance Law, *supra* note 139, at art. 26-II. The cut-off of Fr 4 million, as opposed to Fr 3.6 million for the IGF in 1986, is attributed to (a) the effect of inflation and (b) the fact that President Mitterand, in his election campaign, promised to restore the wealth tax in a way that would affect 100,000 families. The Fr 4 million cut-off brings about 110,000 families within the ambit of the tax. See ASSEMBLÉE NATIONALE NO. 158, *supra* note 10, at 108.

<sup>141</sup> 1988 Finance Law, *supra* note 139, at art. 26-VI. The rate schedule is in article 885 U of the Tax Code. CODE GÉNÉRAL DES IMPÔTS art. 885 U (Fr.).

<sup>142</sup> See ASSEMBLÉE NATIONALE NO. 158, *supra* note 10, at 154. See also 1988 J.O. 1231 (Oct. 21, 1988) (National Assembly Debates). This fourth bracket would supposedly generate an additional Fr 265 million (\$44.2 million) in revenue. It was estimated to affect about 1000 taxpayers. *Id.* at 1235. One argument in favor of this additional bracket was that the IGF had a bracket of 2 percent for fortunes above Fr 20 million. *Id.* at 1144. See *supra* note 66.

<sup>143</sup> "Some Socialists say in private that the tax . . . is a small price to pay to appease their left wing." *French Budget; Taxing Times*, ECONOMIST, Sept. 17, 1988, at 72.

President Mitterand favored a narrowly-based tax that was very progressive. The Socialist Party favored a much more broadly based tax. See Alimi, *Au Secours L'IGF Revient*, L'EXPANSION, June 16, 1988, at 244.

<sup>144</sup> Recall that the previous 1986 rates were .5, 1, 1.5 and 2 percent with a minimum of Fr 3.6 million (\$600,000). See *supra* note 66. According to the Finance Ministry, the reduced rates were for reasons of "economic efficiency" and to align the rate schedules with those of Denmark, Spain, Norway, Finland, the Netherlands and Sweden. See *International Taxes, French Parliament to Consider Wealth Tax Approved by Cabinet*, Daily Tax Rep. (BNA) at G-1 (July 29, 1988) [hereinafter *Int'l Taxes*]. The higher brackets are supposedly an inflation adjustment from the 1986 rate schedule. See ASSEMBLÉE NATIONALE, PROJET DE LOI RELATIF A L'IMPÔT DE SOLIDARITÉ SUR LA FORTUNE, NO. 147, (1988) at 2 [hereinafter PROJET DE LOI NO. 147].

<sup>145</sup> See *Projet De Loi De Finances Pour 1990*, 456 LES NOTES BLEUES 2 (1989). This new bracket is estimated to increase the yield on the tax by Fr 200 million. *Id.*

<sup>146</sup> See PROJET DE LOI NO. 147, *supra* note 144, at 2. In the legislative debates, the opposition pointed out that this was a bit misleading, as the minimum income was expected to cost Fr 9 billion and the ISF to generate only Fr 4 billion. See 1988 J.O. 1145 (Oct. 21, 1988) (National Assembly Debates). Since it was President Mitterand, in his "Letter to the French People," who suggested the earmarking, the opposition claimed that his arithmetical powers had been affected by his age. *Id.* at 1146. In response, the government's representatives indicated that for the first year, due to de-



islative debates, the yield of the tax in fact falls short of the amount necessary to fund the minimum income. The ISF is expected to raise Fr 4.1 billion per year (\$645 million)<sup>148</sup> from a tax base estimated at Fr 925 billion (\$152.2 billion).<sup>149</sup> The cost of the minimum income was Fr 6 billion in 1989 and is estimated at 8 billion for 1990.<sup>150</sup>

Different sources variously estimate that the current version of the wealth tax will affect 110,000 households (0.44 percent of French households),<sup>151</sup> 200,000 households,<sup>152</sup> or 400,000 households.<sup>153</sup> Seventy-four percent of the affected group is estimated to have wealth of between Fr 4 million and Fr 10 million (\$666,000 to \$1.7 million); 20 percent of the group is estimated to have wealth between Fr 10 and Fr 20 million (\$1.7 to \$3.4 million); and 5 percent of the group is estimated to have wealth between Fr 20 and Fr 50 million (\$3.4 to \$8.3 million). One percent of those affected are estimated to have taxable wealth above Fr 50 million.<sup>154</sup>

As under the previous law, business property is excluded from the tax base.<sup>155</sup> Business property has, however, been reclassified under the

lays in starting any new program, the budget for the minimum income provision was Fr 6 billion. The ISF was budgeted at Fr 4 billion and the revenue from the tax on bearer bonds, was projected at 2 billion. *Id.* at 1158.

<sup>147</sup> See Noblecourt, *Les paradoxes de la lutte contre la pauvreté*, Le Monde, July 16, 1988, at 1, col. 3. For a more elaborate description of the "new poor" whom the tax was designed to assist, see ASSEMBLÉE NATIONALE NO. 158, *supra* note 10, at 7-9.

The minimum income would provide benefits of Fr 2,000 (\$333) per month to a single person and Fr 3,000 to a couple, plus Fr 600 for each dependent. It is expected to benefit 500,000 people. See Alimi, *supra* note 143, at 244; Babeau, *LES CAHIERS FRANÇAIS*, *supra* note 45, at 76. Others estimate the plan will benefit up to 800,000 persons. See *The Desirable Face of Socialism*, *ECONOMIST*, May 14, 1988, at 45.

<sup>148</sup> PROJET DE LOI NO. 147, *supra* note 144, at 3.

<sup>149</sup> This estimate was broken down into 53 percent real property and 47 percent personal property. See *Projet de loi Relatif à l'impôt de solidarité sur la fortune*, *LES NOTES BLEUES*, Aug. 8-21, 1988, at 5. The tax base was estimated to be about 10 percent of privately held wealth. See Babeau, *LES CAHIERS FRANÇAIS*, *supra* note 45, at 76.

<sup>150</sup> PROJET DE LOI DE FINANCES pour 1990. There were an estimated 300,000 families receiving minimum income payments in 1989 and 370,000 in 1990. *Id.*

<sup>151</sup> See PROJET DE LOI NO. 147, *supra* note 144, at 2; *Int'l Taxes*, *supra* note 144, at G-1; *Projet de loi Relatif à l'impôt de solidarité sur la fortune*, *LES NOTES BLEUES*, Aug. 8-21, 1988, at 6.

<sup>152</sup> See Babeau, *LES CAHIERS FRANÇAIS*, *supra* note 45, at 76.

<sup>153</sup> See *The Desirable Face of Socialism*, *ECONOMIST*, May 14, 1988, at 45.

<sup>154</sup> *Projet de loi Relatif à l'impôt de solidarité sur la fortune*, *LES NOTES BLEUES*, Aug. 8-21, 1988, at 6.

<sup>155</sup> This means that the ISF is essentially a real estate tax. It was estimated that real estate would account for 47 percent of the total collections. See *Int'l Taxes*, *supra* note 144, at G-2. At one point, it was proposed in the National Assembly that one's personal residence be exempt for the first Fr 1.5 million of value. It was estimated that the exemption would cost Fr 600-800 million. 1988 J.O. 1175 (Oct. 21, 1988) (National Assembly Debates).

Another new feature of the ISF is that the value of listed securities can be deter-

new regulations into three parts: (1) property necessary for a sole proprietor to pursue an occupation that can be categorized as industrial, commercial, artisanal, agricultural, or as a liberal profession; (2) shares of companies of which the taxpayer is an owner and/or employee; and (3) special categories of property, mainly agricultural land.<sup>156</sup>

It is with regard to the shareholdings of closely-held corporations that most of the problems arose under the IGF.<sup>157</sup> The exemption for entrepreneur executives who own over 25 percent of the shares in their companies remains,<sup>158</sup> but the definition of the executive entrepreneur has been made more precise. In the IGF, the 25 percent shareholding had to be held by someone who actually exercised management functions.<sup>159</sup> This rather vague definition gave rise to problems in the drafting of the regulations and many parliamentary questions.<sup>160</sup> The responses to such questions tended to construe narrowly the definition of the covered categories of executive. On the other hand, in several court cases, the legislation was construed very broadly.<sup>161</sup> Thus, in the new statute, the draftsmen tried the alternative of enumerating the categories of executive, i.e. president, director-general. In addition, the IGF had indicated that in order for the shareholding to qualify as business property, the executive position had to be the taxpayer's principal occupation.<sup>162</sup> Again to add a bit more precision to this requirement, the new provision in the ISF requires that the taxpayer receive at least 50 percent of his earned taxable income as compensation for services to the company.<sup>163</sup>

As noted above, the executive must maintain a shareholding of at least 25 percent to obtain the benefit of the exemption for business

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mined by their value on the last trading day of the year, the system under the 1981 law, or at the average price for the 30 trading days preceding January 1. C. Civ. art. 88 T *bis*.

<sup>156</sup> INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at para. 41.

<sup>157</sup> See *supra* notes 99-110 and accompanying text.

<sup>158</sup> In the legislative debates, it was pointed out that there was a paradox in exempting these large shareholders from the tax, while including the shareholdings of those who owned less than 25 percent of the company. 1988 J.O. 1147 (Oct. 21, 1988) (National Assembly Debates).

<sup>159</sup> See *supra* notes 99-102 and accompanying text.

<sup>160</sup> ASSEMBLÉE NATIONALE No. 158, *supra* note 10, at 122.

<sup>161</sup> See, e.g., Cour Cass. Ch. Comm., 86-17.227 (1988); Cour Cass., Ch. Comm., 85-16.964 (1987).

<sup>162</sup> See *supra* note 103 and accompanying text.

<sup>163</sup> See C. Civ. art. 885 O *bis*, subsection 1. Under the IGF, whether the position one held in the enterprise whose shares were claimed to be business property was one's "principal occupation" was determined by several factors including the time spent at the enterprise and the importance of the taxpayer's responsibilities. The salary criterion has simplified the administration of the test. See P. COURTOIS, L'IMPÔT DE SOLIDARITÉ SUR LA FORTUNE 91 (1989) [hereinafter COURTOIS, ISF].

property.<sup>164</sup> This was found to be a major difficulty in large companies and for listed companies.<sup>165</sup> For this reason, an alternative criterion was adopted. If the shareholding does not attain the 25 percent level, it is exempt, if the stock represents at least 75 percent of the executive's gross assets subject to the ISF, *valeur brute de son patrimoine*.<sup>166</sup> Unlike the 25 percent rule in the IGF, however, there is no family attribution, except in the case of holdings by the taxpayer's spouse and minor children who, recall, constitute the taxable entity. Nor are indirect holdings attributed to the taxpayer for purposes of attaining the 75 percent threshold. Neither exemption, however, is of much help to the modern corporate executive, since a significant part of such executive's net worth may consist of her employer's stock (though not 75%) and such executive is unlikely to own a significant percentage of outstanding shares of the company. She will be heavily penalized by the tax.<sup>167</sup>

Finally, the National Assembly amended the government's proposal by adding an exemption of Fr 1 million for the shares of salaried employees participating in an employee buyout of the company.<sup>168</sup> In this case, the exemption did not depend either on the position of the employee or the percentage of the shares owned in the company. The regulations illustrate the operation of this exemption by taking the case of a salaried employee who purchases Fr 4 million of stock as part of an employee leveraged buyout. The employee borrows Fr 2 million to finance the purchase. Under the new statute, for purposes of calculating the tax, the gross value of the investment, Fr 4 million, is reduced by the new Fr 1 million exemption. The remaining amount of Fr 3 million is then reduced by the debt in the same proportion as the gross

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<sup>164</sup> The 25 percent figure was selected to separate portfolio investments from investments in one's "own" business (risk capital). See ASSEMBLÉE NATIONALE NO. 158, *supra* note 10, at 127. Under the IGF, the 25 percent requirement was measured by either voting rights or capital. This, however, left open the possibility of separating the two. That is, a holder of 15 percent of the capital might be given double voting rights, or 30 percent of the votes, thus coming within the 25 percent rule. Under the ISF, it was made clear that the 25 percent requirement meant 25 percent of the capital *and* 25 percent of the voting rights. *Id.* at 127. The ISF also codified the proposition that indirect holdings could count in measuring the 25 percent. This possibility created a field day for hypothetical illustrations. *Id.* at 129-36.

<sup>165</sup> *Id.* at 126.

<sup>166</sup> C. Civ. art. 885 O *bis*, subsection 2.

<sup>167</sup> See INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at 114. In the Senate debates, one Senator posed the hypothetical of an entrepreneur who had two sons — one his successor as director of the family enterprise and one who was mentally handicapped. The shares left to the able-bodied son would be exempt from the ISF tax base, while those left to the handicapped son would be included. See 1988 J.O. 1581 (Nov. 24, 1988) (Senate Debates).

<sup>168</sup> C. Civ. art. 885 O *bis*, subsection 2. The buyout had to take place under articles 220 *quater* and 220 *quater* A of the Civil Code. *Id.*

value of the shares bears to their value after the exemption, i.e. Fr 3 million/Fr 4 million or  $\frac{3}{4}$  times Fr 2 million = Fr 1.5 million.<sup>169</sup> So the tax base is then Fr 1.5 million. Note that this new provision, unlike the earlier exemptions, is not dependent on the position of the taxpayer in the firm, nor in the retention of a threshold percentage of shares.

Another new feature of the ISF is a ceiling, *système de plafonnement*, of 70 percent of taxable income for the combined income tax and ISF.<sup>170</sup> If this level is exceeded, the ISF is reduced.<sup>171</sup> The purpose was ostensibly to discourage taxpayers from "divesting capital to avoid payment."<sup>172</sup> A study of families who paid the IGF in 1984 indicated that almost half (42.5%) had annual incomes of less than Fr 300,000 (\$60,000). In fact, 1 percent of those with reportable fortunes of more than Fr 100 million had incomes of less than Fr 300,000 and more than 25 percent had incomes of less than Fr 400,000.<sup>173</sup> Forty-one percent of the taxpayers reporting a net wealth of between Fr 6.5 million and Fr 8 million had incomes of less than Fr 500,000.<sup>174</sup> And for 4.7 percent of the taxpaying families, income ranged from Fr 0 to Fr 100,000, even though they reported an average net worth of Fr 5 mil-

<sup>169</sup> See INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at 116.

<sup>170</sup> See Babeau, *LES CAHIERS FRANÇAIS*, *supra* note 45, at 76. The Government had originally proposed 80 percent. See ASSEMBLÉE NATIONALE NO. 158, *supra* note 10, at 184; 1988 J.O. 1235 (Oct. 21, 1988) (National Assembly Debates); Herzlich, *supra* note 139. The cost of the reduction was estimated at Fr 100 million. See 1988 J.O. 1235 (Oct. 21, 1988) (National Assembly Debates). According to the estimate of the Tax Council, this would have reduced the 1984 revenues by Fr 500 million. See Alimi, *supra* note 143, at 248.

Technically, the ceiling was on the wealth tax due in the current year plus the income tax for the preceding year. C. Civ. art. 885 Y. The tax base for the ISF is the family, therefore, it is the family's income tax that is taken into account in the calculation. Taxpayers will also receive a credit of Fr 1000 (\$166.60) for each dependent. This is the equivalent of a Fr 200,000 exemption. See COURTOIS, *ISF*, *supra* note 163, at 172; *Int'l Taxes*, *supra* note 144, at G-2.

<sup>171</sup> See INSTRUCTION DU 28 AVRIL 1989, *supra* note 4, at para. 174. The government provided the following example of how the limitation would work. A taxpayer with a net taxable wealth of Fr 30 million would normally pay a wealth tax of Fr 211,200. If that same taxpayer had taxable income of Fr 300,000 on which income tax of Fr 63,710 was due, the taxpayer's total tax bill (income and wealth) would be Fr 274,910. The ceiling would be 70 percent of Fr 300,000, or Fr 210,000. The application of the ceiling would reduce the ISF by Fr 64,910 so that the net ISF due and payable would only be Fr 146,290. See *Projet de loi Relatif à l'impôt de solidarité sur la fortune*, *LES NOTES BLEUES*, Aug. 8-21, 1988, at 7. For other examples, see ASSEMBLÉE NATIONALE NO. 158, *supra* note 10, at 171-83.

<sup>172</sup> In 1984 apparently 600 taxpayers reported a combined income and wealth tax in excess of their income. See Alimi, *supra* note 143, at 247. See also note 62 and accompanying text. Such a proposal was made in 1981. However, it was rejected by the government on the grounds that it might lead to fraud. TIXIER, *supra* note 8, at 70.

<sup>173</sup> ASSEMBLÉE NATIONALE NO. 158, *supra* note 10, at 157.

<sup>174</sup> *Id.* at 158.

lion.<sup>175</sup> Nonetheless, it was projected that less than 1 percent of the taxpayers would pay as much as 70 percent of their income in combined income and ISF taxes.<sup>176</sup>

## 6. CONCLUSION

As the French experiment with an annual tax on net wealth continues, it is premature to draw up a final statement on its successes and failures. To date it seems to have generated no surprises for those familiar with the issues associated with such taxes. On the positive side, it has generated tax revenues from sources that have previously gone untaxed. It has also provided valuable information for the verification of other tax liabilities, particularly the income tax. On the other hand, the exemptions for works of art and business property seem to confine the net effect of the tax to two types of assets — real estate and listed securities — which could result in serious non-tax effects over the long run by discouraging investment in those assets. In addition, favoring entrepreneurs as opposed to corporate executives may also have unpredictable long-term effects on the economy. Furthermore, the compliance costs are high. Mastering the jurisprudence on what constitutes exempted “business property” is no easy task. Moreover, the cost of preparing what is the equivalent in the United States of an estate tax return every year is quite substantial. The compliance costs of the wealth tax may be such that its principal beneficiaries are the tax advisors to those who must file. Finally, it should be noted that the French government has been at great pains to legitimize the annual tax on net wealth by comparing the nature of the tax, the rate schedule, the exemptions, and many of the other provisions, with similar taxes in member countries of the European Economic Community. That reference point may not be relevant to arguments for and against such a tax in other locales.

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<sup>175</sup> *Id.* at 41. Of course the aim of the tax on net wealth is to reach the taxable capacity of people with wealth but not income. In France the “correlation between income and wealth is rather weak.” Kessler & Masson, *On Five Hot Issues In Wealth Distribution*, 32 *EURO. ECON. REV.* 644 (1988).

<sup>176</sup> *ASSEMBLÉE NATIONALE NO. 158, supra* note 10, at 163.