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Nice, December 28<sup>th</sup> 2016

## Objet : The taxation of life annuity ("*rente viagère*")

1 - At a time when the sale in life annuity of real estate appears for a whole generation as a relevant alternative to supplement its income, it is useful to present the very special tax treatment that is reserved for the life annuity.

As the taxation of life annuity is as little known as it is complex, it sometimes constitutes an obstacle to the realization of a real estate sale in life annuity which must be aware. Life annuities can be taxed in different ways depending on their nature, their amount and the value of the assets of the creditor ("*crédirentier*") and debtor ("*débirentier*") concerned.

They may thus be included in the calculation of the income tax ("*impôt sur le revenu*") of the creditor and must be taken into account in determining the basis of the solidarity tax on capital ("*impôt de solidarité sur la fortune*"). Indeed, the life annuity is special in that it is apprehended from a tax point of view as much as an income as a capitalizable element to be included in the estate of the creditor.

Beyond that, the life annuity gives rise to the levying of registration fees and, in certain cases, is not immune to the tax on personal gains ("*impôt sur les plus-values des particuliers*").

### 1. Taxes affecting life annuity

2 - On the occasion of the sale of a building in life annuity, it is generally determined an annuity to be paid annually by the acquirer-debtor ("*acquéreur-débirentier*") to the vendor-creditor ("*vendeur-crédirentier*").

The amount of this annuity will be established at the end of a negotiation during which consideration will be given to various factors: the age of the creditor; the reversible nature of the annuity; if the life annuity is free or occupied. In any case, this annuity will be used to calculate the income tax of the creditor (A) and the solidarity tax on capital of the creditor and the debtor (B).

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At the time of the sale, it will be necessary to establish the registration fees to be paid by the debtor (C) and to take into account the sums paid for the calculation of the tax on personal gains (D).

### **A. Life annuity versus income tax**

3 - The payment of an annual life annuity by a debtor to a creditor will have an impact on the calculation of the income tax of the creditor (1°) and will oblige the debtor to carry out a certain number of formalities (2°).

#### **1° The creditor situation**

4 - The annuity arrears collected annually by the creditor are considered as taxable income taxable in the category of “salaries, wages, indemnities, emoluments, pensions and annuities”.

However, the creditor has a preferential tax system since an adjustment of the taxable base is made according to the age of the creditor. For example, Article 158 (6°) of the French General Tax Code (“*Code général des impôts*”, hereafter “*CGI*”) provides for the tax rebates (“*abattement*”) rates applicable according to the age of the seller on the date on which the annuity comes into force. If the totality of the annuity received is not taxed, the taxpayer will still have to declare the entire amount collected to the tax administration, which will include the taxable portion of the annuity to the income of the tax household (“*foyer fiscal*”).

On this basis, the social levies payable by the creditor in respect of income from capital will also be calculated, in the case of an annuity received for a fee (“*à titre onéreux*”).

5 - If the transaction is carried out by a couple of creditors, the tax administration agrees that the age of the oldest of the two spouses should be retained in the first installment. However, if this solution is more favorable, it is possible to take into account the age of the last survivor at the moment when he receives the annuity for the first time.

On the other hand, if each of the married or “*pacsé*” (i.e. living together under a civil partnership, called PACS) spouses personally receives a life annuity, the age of each of them will be retained in order to calculate the tax base for each of the life annuities collected.

6 - If the annuity is reversible and is received successively by unmarried (or “*pacsé*”) persons, the age of the new beneficiary will be retained at the time when he receives the pension for the first time.

#### **2° The debtor situation**

7 - While the creditor must declare as an income the life annuity received during the year, the debtor cannot deduct from his taxable income the annuity he has paid. Indeed, arrears paid to the creditor are not considered as tax-deductible interests.

8 – However, the debtor must submit himself to a declaratory obligation under penalty of a fine (CGI, article 1768). Each year before 1<sup>st</sup> of February he must send to the Department of Tax Services (“*Direction départementale des services fiscaux*”) a printout No. 2466 indicating the identity of the beneficiaries of the annuity and the sums paid during the previous year. Besides, under section 86 of the CGI, the debtor must keep a payroll record of the amount of the annuities paid during the year.

### **B. Life annuity versus solidarity tax on capital**

9 - When a natural person has a property worth more than 1.3 million euros, he is liable for the solidarity tax on capital (ISF). This raises the question of the impact of the payment of a life annuity on the creditor’s estate (1°) as well as the debtor (2°) in order to measure the impact of an a real estate sale in life annuity on the “ISF” potentially owed by each.

## 1° The creditor situation

10 - The real estate transfer in life annuity does not allow the creditor to escape the solidarity tax on capital since it is necessary to capitalize the annuity paid annually to the creditor, pursuant to Article 885 E of the CGI.

11 - Indeed, unlike a classical real estate transfer, the life annuity does not truly "take out" the real estate property from the creditor's estate. Therefore, it will be necessary to integrate into the base of the "ISF" the life annuity for its capital value.

12 - To assess the property transferred in life annuity, the creditor will take into account the annuity received during the fiscal year concerned, his age in the year of the declaration, his sex and indicate whether the annuity is reversible: these last three criteria determine the multiplier rate. The product of the annual annuity and of this rate makes it possible to determine the capitalization value to be declared.

13 - It is also possible to refer to the scales of life annuities drawn up by the Directorate-General of Taxes ("*Direction générale des impôts*"). These scales are re-evaluated every year to take account of changes in life expectancy. However, the scales used by the Directorate-General of Taxes are different from those applied by insurance companies and are less realistic.

14 - If a "bouquet" has been paid to the creditor at the time of the conclusion of the real estate transfer in life annuity deed, this will not affect the calculation of the capitalization value: the "bouquet" will simply be integrated into the assets of the taxpayer in the category of deposits and will be included in the basis on which the tax will be calculated.

15 - When the life annuity is "occupied", the creditor must also declare the value of his usufruct which will be determined by application of the scale provided for in Article 669, I of the CGI. The tax scale for usufruct applies in the same way if it is a usufruct reserve or a right of use and habitation. By comparison, when the life annuity is "free", only the capitalization value of the annuity will be taken into account in the tax base of the creditor for the "ISF", which he will have to pay to the public treasury.

## 2° The debtor situation

16 - The debtor subject to the solidarity tax on capital may deduct the capitalization value of the life annuity from his taxable assets. That being the case, housing acquired in life annuity is part of his taxable assets. The property in life annuity is part of his estate and he will have to register it.

17 - More precisely, the debtor will have to declare the value in full ownership if the life annuity is free. On the other hand, it will have to declare its value in bare ownership if the life annuity is occupied.

### C. Life annuity versus transfer taxes ("*droits de mutation*")

18 - When the transfer is not subject to VAT - and this will generally be the case with regard to the sale of real estate in life annuities, since the creditor is not a taxable person - the transferee will have to pay the transfer duties at the common rate.

As a matter of principle, the overall rate applicable is 5.09%. However, the Finance Act for 2014 ("*Loi de Finances pour 2014*") has introduced a provision enabling the General Councils ("*conseils généraux*") to raise, on a provisional basis, the rate of the land registration tax ("*taxe de publicité foncière*") or the registration fee provided for in Article 1594 D of the CGI, above 3.80% and within the limit of 4.50%.

From now on, most departments have voted an increase in the tax rate up to the authorized 4.50%. Only five departments retained the rate of 3.80%, namely Indre (36), Isère (38), Morbihan (56), Martinique (972) and Mayotte (976). Côte d'Or (21) voted a rate of 4.45% (not 4.50%). The overall tax rate therefore falls for most of the departments at 5.8% [4.50 + 1.20 + (2.37% \* 4.50%)].

19 - As regards the basis of registration fees ("*droits d'enregistrement*"), it is again necessary to distinguish between "free" and "busy" life annuity. If it is free, transfer taxes will be calculated on the sale price constituted by the bouquet and the capitalization value of the annuity. The tax base will therefore correspond to the value indicated in the deed of sale. The same rule applies if the sale takes place with reservation of the right of use and habitation.

20. On the other hand, where the sale takes place with a reservation of usufruct, transfer rights for consideration will be calculated by using as the basis the value of the bare ownership determined in accordance with the scale established by Article 669 of the CGI.

#### **D. Life annuity versus the taxation of capital gains ("*imposition des plus-values*")**

21 - Finally, it is necessary to mention the tax on capital gains of individuals, which can heavily weigh on the vendor-creditor when he is not covered by an exemption under the law (1°), but which may above all dissuade the acquirer-debtor from disposing of the property acquired in life annuity (2°).

##### **1° The creditor situation**

22 - Since life annuity constitutes an immovable property transfer for a fee, it is taxed as a taxable transaction under Article 150 U of the GTC. Thus, the net realized capital gain will be taxed, after deductions, at the proportional rate of 19% for income tax and 15.5% for social contributions (CSG-CRDS). However, the text provides for various exemption assumptions which very often benefit the vendor-creditor.

23 - Indeed, an immovable property transfer in life annuities generally concerns the principal residence of the creditor. Pursuant to Article 150 U II 1° of the CGI, it will therefore be exempt from capital gains tax. However, it is necessary to be vigilant because the property will cease to be considered as the principal residence of the creditor if during the period preceding the transfer of the immovable property, it is leased or occupied for free by a third party, and even for a short time.

24 - Exemption will also be granted if the transferor has held the property for more than 30 years.

25 - On the other hand, if the creditor or his spouse is entitled to a retirement pension or a second or third category invalidity card, he shall be exempt from tax on the real estate gains of individuals.

This cause of exemption applies only if the reference tax income of the creditor for the penultimate year preceding that of the sale is less than 10 697 euros for the first part of the family quotient, plus € 2,856 for any additional half-share. In addition, to benefit from this exemption, the creditor must not be subject to the solidarity tax on capital.

26 – If he cannot be exempt from taxation on the capital gains of individuals at the time of the sale of the immovable property in life annuity, the creditor shall be subject to double taxation in respect of arrears actually received. Indeed, regarding the taxation of capital gains on immovable property, the annuities that are to be collected subsequently are included in the calculation of the sale price since the capital value of the annuity is added to the bouquet.

Thus, this sum increases the amount of the gross taxable gain. In addition, these annuities are again subject to income tax and social security contributions ("*prélèvements sociaux*") when they are paid in the form of arrears to the creditor.

27 - In this regard, it has already been pointed out that the validity of this tax scheme could be challenged on the basis of Article 13 of the French Declaration of the Rights of Man and the Citizen (DDHC), where there is the constitutional principle of equal taxpayers. In applying this principle, an income cannot be declared in two separate categories of income tax. However, this seems to be the case for the life annuities collected by a creditor imposed at the time of the operation for the capital gains on immovable properties of individuals, and then later as annuities are paid.

## **2° The debtor situation**

28 - The debtor may be liable for capital gains tax if he decides to sell the property before the expiry of a period of 30 years, if the property acquired in life annuity is not his principal residence.

29 - The debtor or his heirs may first wish to resell the property acquired in life annuity before the death of the creditor. In this case, in order to determine the amount of the taxable gross capital gain taxable regarding the tax on capital gains on immovable property, the purchase price to be retained corresponds in principle to the value of the capital representing the annuity established at the time of acquisition of the property plus, where applicable, the portion of the acquisition price paid in cash.

However, in order to take into account for the calculation of the taxable capital gain, of the random nature of the real estate transfer in life annuity deed, the taxpayer can substitute the capital represented by the annuity established at the time of acquisition, the total made up by arrears actually paid to the creditor, to which must be added the capital representing the annuity remaining to be paid on the date of the assignment (the latter being indicated in the notarial deed).

30 - Another situation is much more frequent in practice: the building may be transferred by the debtor after the death of the creditor. A first difficulty results from the establishment of the date that will be taken as the date of acquisition when the creditor had a usufruct reserve.

The tax administration accepts in this case that the date of entry of the bare ownership into the estate of the transferor constitutes the starting point of the period of detention of the property.

31 - The dismemberment of property in the context of a real estate sale in life annuities arouses another difficulty related to the calculation of the acquisition price by the transferor, which was debtor. It is then assumed that the transferor can retain the free market value of the property at the date of entry of the bare ownership in the estate of the transferor, that is to say on the date of acquisition in life insurance.

32 - When there is no reserve of usufruct, concerning the calculation of the taxable gross capital gain and more specifically the calculation of the acquisition price, two scenarios can then occur: either the debtor has paid an amount less than the estimated capitalization value at the time of the sale; or the debtor has paid more than the estimated value.

33 - In the first case, if the debtor financially comes out a winner from the transaction, he will have an interest in retaining the estimated value indicated in the purchase deed as purchase price to calculate the tax on the capital gains to be paid at the time of the resale of the property.

34 - In the second case, if the debtor has paid to the receiver a sum greater than what was initially estimated, he will wish to retain the amount of money actually paid.

35 - The tax administration then considers that the contributor has an option: he may retain the transfer price used to calculate the capital gain realized by the creditor; but if it is more favorable for him, he can retain the sum of the annuities paid, from the fraction of the price paid in cash and the acquisition costs re-evaluated using the coefficients of monetary erosion.

36 - As the taxes liable to weigh on the life annuity have been henceforth presented, it is necessary to mention the risks incurred by the taxpayer who - in one way or another - would try to escape or to reduce this tax burden.

## **2. The risks of tax adjustment threatening the life annuity**

37 - As we have seen, life annuities are very difficult to escape from taxation. Worse, it arouses the mistrust of the tax administration which does not hesitate to rely on Article L. 64 of the Book of Fiscal Proceedings (*"Livre des Procédures Fiscales"*) to sanction the disguised donations (B) and, at least, Article L. 17 of this same book to recalculate the registration fees to be levied for the market value of the property (A).

### **A. The risk of revaluation of the annuity**

38 - The disguised donation is not the only hypothesis of tax reorganization in the face of suspicious sales transactions in life annuities. Thus, when the tax administration considers that the debtor is abnormally profitable in the transaction, it is possible to recalculate the registration rights in relation to the price that should have been charged by reference to the market value of the asset.

Article L. 17 of the Book of Fiscal Proceedings provides that *"as regards registration fees and the land registration tax or tax on added value ("taxe sur la valeur ajoutée") where it is due in place of those rights or tax, the tax administration may rectify the price or valuation of a property that served as a basis for a tax levy, when that price or valuation appears to be less than the actual market value of the goods transmitted or designated in the deeds or declaration "*.

### **B. The risk of requalification of the sale**

39 - The tax regime for the sale of immovable property in life annuities may seem attractive to the taxpayer who wishes to transfer property to relatives, friends or relatives because it proves to be more advantageous than the tax regime applicable to donations. Indeed, transfer duties free of charge (*"droits de mutation à titre gratuit"*) are particularly high in France, especially when the donation does not benefit the direct descendants or the spouse.

Thus, Article 777 of the CGI provides for tax rates varying according to the family relationship between the deceased and his beneficiary and up to 60%. By comparison, a sale of immovable property in life annuities is simply subject to registration fees, although the rate has increased in most departments, but never exceeds 5.8%.

40 - Such an assembly must however be discouraged because, under these circumstances, the risk of requalification in disguised donation is very real.

41 - The tax administration will seek to establish the existence of an abuse of rights on the basis of Article L. 64 of the LPF. In order to establish the existence of a disguised donation in the sale of immovable property in life annuities, the tax authorities must establish the existence of a cluster of indices.

42 - In order to do this, various elements could have been retained by the Administration to characterize the existence of a disguised donation.

Thus, the life annuity established at an unusually high amount, compared with the value of the property transferred; the waiver by the creditor of the security interest usually requested to the debtor; the existence of a relationship between the creditor and the debtor; the high age of the creditor and his precarious state of health at the time of the sale followed by the death of the creditor in a short period of time, leading to the absence of any hazard; the lack of income of the debtor to pay the annuity; the absence of "bouquet" are elements constituting indices, verified by the tax authorities in order to establish the existence of an abusive arrangement.

43 - Admittedly, the existence of an abuse of rights is rarely obvious, but such a requalification has already been validly accepted. At the same time, attempts to qualify sales as a donation disguised by the tax administration are not all accepted, in particular because some indices used, such as the death in the short term of the creditor, result from the necessarily random nature of the sale in life annuity.

Thus, the Advisory Committee ("*comité consultatif*"), which is often called upon to supervise the operation, may have considered in certain cases that the tax administration was justified in using the procedure provided for in Article L. 64 of the LPF, and in other circumstances, have considered that the abuse of right was not established.

44 - But in any event, if the tax administration succeeds in establishing the existence of a disguised donation behind a sale in life annuity, the fraud is characterized. Not only will the fraudster have to pay the tax that he would have had to pay at the time of the lifetime sale, but he would have to pay a particularly heavy penalty to the tax authorities.

If an abuse of rights is established, a penalty of 80% in bad faith is incurred, to which interest at the rate of 0.40% per month, deducted from the date at which the donation is presumed to have been made, on the basis of the duties evaded by the taxpayer.

If it remains possible to deduct the transfer tax paid by the taxpayer, in practice such a requalification can result in a financial penalty exceeding the value of the property.

45 - Moreover, in addition to the risk of abuse of rights, in the context of family transmission analyzed, when the sale is accompanied by a reservation of usufruct, if the purchaser is a successor or an intermediary, it will be sufficient for the tax administration to rely on Article 1751 of the CGI to establish a presumption of ownership. The latter can only fall after demonstration of the reality of the payments of the life annuity.

46 - **Conclusion.** - The sale of immovable properties in life annuities is an old institution that is gradually rediscovered in the face of the ageing of an age group that aspires more and more to increase its purchasing power by making its real estate assets liquid.

However, the sale of an immovable in life annuity is complex to put in place and suffers from an unfavorable tax treatment, which it would be opportune to rethink if one wishes to see its use democratized.

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