Business transfer strategies in France

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How to transfer a family business to the next generation(s)?

Transferring over generations is a crucial issue for family businesses owners. Aside from anticipating management transition, the cost has to be monitored carefully.

Between a gift and a sale, it appears difficult to identify the ideal way to transfer a family business to following generations. Gift is often viewed as very expensive from a tax perspective because gift tax is assessed on the fair market value of the business. Sale may be less expensive taxwise thanks to favourable regimes for capital gains, but funding the purchase may be difficult for the upcoming generation.

French law provides for three very powerful tools to give a family business: the "*Pacte Dutreil*", the "*donation-partage transgénérationnelle*" and the split of ownership between bare-ownership and usufruct. Combining those tools allows reaching effective rates extremely low, which makes a gift, in many cases, more efficient than a sale from a tax perspective.

1. The "*Pacte Dutreil*" is a sophisticated shareholder agreement where:
   - At least 2 shareholders takes a commitment to keep their shares for a minimum 2-year period (collective lock-up). Commitment is taken for themselves and their heirs. The gift must occur during the collective lock-up period.
   - Beneficiary of the gift of shares takes the commitment to carry-on the collective lock-up period until its end, and then keep the shares for an additional period of 4 years starting at the end of the collective lock-up (individual lock-up).
   - One of the signatories of the commitment must run the business for a minimum 3-year period as from the gift date.

   Correlatively, taxable basis for gift tax purposes is reduced by 75% (i.e. gift tax is applied on only 25% of the fair market value of the business, instead of 100%).

2. The "*donation-partage trans-générationnelle*" is a settlement gift where the donor gives to different generations. Used in a 2-tier planning, it may provide powerful benefits in terms of effective taxation rates.

   In a first step a gift is made to the second generation. In a second step, while the initial donor is still alive, assets that were given to the second generation are reinstated in a new gift, from the original donor to the third generation, with the second generation's agreement.

   If less than 15 years passed between the two steps, both gifts are subject to gift tax, but tax paid upon the first gift may be deducted from tax due upon the second gift (no refund if exceeding). Such deduction brings the overall cost up to the level of the more onerous gift from a tax perspective, etc. Which means that a transfer over two generations is taxed as a transfer over only one generation!

   If more than 15 years passed between the two steps, the second gift will not be subject to gift tax but to a flat 2.5% "*droit de partage*".

3. Split of ownership is very common in France and allows giving bare-ownership (construed as a part of the full ownership) based on a reduced value at the time of the gift (because of the lifetime usufruct retained by the donor – the older the donor is, the lower the value of the usufruct will be, and the higher the value of the bare-ownership will be).

   Upon death of the donor, usufruct extinguishes and the full ownership is recomposed tax free in the hands of the former bare owner (i.e. the increase in value between the gift and the death of the donor is also transferred tax free).

   Combined with the "*Pacte Dutreil*", taxable basis for a gift of bare-ownership by a 50-year old donor is only 10% of the total value of the asset!

Combining those three tools allows monitoring tax cost of a gift over two generations, while ensuring that each generation is involved in the family business.

Each tool is quite sophisticated in itself, so combining them could not be contemplated without involving advisors or without reviewing carefully each situation to make sure that the solution would be efficient.

In some cases, effective rates to transfer a business over two generations are between 5% and 10%! In such cases, no doubt that a gift is less expensive than a sale.

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