FRANKLIN
SOCIÉTÉ D'AVOCATS

IBA 20th Annual International Wealth Transfer Practice Conference
2-3 March 2015

The future of private wealth planning – more than just compliance

Life insurance in France

Jérôme Barré
Partner
Guest lecturer at Paris IX Dauphine University, Paris V Descartes University and ESCP Europe School of Management.

I. Introducing French Life Insurance

1. Definition of life insurance
2. Different types of life insurance
3. Different types of financial management of life insurance

II. Tax treatment of life insurance

1. Life insurance and income tax
2. Life insurance and wealth tax
3. Life insurance and transfer of assets at death
4. Transfer of assets planning and life insurance

I. Introducing French Life Insurance

1. A definition of life insurance

Life insurance can be termed as

- an agreement between a policyholder and an insurer
- where the insurer for a consideration (premium)
- agrees to pay a sum of money (either a capital or an annuity) either to the policyholder or to the insured person (generally the policy holder is the insured person) or to a third party beneficiary
- upon the occurrence of an event in the insured's individual life (either life or death)

The Cour de cassation qualified life insurance as an insurance policy the effects of which depend on human lifespan which is per se based on a risk (Cour de cassation , decision of March 23rd 2004)

I. Introducing French Life Insurance

1. A definition of life insurance

Distinction between life insurance and investment bond

The risk covered will be a key notion to differentiate a life insurance policy from an investment bond.

An investment bond will not refer to a risk covered. It cannot de defined as an insurance transaction as it was defined by the European Court of Justice in 1999: « the essentials of an insurance transaction are, as generally understood, that the insurer undertakes, in return for prior payment of a premium, to provide the insured, in the event of materialization of the risk covered, with the service agreed when the contract was concluded.” (ECJ February 25th 1999 case C-349/96, *Card Protection Ltd*).

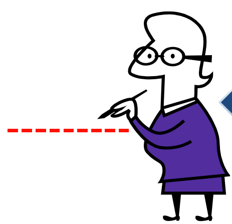
The distinction will be especially relevant considering transfer of assets insofar as the capital paid from an investment bond when the subscriber dies will be part of his estate whereas the capital paid from a life insurance policy won’t.

I. Introducing French Life Insurance

1. A definition of life insurance

Legal basis: life insurance is based on a stipulation for the benefit of a third party (French Civil code – Article 1121)

Contract



Policy holder (stipulating party)

Name or remove

beneficiaries

If there is no third party beneficiary mentioned to the policy, the stipulating party is presumed to have stipulated for his own benefit.

The Insurer (insurance company) becomes the funds owner.
The policy owner then cannot interfere with the funds management. If he did so, the life insurance contract would be considered as a simple saving contract with none of the advantages of life insurance.

The Insurer only has a debt in cash towards the policy holder.

I. Introducing French Life Insurance

2. Different types of life insurance

- **Life insurance in case of death**

Objective: provide a lump sum of money to the beneficiary when the insured person dies.

- Can be temporary: a term is specified in the policy

→ The principal will be paid to the beneficiary if the insured dies before the specified term of the policy.

If the insured is still alive when the term of the policy occurs, the insurer will keep the premiums paid by the insured during the life of the policy and will not pay the principal to the beneficiary.

The payment of the principal will be achieved by a one-off lump-sum payment

I. Introducing French Life Insurance

2. Different types of life insurance

- or permanent: no term is specified in the policy

  → The principal will be paid to the beneficiary when the insured dies.

  The payment of the principal will then take the form of
  - either a one-off lump-sum payment
  - or a pension paid until the occurrence of a specified term (retirement for example)
  - or a life annuity

I. Introducing French Life Insurance

2. Different types of life insurance

- **Life insurance in case of life**

Objective: build savings. This type of life insurance has become the main vehicle for individuals to supplement the state's pay-as-you-go retirement system.

- Can be a deffered lump-sum payment

→ The principal will be paid to the beneficiary if the insured lives beyond the specified term of the policy.

If the insured dies before the term of the policy occurs, the policy can provide for a refund of capitalized premiums.

I. Introducing French Life Insurance

2. Different types of life insurance

- or a life annuity

  - Immediate life annuity

→ As soon as the policy comes into effect, a life annuity is paid to the beneficiary. Its amount will vary according to the age of the insured and the amount of the premiums paid.

If the beneficiary dies, the life annuity may be turned into a joint and last survivor annuity.

  - Deffered life annuity

→ A life annuity will be paid to the beneficiary if the insured is still alive at the specified term of the policy.

If the beneficiary dies, the life annuity might be turned into a joint and last survivor annuity.

I. INTRODUCING FRENCH LIFE INSURANCE

2. Different types of life insurance

- **Endowment life insurance**

Objective: combination of life insurance in case of death and life insurance in case of life. Both risks are covered.

→ The principal will be paid to the beneficiary if the insured lives beyond the specified term of the policy.

If the insured dies before the term of the policy occurs, the principal will be paid as well to the beneficiary.

The premiums paid are broken down according to the risk covered – either life or death. As a consequence, the value of the policy when the term occurs depends on the amount of premiums allocated to each risk.

I. Introducing French Life Insurance

3. Different types of financial management of life insurance

- **Euro-based life insurance**

Premiums and policy investment are expressed in Euros.

Guaranteed rate of return for the term: the sum to be paid is determined beforehand = guaranteed capital

Most of the time, euro-based life insurance is based on the rate of government bond certificates, which makes it quite a secure investment.

- **Unit-linked life insurance policy**

Premiums and policy benefits are not expressed in euros but in units of an investment vehicle, such as shares of a mutual fund, bonds or stock.

Policy benefits then fluctuate directly with the market values of these units or shares. As a consequence, this type of life insurance is riskier than Euro-based life insurance but it can also prove to be more lucrative.

- **Multi-investment vehicle life insurance**

Premiums and benefits are expressed in terms of one or more unit-- linked investment vehicles and one investment vehicle in euros.

II. Tax Treatment of Life Insurance

- The tax treatment applied to a life insurance policy depends on the State of residence of the policy holder

  → If the policy holder is a French tax resident, French taxation rules will apply regardless of the state in which the policy was suscribed (foreign insurance companies).

II. Tax Treatment of Life Insurance

1. Life insurance and income tax

- **Voluntary disclosure**

French tax residents must disclose to the French tax authorities any life insurance policy contracted abroad.

If not, a € 1,500 fine will be applied to each policy the tax payer has failed to disclose (a € 10,000 fine if the State in which the life insurance policy was contracted is considered a non-cooperative state)

If the value of the undisclosed life insurance policy is superior to € 50,000 on Dec. 31st of the tax year during which the policy should have been disclosed, the fine will reach 5% of the value of that policy.

II. Tax Treatment of Life Insurance

1. Life insurance and income tax

- The life annuity will be taxed for a certain fraction according to income tax progressive scale - article 158, 6. French Tax code

Income tax progressive scale – to be applied to 2014 income	
Part of taxable income	**Taxe rate**
Below **9 690 €**	0 %
From **9 690 €** to **26 764 €**	14 %
From **26 764 €** to **71 754 €**	30 %
From **71 754 €** to **151 956 €**	41 %
Beyond **151 956 €**	45 %

- Life annuity as a yield from life insurance will be submitted to 15.5% social taxes.

II. Tax Treatment of Life Insurance

1. Life insurance and income tax

The taxable basis of the life annuity will depend on the age of the beneficiary when the life insurance policy comes to term:

- under 50 years, 70% of the life annuity will be taxed
- between 50 and 59 years, 50% of the life annuity will be taxed
- between 60 and 69 years, the taxable basis will be 40% of the life annuity
- over 70 years the taxable basis will be 30% of the life annuity

II. Tax Treatment of Life Insurance

1. Life insurance and income tax

- Yields from life insurance policies turned into the payment of a one-off lump sum of money are submitted to income tax and 15.5% social taxes.

Two hypothesis:

✓ The policy is not surrendered

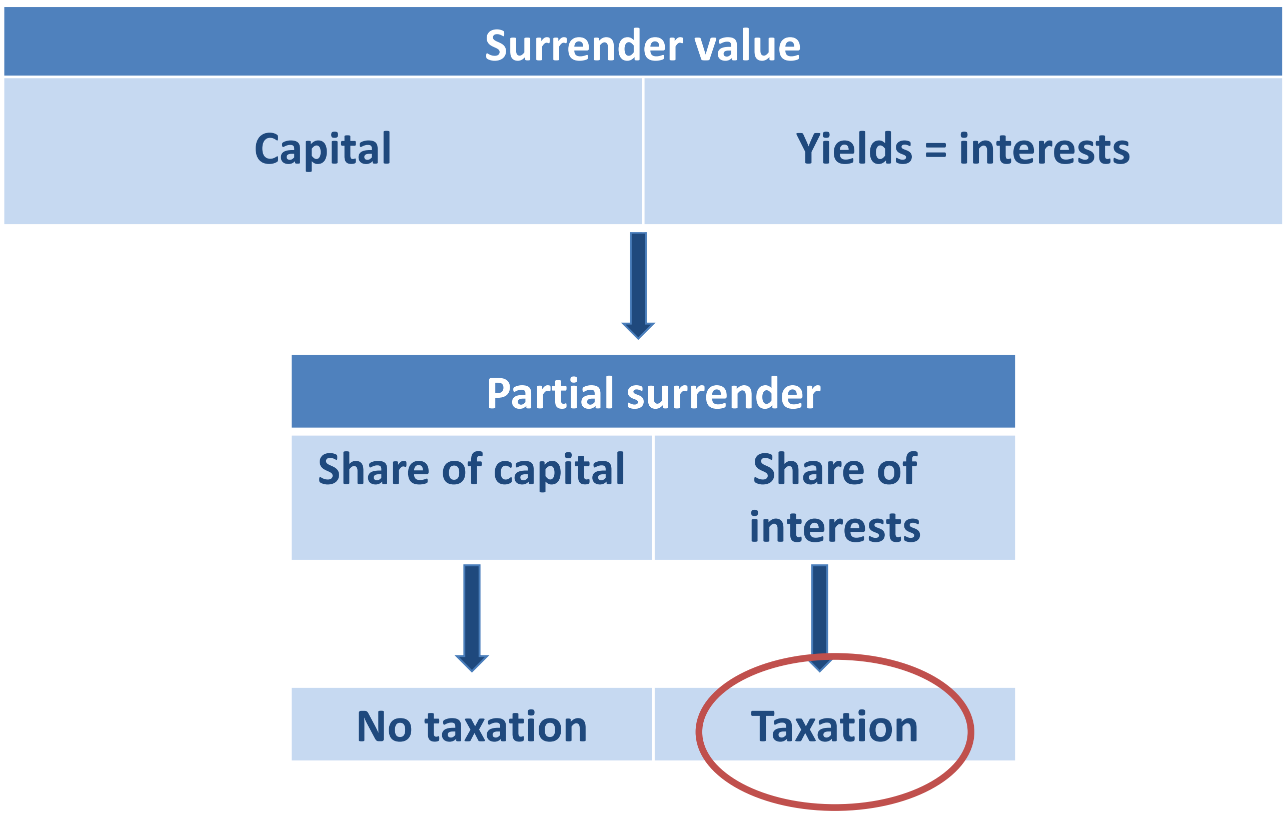
Euro-based life insurance	Unit-linked life insurance
15.5% social taxes on interests as soon as they are entered into account	No taxation of capital gains even if the capital is reinvested in another vehicle

II. Tax Treatment of Life Insurance

1. Life insurance and income tax

✓ The policy is surrendered – in full or in part.

The surrender value is made of a portion of the capital and an increase of value of the policy represented by interests (the part of interests included in the surrender value will be taxed).



II. Tax Treatment of Life Insurance

Life insurance's tax treatment proves to be very advantageous if partial surrender is performed after 8 years following the conclusion of the contract.

Partial surrender: regressive taxation

Total surrender or partial surrender	Tax treatment
Before 4 years	Income tax according to progressive scale (up to 45% for 2014 income) or 35% withholding tax if taxpayer opts out + 15.5% social taxes
Between 4 and 8 years	Income tax according to progressive scale or 15% withholding tax if taxpayer opts out + 15.5% social taxes
After 8 years	Annual tax rebate: € 4.600 for a single person, € 9.200 for a couple filing jointly. The remainder is taxed according to progressive scale or 7.5% withholding tax if taxpayer opts out + 15.5% social taxes

In any case, social taxes will apply – article 136-7 I. French Social Security code

II. Tax Treatment of Life Insurance

2. Life insurance and wealth tax

French tax residents are taxable on their worlwide assets as soon as the net value of their estate is superior to € 1,300,000 (for 2015).

Net surrender value (« valeur de rachat ») of life insurance policy will then consist in an asset and will have to be reported on the wealth tax return.

Wealth tax progressive scale

Total assets on 1.1.2015

≤ € 1,300,000 → **No wealth tax**

> € 1,300,000 →

Below €800,000	0%
From €800,000 up to and including € 1,300,000	0,5%
From €1,300,000 up to and including € 2,570,000	0,7%
From € 2,570,000 up to and including € 5,000,000	1
From € 5,000,000 up to and including € 10,000,000	1,25%
Beyond € 10,000,000	1,50%

II. Tax Treatment of Life Insurance

3. Life insurance and transfer of assets at death

TAX TREATMENT OF LIFE INSURANCE AT THE DEATH OF THE INSURED PERSON

<u>Tax treatment depends whether premiums were paid before or after 70 years</u>

- ❑ Premiums paid **before the age of 70** – Article 990 I French Tax code

  - capital paid to the surviving spouse (or the civil partner) is tax exempted.

  - capital paid to others beneficiaries : exemption from tax up to € 152,500, and taxation at the following rates:

    From € 152,500 to € 700,000: 20% tax rate.

    Beyond € 700,000: 31.5% tax rate.

  - For French inheritance purposes, premiums paid before the age of 70 are not included in the estate transferred;

  - Inheritance tax scale is NOT applied (45% maximum between parents and children, 60% between non-parents).

Let's consider a € 2,000,000 capital paid to a sole beneficiary
Premiums were paid before the age of 70.

Up to € 152,500	From €152,500 up to € 700,000	Beyond € 700,000
EXEMPTION	**20%**	**31,25%**
€ 0	+ € 109,500	+ € 406,250

= € 515,750

Average tax rate = 25,8 %

FRANKLIN
SOCIÉTÉ D'AVOCATS

II. Tax Treatment of Life Insurance

3. Life insurance and transfer of assets

- Premiums paid **after the age of 70** – Article 757B French Tax code

  - capital paid to the surviving spouse (or the civil partner) is tax exempted.
  - capital will be included in the estate transferred and then submitted to inheritance tax after a rebate of € 30,500.
  - Interests will be exempted from tax.

FRANKLIN SOCIÉTÉ D'AVOCATS

Inheritance tax scale applicable for 2015

DEGREE OF KINSHIP	VALUE OF ASSETS	TAX RATE
DIRECT DESCENDANTS	Below € 8 072	5,00%
	From € 8 072 to € 12 109	10,00%
	From € 12 109 to € 15 932	15,00%
	From € 15 932 to € 552 324	20,00%
	From € 552 324 to € 902 838	30,00%
	From€ 902 838 to € 1 805 677	40,00%
	Beyond € 1 805 677	45,00%
SIBLINGS	Below € 24 430	35,00%
	Beyond € 24 430	45,00%
OTHERS	Nephews and nieces, uncles and aunts, cousins	55,00%
	No kinship	60,00%

Let’s consider

a life insurance policy worth € 2 million paid to the children of the deceased (premiums were paid after the age of 70).

The fraction of premiums paid after the age of 70 are included in the estate transferred and then submitted to inheritance tax

Fraction of taxed premiums = 2,000,000 – 30,500 (tax rebate) = 1,969,500

This amount will be added up to the value of the transferred estate.

The taxable basis to inheritance tax will then be 1,969,500

FRANKLIN
SOCIÉTÉ D'AVOCATS

Inheritance tax scale is applied as follows:

Up to € 8,072	From €8,072 up to € 12,109	From € 12,109 to € 15,932	From € 15,932 to € 552,324	From € 552,324 to € 902,838	From € 902,838 to € 1,805,677	Beyond € 1,805,677
5%	**10%**	**15%**	**20%**	**30%**	**40%**	**45%**
404	404	573	107,278	105,154	361,135	73,720

404 + 404 + 573 + 107,278 + 105,154 + 361,135 + 73,720

= 648,668

Average tax rate = 33 %

Comparison of inheritance cost in presence of a life insurance policy of € 2,000,000

	Tax	Average tax rate
Premiums paid before 70 years	515,750	25.8%
Premiums paid after 70 years	648,668	33%

FRANKLIN
SOCIÉTÉ D'AVOCATS

II. Tax Treatment of Life Insurance

3. Life insurance and transfer of assets

- **In an international context, French inheritance tax will be due when:**

  - ✓ the policy holder is a French tax resident when the policy terminates

  - ✓ the beneficiary is a French tax resident when the policy terminates, even if the policy holder was a non resident of France when he suscribed the policy or when it terminates.

II. Tax Treatment of Life Insurance

4. Transfer of assets planning and life insurance

Life insurance is to be considered first:

- Optimization of the tax rebates of € 152,500:
  - ✓ the more beneficiaries, the more tax rebates.
  - ✓ if the capital is made of premiums paid before the age of 70, it will be judicious to have distant relatives and other third parties (especially cohabitants) as beneficiaries because they will be taxed at a lower rate (maximum 31.50%) than inheritance tax (60%).

The rule is here different from ordinary inheritance law rules by which an heir who waives his right to his portion of estate automatically sees this portion transferred to his own heirs.

II. Tax Treatment of Life Insurance

4. Transfer of assets planning and life insurance

- Possibility to consider subsequent beneficiaries: the first beneficiary will not accept the life insurance policy and then it will be passed onto a second beneficiary.

  Example: children named as first beneficiaries and grandchildren as second beneficiaries. Children can waive their right to the capital and then the grandchildren will receive it as second beneficiaries.

  It will be necessary to name the subsequent beneficiary in the beneficiary clause. If not, the first beneficiary will not be entitled to name himself another beneficiary to the policy.

  The rule is here different from ordinary inheritance law rules by which an heir who waives his right to his portion of estate automatically sees this portion transferred to his own heirs.

II. Tax Treatment of Life Insurance

4. Transfer of assets planning and life insurance

- If the beneficiary is a minor, it is possible to provide for an administrator in the beneficiary clause. It may also be relevant to provide for a duty of allotting funds for a certain use.

- Possibility to **split the beneficiary clause** between the surviving spouse and the descendants:

  - ✓ The surviving spouse will get the usufruct of the capital
  - ✓ The descendants will get the bare ownership

  When the insured person dies, the insurer pays the capital to the surviving spouse who has the right to use it freely provided that an equivalent capital will have to be returned to the bare owners when the usufruct ends – generally when the surviving spouse dies, but it can be stipulated otherwise.

  When the usufruct ends, the bare owners, as they are creditors to the surviving spouse, will get the capital back free of tax.

II. Tax Treatment of Life Insurance

4. Transfer of assets planning and life insurance

Legal advantages to organise estate planning

- Capital paid to beneficiary because of the death of the insured party will not be taken into account as a part of the estate of the deceased.

  Limit: capital paid to beneficiaries considered as premiums clearly excessive regarding the policy holder's financial capacities. Heirs may ask to the reduction of these premiums before Courts.

- Capital paid to beneficiary will not be subjected to forced heirship rules. For example, it will not be taken into account to determine the reserved portion of the children.

- Capital cannot be seized by the deceased's creditors, except French tax treasure since 6 Dec. 2013.

- During his lifetime, the policy holder can freely dispose of the life insurance funds through partial or total surrender (except if the benficiary has accepted the life insurance).