

## LEGAL AND TAX ISSUES

# Renting furnished accommodations

*Furnished tenancy is governed by different legal and tax regulations from those that apply to unfurnished accommodations. You need to know more before making the investment.*

The rental of furnished accommodations is usually described as an attractive tax option. However, this generic term encompasses numerous scenarios with which you should be familiar before making a decision.

### ➤ A flexible legal framework

The law of 6 July 1989, which explicitly excludes furnished tenancy from its purview, imposes certain requirements on lessors. For example, leases must be for a period of at least three years, and owners must give tenants six months' prior notice before removing them from the residence. Tenants may be removed only for failure to comply with their responsibilities or in the event that the lessor must regain possession of the residence in order to live in it or sell it.

### A truly furnished residence

The law of 6 July 1989 does not define furnished tenancy, which must be assessed on a case-by-case basis. However, past court rulings suggest that the furniture provided by the lessor must be of sufficient quantity and quality to meet the tenant's essential needs. Each room must be furnished. It is therefore very important, when drawing up the schedule of condition prior to signature of the lease, to prepare a precise inventory of the furniture included in the rental and to attach this inventory to the lease. Judges are not bound by the parties' characterisation of the transaction and may redefine the latter as a residential tenancy.

### Wide latitude

French law gives considerable latitude to the parties to a furnished tenancy. For example, they may establish a verbal lease that

complies with the rules of ordinary law governing rentals, and specifically with the broad provisions of the Civil Code. Nonetheless, it is strongly recommended that the parties sign a lease contract that defines the rental terms and conditions, in order to avoid any subsequent disputes. Such a contract will include the length of the rental, the procedures for giving notice, the amount of rent and the procedure for setting it, and liability for repairs.

### Decent housing

The law on urban solidarity and renewal requires all lessors, including those renting furnished accommodations, to provide decent housing. The basic requirements for decent housing were established in a decree dated 30 January 2002, including minimum inhabitable surface area, adequate amenities, etc. (law of 13 December 2000, Article 13). In addition, if the building is old, lessors must verify that the law of 1 September 1948 is not applicable.

### More than four furnished lodgings

A specific set of rules and regulations governs furnished accommodations provided by a lessor who routinely lets more than four flats that constitute each tenant's primary residence (Article L.632-7 of France's Building and Residential Code [*Code de la construction et de l'habitation*]). This imposes somewhat greater restrictions on each party. For example, the lease is for a period of one year and may be tacitly renewed. In addition, any owner who does not wish to renew the rental contract must notify the tenant three months before the contract expires. The owner must also

indicate the grounds for refusing to renew the lease.

### **Other restrictions**

There are various other provisions scattered throughout French law that apply to furnished tenancies. France's Unfair Terms Commission (*Commission des clauses abusives*) has drawn up a list of stipulations that may not be imposed on tenants. Moreover, any transformation of residential premises into furnished accommodations requires official authorisation (cf. Article L.631-7 of the Building and Construction Code). But this provision applies only to "professional" lessors of furnished accommodations, i.e. those who routinely let several furnished lodgings in the sectors identified in the aforementioned article.

#### **➤ A variety of tax rules**

Whereas from a legal standpoint furnished tenancy is a civil rather than commercial activity, for tax purposes it is considered a commercial business. As a result, any earnings from the furnished rental of a building, either new or old, are taxed as business profits (*bénéfices industriels et commerciaux*, or BIC).

### **Tax-exempt rentals**

Certain rentals are not taxed. For example, lessors who let or sublet a furnished portion of their primary residence are exempted from tax on all earnings from this activity.

The rented rooms must constitute the tenant's or subtenant's primary residence, and the rental price must fall within a reasonable range. For example, the annual rent per square metre of inhabitable surface area must not exceed a set maximum (for 2003, this maximum is €142 in Ile de France and €102 elsewhere in France; see the General Tax Code, Article 46, AGA of Appendix III).

### **Professional lessors of furnished accommodations**

Those who wish to be recognised as professional lessors of furnished accommodations must meet two conditions (General Tax Code, Article 151 *septies*). First, they must be registered with the local trade and companies register. Certain registries will refuse any registration application from a taxpayer and natural person conducting such a business, on the basis that the rental of furnished lodgings is a civil activity. However, the tax authorities have indicated that they will waive this requirement if taxpayers present proof that their application for inclusion in the trade and companies register was denied. In addition, the lessor must earn annual revenue of at least €23,000 including tax from rentals or must obtain at least 50% of total income from this activity.

### **Revenue of €23,000**

This threshold is designed to reflect the total income earned by the members of a single tax household. This revenue may come from renting just one flat. If operations begin during the course of the year, this threshold may be revised in proportion to the duration of the rental.

### **Businesses**

If the lessor is a partnership or a limited liability company controlled by one person or a family, the €23,000 threshold is assessed for each partner, with revenue distributed among the partners in accordance with their respective share of the company's earnings.

### **At least 50% of income**

Net revenue from furnished tenancy is compared to total net revenue in the category (before expenses are deducted from overall revenue and prior deficits), including revenue from furnished rentals and revenue that is taxed at a proportional rate, if any. An adjustment will be needed for companies that began operations during the course of the year.

### **Tax benefits**

Professional lessors receive several tax benefits so long as they are taxed on their

actual profits (*régime réel d'imposition*). This tax rate is optional if the lessor's annual pre-tax earnings do not exceed €76,300, and applies by rights otherwise. The property must be recorded as an asset on the lessor's balance sheet. The lessor can then deduct property expenses in addition to rental expenses, including interest on loans, depreciation of the property, insurance, property tax and legal fees for official documents. Overall taxable income can be reduced on the basis of reported deficits.

### **Deficits that can be charged to other income**

At least in the first few years, total expenses will generate a deficit that can be deducted without limitation from the taxpayer's overall income. However, amortisation can be deducted only up to a ceiling equal to total rent payments, once applicable expenses have been deducted. Therefore, amortisation cannot create or increase the deficit, but any amortisation affected by this rule can be charged against future profits, with no time restrictions. In addition, professional lessors who are members of an approved management centre are eligible for a tax allowance.

### **Non-professional lessors**

If the conditions cited above are not met, the lessor is considered non-professional. However, these rentals remain subject to the rules governing business profits (BIC). The taxpayer may qualify for the rules applicable to microenterprises if his or her annual pre-tax earnings are less than €76,300. In this case, a fixed-rate rebate of 72% is applied to turnover to yield the taxpayer's net taxable income. The lessor is then taxed on the remaining 28% at the marginal tax rate.

### **The option of tax on actual profits**

Taxpayers may opt to be taxed on the basis of their actual profits if, for example, their potentially deductible expenses exceed the 72% allowance. But bear in mind that any reported deficits may not be charged against overall revenue. Such deficits may only be

charged against profits from all non-professional activities. These profits must be taxable as business profits and must have been earned in the same year or in the five subsequent years.

ALAIN DELFOSSE

### **THE YEAR OF DELIVERY**

When properties are acquired while still under construction, delivery of the building must occur in the same year that it is made available for rental. If this is not the case, any expenses incurred during the acquisition year (e.g. interest on loans) may not be deducted from rental income in the following year. According to the tax authorities, these expenses may only be charged against earnings from non-professional activities.

### **OTHER TAX BENEFITS**

Professional lessors renting furnished accommodations may also be entitled to other tax benefits (wealth tax, tax on capital gains, etc.). In addition, they may be able to recover VAT paid when they acquired the property by following certain procedures. They are, however, subject to local business tax.

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## Renting furnished flats to students

*For lessors, it may prove advantageous to rent furnished accommodations to students, so as to avoid the legal obligations imposed on rental premises that sit empty.*

Furnished accommodations that are rented to students are not covered by the law of 6 July 1989. In fact, Article 2 (Paragraph 2) of the law stipulates that it does not apply to furnished premises (see article on page 18).

### Decent housing

Housing must be in good condition, specifically with regard to paintwork, wallpaper and carpeting, upon being turned over to the tenant. It must also provide decent accommodations. In other words, the residence must have a minimum surface area of nine square metres for one person and must be equipped with a heating installation (at least one electrical socket) and a kitchen area that includes a sink with hot and cold water as well as space for installing cooking equipment. The flat must include a WC unless it consists of only one room, in which case the WC may be located outside the flat. If these standards are not met, the lessor may be required to upgrade the premises in order to bring them into compliance.

#### ➤ The lease contract

Apart from the obligation to provide tenants with decent housing, furnished tenancies are governed by the Civil Code. Therefore, the parties are contractually free to establish the terms and conditions of the lease and, specifically, the rent. A written contract is not required, but strongly recommended nonetheless.

### Advantages of a written agreement

It's worthwhile to come to an agreement with the student regarding a number of important points. Lessors are advised to put their agreement with the tenant in writing. It should include the duration of the rental period and the prior notice required, the security deposit, the amount of rent and possible indexation of the rent, monthly payment dates, any payments required during the summer months, expenses that must be borne by the tenant (electricity, gas, telephone), kitchen access, housing of visitors, rental insurance, etc. Both parties should have a clear understanding of the rental terms and conditions from the outset.

### Inventory and schedule of condition

Each party to the agreement is responsible for assessing any change in the condition of the furnishings on the basis of a precise and detailed inventory of the furniture. This document is attached to the lease contract. Unless a schedule of condition is performed, the flat is deemed to have been in good condition when the student assumed occupancy. The tenant may therefore demand a schedule of condition if the lessor does not offer to conduct one.

### Lessors letting more than four residences

If the lessor is letting more than four furnished residences, the lease must be established in writing. The minimum duration of the lease is one year. The tenant may terminate the contract at any time after prior notice of one month, delivered by registered mail with a request for acknowledgement of receipt. In the absence

of communication from the lessor, the lease is tacitly renewed under the same terms and conditions. If the lessor refuses to extend the lease, he or she must inform the student renter three months prior to the end of the lease. A court may invalidate the removal of a tenant if there is no legitimate grounds for refusing to extend the lease.

### **Payment of rent during holiday periods**

If the lease agreement stipulates that the residence is being rented solely for the academic school year, the student is not obligated to pay rent during the holiday period. On the other hand, if the residence is being rented for a longer period – one year, for example, with a tacit extension of the lease thereafter – the student must normally pay the rent until the end of the period stipulated in the agreement. The student may sublet the residence during the summer months, unless the lessor has included a provision in the lease that prohibits subletting of the flat or requires the lessor's prior approval.

### **Two special cases**

#### **Housing in return for odd jobs**

Housing may be offered to students in return for certain odd jobs. This involves an

employment contract rather than a tenancy, in which the lessor agrees to house the student in exchange for a few hours a week of work or babysitting. The two parties will come to an agreement on the terms of the contract.

### **Subletting a room**

Does a tenant have the right to sublet a room to a student? Not unless the tenant obtains the owner's approval, including an agreement on the rent to be charged. Naturally, once the rental period comes to an end, the student will no longer be entitled to remain in the residence.

RAYMOND WILLMANN

### **ARE RENTALS TO STUDENTS CONSIDERED SEASONAL?**

Tenancy by a student may be considered seasonal if it is solely for the academic school year. The courts have ruled that there is an academic season that may last up to ten months (Court of Appeal [*Cour d'appel*] of Aix-en-Provence, 10 January 1986: *Rev. Administrer*, July 1986, p. 26, note by J.M. Gélinet). In this case, it is essential that the contract include a provision to this effect. If such a clause is present, the student must vacate the premises in full on the date agreed in the contract.

## Rental

### A practical example

# Non-professional furnished tenancies

*Mr Lucien Lenoir, an engineer residing in Paris, has just inherited from his father, who died on 10 January 2003, a large villa in Deauville. Mr Lenoir would like to keep this villa, live in it on an occasional basis and at the same time earn a profit from the residence. One suggestion is that he rent out the villa, furnished, during the summer months.*

The villa's desirable location could help generate gross revenue of about €50,000 per year. Mr Lenoir has an annual income of €100,000 from his occupation. The task is to assess the advantages and disadvantages, particularly in terms of tax liability, of an asset strategy such as this. France's tax rules recognise "non-professional" lessors of furnished accommodations, i.e. those who earn an annual sum of no more than €23,000 or obtain less than 50% of their total income from this activity, which would be the case with Mr Lenoir.

### Income tax

Furnished tenancies are unique in that, even when offered on a non-professional basis, they are considered civil activity from a legal standpoint but commercial activity from a tax standpoint. Note that the second supplementary budget act for 2002 eliminated the requirement that professional lessors be registered with their local trade register. Therefore, lessors of furnished accommodations are taxed on business profits rather than property income.

### Just 28%

When annual earnings are less than €76,300, the tax rules for so-called microenterprises become applicable. These rules offer a considerably reduced tax burden and require fewer tax returns. The taxpayer need merely enter the gross rent amount on the annual income tax return. The tax authorities automatically apply a flat 72% deduction for expenses. In other words, the tax is calculated on the basis of 28% of gross income.

### Social security contributions

Those who rent furnished accommodations must pay the general social security contribution (CSG) and other social security contributions totalling 10% of net income.

### VAT

Since 1 January 1991, furnished tenancies, whether permanent or seasonal, have been exempt from VAT so long as no related services resembling those of a hotel are provided.

### Local taxes

Lessors of furnished accommodations are liable for the business tax or the council tax. In principle, they are subject to the business tax, but those who let a second home as furnished accommodations for just a few weeks out of the year are exempt from the business tax and are subject to the council tax instead. The home itself will, of course, remain subject to property tax.

### Capital gains tax and wealth tax

If the building is sold, any capital gains will be assessed in accordance with the rules established for private capital gains. Non-professional lessors of furnished accommodations are not exempt from the wealth tax, since the asset is not related to their occupation.

### Pros and cons

Clearly, the tax rules for furnished tenancies are attractive. However, bear in mind that that this type of management can require a greater effort than may be apparent.

Tenants are not always careful. You must conduct a schedule of condition and an inventory of the furniture with each change of tenant. As with any undertaking, there are pros and cons to be considered.

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