

Should dividends paid out of reserves be considered as “fruits” or “produits” for French tax law purposes?

Wherever the ownership of equity shares is dismembered, when the shareholders resolve to pay a dividend out of distributable reserves, the right of use enjoyed by the beneficial owner of the equity shares applies - unless otherwise agreed upon between the beneficial owner and the bare owner - in the form of a quasi-usufruct to the “*produits*”^[1] derived from this distribution and paid in relation to the shares held in usufruct, so that the beneficial owner has a debt obligation to return such “*produits*” at the end of the usufruct, such debt, as per applicable legal provisions, being deductible from the estate assets when the usufruct lapses as a result of the death of the beneficial owner.

In a landmark decision^[2], the Commercial Chamber of the *Cour de Cassation* (French Supreme Court) put an end to the controversy surrounding the nature of the **dividends paid out of reserves**, by ruling that wherever the ownership of equity shares is dismembered, when the shareholders resolve to pay a dividend out of distributable reserves, the right of use enjoyed by the beneficial owner of the equity shares applies - **unless otherwise agreed** upon between the beneficial owner and the bare owner - in the form of a **quasi-usufruct** to the “*produits*” derived from this distribution and paid in relation to the shares held in usufruct.

As such, dividends can be considered either as “*fruits*” or as “*produits*”, depending on where they come from:

- Dividends paid out of the distributable profits of the past financial year are to be considered as “*fruits*”^[3];
- Dividends paid out of available reserves are to be considered as “*produits*” (even though, in practice, such reserves are made up of undistributed past profits...), thereby creating a quasi-usufruct, unless

otherwise agreed upon between the beneficial owner and the bare owner.

This ruling has significant consequences from a tax law perspective: Subject to the above, the beneficial owner becomes bound, under Article 587 of the French Civil Code^[4], by a **debt** obligation to return the “*produits*” at the end of the usufruct and such obligation is **deductible from the estate assets** when the usufruct lapses as a result of the death of the beneficial owner^[5].

This ruling, which has already been much criticized by French legal writers and scholars, should be given credit for ending more than a century of debates and uncertainties over the treatment of dividends paid out of reserves.

^[1] French law makes a distinction between “*fruits*” and “*produits*”. “*Fruits*” are things which are produced periodically by a principal thing without diminution of its substance while “*produits*” are derived from a principal thing whose substance is thereby diminished.

^[2] Commercial Chamber of the *Cour de Cassation*, May 27, 2015, n° 14-16.246.

^[3] Cf. in particular decision of the Civil Chamber of the *Cour de Cassation*, October 21, 1931. This is now a well-established case law.

^[4] “*Where a usufruct includes things which cannot be used without being consumed, such as money, grain, liquors, the beneficial owner has the right to use them, but with the responsibility of returning, at the end of the usufruct, either things of the same quantity and quality or their value appraised at the time of restitution.*”

^[5] Article 773, 2° of the French Tax Code stipulates that (i) debts from the deceased to the heirs or intermediaries are not deductible; (ii) however, “*when the debt has been created under a notarized deed or a private agreement with a certain date before the commencement of inheritance proceedings other than through the death of one of the contracting parties, the heirs, donees and legatees, as well as the deemed intermediaries, have the right to prove that the debt is established and that it exists as of the commencement of the inheritance proceedings*”.

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