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## Macron's wealth tax reform: a red light for France's property industry?

The owners of luxury French properties are facing a reformed wealth tax, designed to encourage them to shift capital into business investments.

New French president Emmanuel Macron has just introduced a major reform of the country's wealth tax, focusing it directly on property investments in a bid to push more cash into other sectors of the economy.

Nearly a year after Emmanuel Macron became president of France, his much-touted programme of economic reforms is coming into effect. And one of the first measures out of the blocks is reform of the country's wealth tax, the charge on assets dubbed an 'invitation to leave France' by economic liberals. So how are the changes likely to affect growth, and does the reformed system provide a useful model for other countries?

First introduced by the Socialist Party in the 1980s, the wealth tax was levied on individuals with assets above 1.3m euros (US$1.5m). Given France's left-leaning politics, successive governments of both left and right saw the redistributive tax as politically untouchable. And François Hollande, Socialist president between 2012 and 2017, introduced even tougher fiscal measures – imposing a 75% income tax on high earners, and declaring finance "the enemy".

But Hollande's protégé Macron, who left the Socialist Party to found the independent En Marche! Movement, promised as part of his election campaign to break with this heritage – creating a more modern France that would be open to business. Wealth tax reform was a key part of that pledge.

The goals of reform

From 1 January, the wealth tax was abolished and replaced by a new tax on property holdings. Other kinds of assets are exempt from the new tax, which retains both the old eligibility threshold of 1.3m euros, and the charging schedule: rates start at 0.5% of the assets' value, and climb to reach 1.5% when portfolios top 10m euros. It also retains the discount on taxpayers' primary residence, which is assessed at 70% of market value.

Macron hopes to invigorate growth by pushing cash away from property and into more productive forms of investment, and to attract businesses and high-net worth individuals considering relocating from the UK in the light of the Brexit vote.

According to Paris tax attorney Stéphanie Ernould, the reforms are also designed to align the French system with other European countries where taxes on capital are lower, such as Belgium and Portugal; and, ultimately, to reduce the unemployment rate by triggering investment into innovation and research.

Macron's economy minister, Bruno Le Maire, points out that far fewer people will pay the tax in its new guise: numbers will fall about 40% to just 150,000, he says, with receipts tumbling by some 3.2b euros to just 850m euros.

Delivery challenges

This represents a major tax cut for the rich – and Ernould argues that ministers should be doing more to ensure that savings are redirected into useful investments. The reform “surely implies a responsibility for the government to set up a policy to get taxpayers to ‘transfer’ that excess cash from the tax savings into businesses,” she says.

Given successive governments’ reluctance to lighten the taxes paid by the rich, the changes have sparked relatively little public opposition – something that surprises Sonia Bonnabry, partner at the Lexcom firm of tax lawyers in Paris. However, Bonnabry points out that the reform is set to run into resistance from the property sector: real estate professionals are the biggest single losers in the new system, she points out, and they “deplore the fact that the new property tax does not distinguish between property investment for rental income, and dynamic types of property investment that create jobs and are part of the real economy.”

As the new tax focuses on relatively illiquid investments, Bonnabry adds, the tax office will face greater problems in valuing people’s assets. “To try to get around this, the reform seeks to unify the declaration system, ” she explains. “For the wealth tax, only taxpayers with assets of more than 2.6m euros had to fill in a declaration detailing the composition of their wealth and the value of each asset. With the property tax, all taxpayers – whatever their assets – will have to complete this onerous task each year. ”

Economic doubts and perverse incentives

Stéphanie Ernould says the reforms are also designed to align the French system with other European countries.

It is far from clear that all this extra paperwork will help to divert more cash into business development, R&D and capital investment. The left-wing French economist Thomas Piketty, writing in Le Monde in May 2017, argued that there’s no reason to assume that financial investment is necessarily more productive than property investment. And Frédéric Douet, professor in fiscal law at the University of Rouen-Normandie, warns that the French people’s traditional risk aversion remains a formidable obstacle to increased business investment.

Savings contracts introduced by former finance minister Dominique Strauss-Kahn and former president Nicolas Sarkozy offered tax breaks in return for exposure to French and European stock markets, Douet recalls, but the French public largely steered clear. And he argues that Macron’s distinction between the ‘real economy’ and property income ignores the fact that the construction industry involves more than 400,000 businesses employing more than a million people.

Douet also points out that the old wealth tax offered exemptions for those investing in small businesses – either directly, or via pooled investment funds. This provided a valuable flow of capital into start-ups and small enterprises, he says; and this stream has now dried up. Professor Douet fears that regional small businesses, which find it the hardest to get financing, will be forced into other forms of capital raising such as crowdfunding. Macron could have stimulated investment in small businesses without such a major tax reform, he argues, simply by raising the wealth tax exemption for these investments from 50 to 100%.

Make the change, and watch carefully

France’s economy minister, Bruno Le Maire, points out that far fewer people will pay the tax in its new form.

Ernould is more optimistic, arguing that a parallel increase in the regular income tax reduction for investment into some small businesses and other qualified bodies, which is rising from 18% to 25%, will balance the loss of the wealth-tax credits. But the reform’s impact on flows of investment across France will only become clear slowly, as citizens complete their wealth tax forms, calculate how the changes affect them, and adjust their financial strategies.

In many cases, their freedom of manoeuvre is anyway constrained. According to Douet, France’s richest 30% of taxpayers have only 20% of their assets in property – and in many cases this represents the family home: the focusing of wealth tax on this asset is unlikely to prompt them to sell it and invest their money elsewhere. We may see more substantive changes in behaviour among professional investors who hold portfolios mixing property and other forms of investments, but the limited size of this group will constrain the reform’s economic impact.

If the reforms succeed in their ambitions, though, Macron’s ministers are likely to receive a flow of visitors from other countries eager to push cash out of property markets and into business investments. After years of stasis, he has taken the leap; if he finds his landing ground stable, others are likely to follow. And if he disappears into the mud, we’ll have learned a lesson: never underestimate France’s tradition of risk-averse financial behaviour.