

THE BENEFITS OF A LIFE INSURANCE POLICY FOR PASSING ASSETS THROUGH GENERATIONS IN FRANCE



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A popular investment for French people, life insurance can be relevant whether you want to finance a medium-term project or prepare for your retirement.

In this article, Krystel Gillard, Tax and Legal Counsel - France, explains the many advantages offered by Life insurance in France, including lower taxation, secure capital transfer, passing on capital outside the estate assets and the possibility of transforming your capital into a life annuity.

FRENCH PEOPLE TRUST IN LIFE INSURANCE

Life insurance is the preferred investment of French people, and continues to be so despite the various health, political and financial crises.

Unit-linked contributions are on the rise - as at the end of January 2022, the total amount of life insurance policies outstanding reached €1,871 billion, up 4.3% over the last year. There are approximately 18 million policyholders and 38 million beneficiaries in France. For French savers, life insurance represents a buffer against the various effects that a crisis, with its economic impacts, can have.¹

TAX BENEFITS

In France, life insurance is an excellent way to optimise the transmission of an inheritance and to reduce inheritance taxes, thanks to its advantageous legal and tax position. Where beneficiaries have been nominated, the life insurance policy forms a separate estate, and the sums received by the beneficiary from the contract at the time of the death of the insured, benefit from a special inheritance tax treatment.

For life insurance policies taken out after 13 October 1998, there are two possible inheritance tax consequences which are dependent on the age of the insured when the premiums were paid.

	PREMIUMS PAID BEFORE 13 OCTOBER 1998	PREMIUMS PAID ON OR AFTER 13 OCTOBER 1998
Premiums paid before the insured's 70th birthday	No taxation and no inheritance tax	<ul style="list-style-type: none"> › Tax allowance of €152,500 per beneficiary on the received capital death › From €152,501 to €852,500: 20% withholding tax › Over €852,500: 31.25% flat-rate withholding tax
Premiums paid after the insured's 70th birthday	<ul style="list-style-type: none"> › €30,500 tax allowance to be distributed among all beneficiaries in proportion to the capital received › Application of gift tax for premiums paid that exceeds €30,500. The rate is depending to the relationship between the beneficiary and the insured. 	

¹Source: www.franceassureur.fr

Life insurance policies taken out before 20 November 1991 are subject to the same taxation² regardless of the age of the insured when the premiums are paid:

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No taxation and no inheritance tax	<ul style="list-style-type: none"> › Tax allowance of €152,500 per beneficiary on the received capital death › From €152,501 to €852,500: 20 % withholding tax › Over €852,500: 31.25% flat-rate withholding tax

BENEFICIARY CLAUSE

The "beneficiary clause" is the provision in a life insurance policy that designates the person(s) who will benefit from the accumulated savings in the event of the death of the insured. Most often, the policyholder is the person insured.

The insured is free to draft this clause in the way they see fit. However, it must be drafted as precisely as possible, so that there is no ambiguity about the identity of the beneficiaries. The beneficiary can be a natural person as well as a legal person.

This is an example of a standard French clause: "My spouse, failing that my children, failing that my heirs"

If no beneficiary is identifiable, the death benefit will be returned to the estate of the deceased insured, and would therefore not benefit from the advantageous succession and inheritance tax treatment, hence the importance of drafting this beneficiary clause.

However, the insured may also choose to nominate his or her beneficiaries by name. In this case, the beneficiary clause must be drafted clearly enough to leave no room for interpretation. The insured must indicate the civil status of the beneficiary(ies): surname(s) (and, if applicable, maiden name(s)), first name(s), but also date(s) and place(s) of birth, which are essential to avoid the risk of disputes.

If beneficiaries are specifically named, it is strongly advised to update the beneficiary clause regularly as the status of the insured or the beneficiary may change (due to marriage, divorce, birth or death).

The insured also decides how to distribute the capital among the beneficiaries. He can choose to pay all capital to a single person or divide it among several, either equally by "equal shares", or by a defined proportion "of XX% of the sums" to each. It can also impose specific amounts, for example "€20,000 for so-and-so".

The insured can also "dismember" his or her beneficiary clause and transfer the bare ownership to one person and the usufruct (the right to enjoy the capital during their lifetime) to another. The full ownership will revert to the bare owner at the end of the period of dismemberment or at the death of the usufructuary. Thus, the benefit of the capital can be deferred to a defined age of the beneficiary. This type of clause can be a way to defer the delivery of the capital to a minor or a young adult.

The insured can also include an option clause stating, for example, "Mrs. X, who may elect to receive either the entire principal, one-half, or one-quarter. The remaining portion of the principal will revert to Mrs. Y.". Thus, rather than fixing the share to be paid to each beneficiary, the option clause allows the insured to delegate this choice to a first-ranking beneficiary when the policy is terminated. The latter can choose the share he/she wishes to keep and the one he/she wishes to "transmit" to the second beneficiary, depending on the situation at that time.

USUFRUCT, BARE OWNERSHIP AND FULL OWNERSHIP: WHAT ARE THE DIFFERENCES?

The right of **full ownership** is the sum of the right to enjoy a property, to use it and to receive its fruits/benefits. This right can be dismembered and shared between several individuals, one having **the usufruct** and the other **the bare ownership**. Let's define these three terms:

Usufruct is the right to enjoy a property (to use it or to live in it), to receive its benefits or "fruits" (for example, a rent or a death capital), without having the right to dispose of it (to sell it or make it disappear for example).

Bare ownership is the right to dispose of a property, but not to use it (enjoy it), nor to receive its income. For example, the rental income of a property or the death capital of a life insurance won't be received by the bare owner.

Full ownership is the right to use the property, to dispose of it and to receive the income/benefit from it. In short, full ownership = usufruct + bare ownership.

THE DISMEMBERMENT OF THE BENEFICIARY CLAUSE - "CLAUSE BÉNÉFICIAIRE DÉMEMBRÉE"

The dismemberment of the beneficiary clause allows a double transmission of capital to several people. Under this provision, the policyholder can designate the spouse as beneficiary of the "usufruct", and the three children as beneficiaries of the "bare ownership".

This will allow, among other things:

- › At death, the payment, to the spouse (who will be the usufructory, without being the full owner), of the entire capital on the life insurance contract.
- › The benefit for the children of a claim of restitution to be made on the succession. As the usufruct is most of the time for life, it is at the death of the usufructuary that the full ownership will be reconstituted in the hands of the bare owner.

TAX ASPECTS

A dismemberment of the beneficiary clause ("clause bénéficiaire démembrée") offers the additional advantage that the value of the bare ownership is reduced by the "value" of the usufruct. This can result in significant Inheritance Tax savings, especially where the usufructory is the spouse of the insured, in which case the usufruct will be free of inheritance tax.

²Rates according to the French inheritance tax law.

The value of the usufruct for inheritance tax purposes is determined by a simple mortality table based on the age of the usufructor:

USUFRUCTUARY AGE	USUFRUCT VALUE	BARE OWNERSHIP VALUE
21 - 30	80 %	20 %
31 - 40	70 %	30 %
41 - 50	60 %	40 %
51 - 60	50 %	50 %
61 - 70	40 %	60 %
71 - 80	30 %	70 %
81 - 90	20 %	80 %
90+	10 %	90 %

The tax gain via the dismemberment of the beneficiary clause for a policy taxed according to the article 990I of the French life insurance code, is all the more important where the value of the policy is high and the usufructuary spouse is young in order to play on the maximum leverage effect.

IMPORTANT NOTES

The dismemberment of the beneficiary clause is not a trivial act. It is very important to know exactly what the financial objectives of the clients are. A quasi-usufruct agreement is strongly recommended to set up the relationship between the beneficiaries by determining the amount of the "restitution claim". To recall its existence and make it enforceable against the estate of the quasi-usufructuary, it must be registered with the French tax authorities or by notarial act.

ACCEPTANCE OF THE BENEFICIARY CLAUSE

The most effective way to ensure a proper transmission of the capital is to inform beneficiaries that they have been designated as beneficiaries of a life insurance policy, so that they can recover the capital after the death of the policyholder.

Before the death, if the beneficiary is informed by the insured and in agreement with him/her, he/she can choose to accept the life insurance. This is materialized by the signature of a tripartite endorsement between the insurer, the beneficiary and the policyholder. It is also necessary to wait for a period of 30 days from the conclusion of the policy. On the other hand, a refusal of the life insurance prior to the death is not possible.

Once accepted, it becomes irrevocable and the life insurance policyholder can no longer make a surrender or pledge the policy without the beneficiary's authorization.

Upon the death of the insured, the accepting beneficiary may choose to waive the benefits of the life insurance policy or not.

NOTE

Until 2007, it was not that simple. Indeed, an informed person could accept the benefit of the life insurance without the knowledge of the policyholder, by a simple letter to the insurer. The policyholder was thus trapped, unable to recover his capital or modify the beneficiary clause without the agreement of the said beneficiary.

BENEFICIARIES WHO ARE EXEMPT FROM TAXATION

Some beneficiaries, such as the ones nominated by a beneficiary clause or by will, are exempt from any taxation. This is the case for:

- › the surviving spouse
- › the partner in a civil partnership
- › the brother or sister under conditions (being single, widowed, divorced or legally separated, and that at the death of the policyholder, aged over 50 years or suffering from a disability preventing him/her from supporting himself/herself, he/she has lived with the deceased during the 5 years preceding the death).

FRENCH CASE ABOUT THE BENEFICIARY CLAUSE

Cour de cassation, 1ere chambre civile du 17 novembre 2021, pourvoi 20-12.711

Court of Cassation, 1st Civil Chamber of 17 November 2021, Appeal 20-12.711

This recent French Case illustrates the necessity to wisely and precisely write the "beneficiary clause".

In France, it has been known for a long time now that when the policyholder modifies his beneficiary clause in favour of someone else, he does not have to inform the person he had previously designated. However, does this also apply when the change has been made by a judge?

THE FACTS

A woman took out several life insurance policies, designating her son and daughter as beneficiaries and, in the event of the pre-death of one of them, the surviving child. Her daughter died, leaving two daughters to succeed her. The policyholder was then placed under guardianship and one of her granddaughters became her guardian.

The life insurance policies at that time named the son as the sole beneficiary. But the guardian asked the guardianship judge to modify the beneficiary clause "in favour of the heirs according to the legal devolution". In other words: the children and their descendants. The guardianship judge authorised her to do so, by an order that was not notified to the son. The son appealed against this decision.

The judges ruled against the son. According to them, the guardianship judge did not have to notify the son of his decision: he had no vested right to the capital from the life insurance policies, as the nomination was revocable. To do so, he would have had to accept the benefit of these policies in advance with the agreement of the policyholder, which he had not done in this case.

FLEXIBILITY IN THE TRANSMISSION OF ASSETS

Unlike a gift, which by its very nature divests the donated property, life insurance makes it possible to anticipate the transmission of the estate by preserving the free disposal of the capital and reducing inheritance taxes.

Indeed, this flexibility and the practical aspect of life insurance allows the policyholder to use the sums on the policy during one's lifetime, for example to supplement their income, and to transmit the remaining amount outside the estate at the time of death.

Another important advantage is that, as the death benefit is passed on outside the estate, it is not subject to the rules of devolution of the estate, nor to those of the reduction for infringement of the insured's heirs' reserve. Therefore, it is possible to benefit the beneficiary (who may be a third party) through a life insurance policy to the detriment of the heirs with right of first refusal.

It is important to know that if the amount of the premiums paid represents a substantial part of the policyholder's wealth, they could be considered as "exaggerated premiums". Consequently, the Court may consider that the policyholder intended to disinherit certain normally protected persons ("forced heirs" = "héritiers réservataires"), which may result in the portion of the death benefit considered excessive being reintegrated into the estate.

CONCLUSION

Thanks to its flexibility and advantageous taxation, life insurance is an ideal investment for many life projects. The ability to withdraw savings at any time allows the policyholder to release the sums needed to finance many projects.

Moreover, a life insurance policy has no end date: it is closed on the occasion of a total surrender, on the decision of the policyholder, or on death. The same policy can therefore be used to prepare for multiple projects, during working life, after retirement (to generate additional income) and for inheritance purposes.

It is also possible to open several policies and dedicate them to a particular asset objective. For example, you can have one policy that will be used to build up savings for retirement, in order to have capital that can be easily withdrawn to generate additional income tax efficiently, and another that will be used solely to build up capital to be passed on to designated beneficiaries as part of the estate.

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