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Property ownership tax and commercial lease: Who should pay ?

The property ownership tax (*taxe foncière*) is a local tax levied once a year by municipalities. To calculate the amount of the tax, tax authorities use the cadastral rental value of the property. This base is then multiplied by the tax rate set by each municipality. Any owner of a real estate property is liable for the property ownership tax.

However, while the owner is effectively legally liable for this tax, it is permissible, under a commercial lease agreement, for the latter to pass all or part of the burden of this tax to the lessee of the property. But what exactly does the law say?

A look back at a three-part debate on the property ownership tax.

1. Allocation of the property ownership tax between the lessor and the lessee

Law No. 2014-626 of June 18, 2014 on craft and retail sectors and micro-companies, known as the "Pinel Law" (the "Law") has introduced amendments to the legal regime governing commercial lease agreements.

Since its adoption, "*every lease [must] include a precise and restrictive inventory of the categories of service charges, taxes, duties and fees related to the commercial lease, with an indication of how they are to be allocated between the lessor and the lessee*".

The Implementing Decree No. 2014-1317 of November 3, 2014 sets out in particular the list of the above-mentioned expenses that cannot be charged to the lessee.

Following a question asked by a member of Parliament to the Government about the possible limitation of the lessor's contractual freedom to pass on the burden of the property ownership tax to the lessee, the Minister of Housing indicated that taxes, duties and fees for which the lessor is legally liable as per applicable legal provisions cannot be charged to the lessee. However, the property ownership tax, as well as taxes, duties and service charges related to the use of the premises or building and the services from which the lessee benefits directly or indirectly, are not *de facto* the responsibility of the lessor, insofar as the lessee benefits from them.

It is therefore permissible to charge the lessee for the payment of the property ownership tax and its additional taxes, provided however that this has been included in the commercial lease agreement[1].

2. Consequence *of the passing of the ownership property tax to the lessee on the rental value of the leased premises*

While the above-mentioned Decree lays down the principle of tax allocation, it has not modified the previous state of the law, which provides, pursuant to Article R. 145-8 of the French Commercial Code that "*From the point of view of the parties' respective obligations, […] the obligations normally incumbent on the lessor that have been passed on to the lessee, without consideration, represent a factor that reduces the rental value*".

As such, when the lessee is required to refund the property ownership tax under the terms of the commercial lease agreement, this is considered as a charge justifying a reduction in the rental value of the premises.

This principle nevertheless invites discussion if we consider that the burden of the property ownership tax transferred to the lessee corresponds to the use of the premises.

In any case, once the burden of the property ownership tax has been divided between the lessor and the lessee, the question of the rental value arises. When the tax is paid by the lessee, should we infer therefrom that the amount of the property ownership tax is to be deducted from the amount of rent paid by the later?

3. Assessment of the rental value of the leased premises

The assessment of the rental value falls within the remit of trial judges who apply for this purpose the method they consider most appropriate. As such, the deduction of the property ownership tax was denied in the two following cases:

- The refund of the property tax to the lessor was a standard practice in the industry in which the lessee operated [2];
- The Court of Appeals referred to the prices applied in the neighborhood for businesses that, in addition to rent, bear the full or partial burden of property ownership tax[3].

This second case is, however, both debatable and debated:

This case concerned a dispute over the amount of the renewed rent under a commercial lease agreement. The Court of Appeals of Aix-en-Provence had set the revised rent taking into account the payment of the property ownership tax by the lessee, thereby reducing the rental value.

The lessor challenged this decision, arguing that the rents under other commercial lease agreements used for comparison purposes also included an obligation for lessees to refund the property ownership tax. An allowance could therefore not be retained without examining whether these rents under commercial leases used for comparison purposes actually caused the property ownership tax to be passed on the lessees.

The *Cour de Cassation* (French Supreme Court) ruled in favor of the lessor and quashed the judgment of the Court of Appeals because this latter had failed to investigate this issue.

Consequently, while Article R145-8 of the French Commercial Code lays down the rule, the *Cour de Cassation* lays down the principle: when the trial judges make a sovereign assessment of the rental value of commercial premises according to the method of comparison with the prices applied in the neighborhood, the deduction of the amount of the property ownership tax is not allowed if the rents under other commercial leases used for comparison purposes also place lessees under the obligation to pay the property ownership tax.

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[1] Ministerial Response n°10018; JOAN, May 9 , 2017. P. 3301).

[2] Court of Appeals of Aix-en-Provence, June 30, 2015, n° 14/11266

[3] 3rd Civil Chamber of the *Cour de cassation*, March 16, 2017, n° 16-11972