Article I

Article I of the Protocol revises Article 4 (Resident) of the Convention by adding two subparagraphs to paragraph 2(b), and by replacing subparagraphs (b)(iii) and (iv). These changes clarify the meaning of “resident” in certain cases, and address the treatment of cross-border investments made through partnerships and other similar forms of entity. The changes were necessary because of differences in the way France and the United States view such entities.

In general, subparagraphs 2(b)(iv) through (b)(vi) provide specific rules in the case of income derived through fiscally transparent entities such as partnerships and
certain estates and trusts. In general, fiscally transparent entities are entities the income of which is taxed at the beneficiary, member, or participant level. Entities falling under this description in the United States include partnerships, common investment trusts under Internal Revenue Code section 584, and grantor trusts. This paragraph also applies to U.S. limited liability companies (“LLCs”) that are treated as partnerships for U.S. tax purposes. Entities that are subject to tax, but with respect to which tax may be relieved under an integrated system, are not considered fiscally transparent entities.

The Protocol revises paragraph 2(b) by moving a “fonds commun de placement” from subparagraph (b)(iii) to (b)(iv). Thus, a “fonds commun de placement” is no longer an automatic resident under the Convention; instead, it is treated as a partnership for purposes of claiming U.S. tax benefits under the Convention. Thus, it will be considered a “resident of a Contracting State,” but only to the extent that the income it derives is treated in that Contracting State as the income of a resident. This is consistent with the rule allowing for specific identification of an entity by the treaty partners as a resident entitled to claim treaty benefits. See Treas. Reg. § 1.894-1(d)(1).

The Protocol clarifies that under subparagraph (b)(iv), an item of income, profit or gain derived by a fiscally transparent entity will be considered to be derived by a resident of a Contracting State if a resident is treated under the taxation laws of that State as deriving the item of income. In the case of income or gains arising in France, treaty benefits are available only if the conditions set forth in subparagraphs (b)(iv)(aa) through (dd) are also met: there is no contrary position in a double taxation convention between either Contracting State and the third state; the fiscally transparent entity is not treated as a corporation for tax purposes, or otherwise liable to tax on French source income in its own hands or in the hands of its partners, beneficiaries, or grantors under the tax laws of the third State; a partner’s, beneficiary’s or grantor’s share of income or gain is generally taxed in the same manner as it would have been were that income or gain derived directly, except to the extent resulting from differences in accounting methods, accounting periods, or other similar differences; and information concerning the fiscally transparent entity, or its partners, beneficiaries, or grantors, may be exchanged under the terms of a double tax convention between the Contracting State in which the income arises and the third State.

For example, if a French company pays interest to an entity that is treated as fiscally transparent for U.S. tax purposes, the interest will be considered derived by a resident of the United States only to the extent that the taxation laws of the United States treats one or more U.S. residents (whose status as U.S. residents is determined, for this purpose, under U.S. tax law) as deriving the interest for U.S. tax purposes. In the case of a partnership, the persons who are, under U.S. tax laws, treated as partners of the entity would normally be the persons whom the U.S. tax laws would treat as deriving the interest income through the partnership. Also, it follows that persons whom the United States treats as partners but who are not U.S. residents for U.S. tax purposes may not claim a benefit for the interest paid to the entity under the Convention, because they are not residents of the United States for purposes of claiming this treaty benefit. (If, however, the country in which they are treated as resident for tax purposes, as determined
under the laws of that country, has an income tax convention with France, they may be entitled to claim a benefit under that convention.) In contrast, if, for example, an entity is organized under U.S. laws and is classified as a corporation for U.S. tax purposes, interest paid by French company to the U.S. entity will be considered derived by a resident of the United States since the U.S. corporation is treated under U.S. taxation laws as a resident of the United States and as deriving the income.

The same result obtains even if the entity is viewed differently under the tax laws of France (e.g., as not fiscally transparent in the first example above where the entity is treated as a partnership for U.S. tax purposes). Similarly, the characterization of the entity in a third country is also irrelevant, even if the entity is organized in that third country. The results follow regardless of whether the entity is disregarded as a separate entity under the laws of one jurisdiction but not the other, such as a single owner entity that is viewed as a branch for U.S. tax purposes and as a corporation for French tax purposes. These results also obtain regardless of whether the entity is organized in the United States or, subject to the limitations above, in a third country).

For example, income from U.S. sources received by an entity organized under the laws of the United States, which is treated for French tax purposes as a corporation and is owned by a French shareholder who is a French resident for French tax purposes, is not considered derived by the shareholder of that corporation even if, under the tax laws of the United States, the entity is treated as fiscally transparent.

These principles also apply to trusts to the extent that they are fiscally transparent in either Contracting State. For example, if X, a resident of France, creates a revocable trust in the United States and names persons resident in a third country as the beneficiaries of the trust, X would be treated under U.S. law as the beneficial owner of income derived from the United States. In that case, the trust’s income would be regarded as being derived by a resident of France only to the extent that the laws of France treat X as deriving the income for French tax purposes.

New subparagraph (iv) is not an exception to the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions). Accordingly, subparagraph (iv) does not prevent a Contracting State from taxing an entity that is treated as a resident of that State under its tax law. For example, if a U.S. LLC with French members elects to be taxed as a corporation for U.S. tax purposes, the United States will tax that LLC on its worldwide income on a net basis, and will impose withholding tax, at the rate provided in Article 10, on dividends paid by the LLC, without regard to whether France views the LLC as fiscally transparent.

New subparagraph (b)(v) applies to a fiscally transparent entity organized in the United States that derives income from the United States and France. In the United States, the fiscally transparent entity is treated as a resident in proportion to the income it derives from both Contracting States. Such entity will also be treated as a resident of France to the extent that it derives French source income allocable to French resident partners, beneficiaries or grantors. The purpose of the latter provision is to ensure that
France will not be denied the ability to tax the income of a French partner in a U.S. partnership, even though France otherwise might treat the U.S. entity as an entity that is not fiscally transparent.

New subparagraph (b)(vi) clarifies that, for purposes of subparagraphs (b)(iv) and (v), the income derived by a fiscally transparent entity is considered to be treated under the tax laws of one of the Contracting States as the income of a resident to the extent it benefits a partner, beneficiary, or grantor that is a pension trust, other organization, or not-for-profit organization referred to in subparagraph (b)(ii), even if such income is exempt from tax under the laws of that State.

**Article II**

Article II of the Protocol modifies Article 10 (Dividends) of the Convention by deleting and replacing the last sentence in the final paragraph of paragraph 2. Article 10 provides rules for the taxation of dividends paid by a company that is a resident of one Contracting State to a beneficial owner that is a resident of the other Contracting State.

Paragraph 2 limits the right of the source State to tax dividends beneficially owned by a resident of the other Contracting State. In the case of dividends paid by a U.S. real estate investment trust (“REIT”), the U.S. tax is limited to 15 percent of the gross amount of dividends in certain circumstances; otherwise, the statutory rate of thirty percent applies. The Protocol broadens the scope of paragraph 2 by enlarging the class of shareholders that qualify for the reduced rate of withholding tax. These changes are consistent with provisions in recent U.S. treaties.

Under new paragraph 2, the 15 percent maximum rate of withholding tax is applicable to dividends paid by a U.S. REIT if one of three conditions is satisfied: the beneficial owner of the dividend is an individual holding an interest in the REIT of not more than 10 percent; the dividend is paid on a class of stock that is publicly traded and the beneficial owner of the dividend is a person holding an interest of not more than 5 percent of any class of the REIT’s stock; or the beneficial owner of the dividend is a person holding an interest in the REIT of not more than 10 percent and the value of no single interest in real property owned by the REIT exceeds 10 percent of the value of the REIT’s total interest (i.e., the REIT is diversified). If none of these conditions are met, dividends paid by the REIT will be subject to the U.S. domestic withholding rate of 30 percent.

**Article III**

Article III of the Protocol replaces Article 18 (Pensions) of the Convention. Article 18 provides rules for the taxation of pensions and social security benefits.
Paragraph 1

Paragraph 1 provides for exclusive source country taxation of social security benefits, pension distributions and other similar remuneration paid by a pension or other retirement arrangement established in one Contracting State to a resident of the other Contracting State. The rule applies to both periodic and lump sum payments.

Paragraph 2

Subparagraph (a)(i) of paragraph 2 allows an individual who exercises employment or self-employment in a Contracting State to deduct or exclude from income in that Contracting State contributions made by or on behalf of the individual during the period of employment or self-employment to an exempt pension trust established in the other Contracting State. Thus, for example, if a participant in a U.S. qualified plan goes to work in France, the participant may deduct or exclude from income in France contributions to the U.S. qualified plan made while the participant works in France. Paragraph 2, however, applies only to the extent of the relief allowed by the host State (e.g., France in the example) for contributions to an exempt pension trust established in that State.

Subparagraph (a)(ii) provides that, in the case of employment, accrued benefits and contributions by or on behalf of the individual’s employer, during the period of employment in the host State, will not be treated as taxable income to the employee in that State. Subparagraph (a)(ii) also allows the employer a deduction in computing business profits in the host State for contributions to the plan. For example, if a participant in a U.S. qualified plan goes to work in France, the participant’s employer may deduct from its business profits in France contributions to the U.S. qualified plan for the benefit of the employee while the employee renders services in France.

As in the case of subparagraph (a)(i), subparagraph (a)(ii) applies only to the extent of the relief allowed by the host State for contributions to pension funds established in that State. Therefore, where the United States is the host State, the exclusion of employee contributions from the employee’s income under this paragraph is limited to elective contributions not in excess of the amount specified in section 402(g). Deduction of employer contributions is subject to the limitations of sections 415 and 404. The section 404 limitation on deductions is calculated as if the individual were the only employee covered by the plan.

France has both mandatory and non-mandatory pension plans. The relevant comparison, for purposes of determining the amount and timing of deductions for French tax purposes of amounts contributed to a U.S. retirement arrangement, is to the French mandatory plans, provided that the French competent authority agrees that the U.S. arrangement in question generally corresponds to the French mandatory plan (even though the U.S. arrangement may not be mandatory).
Subparagraph (b) of paragraph 2 limits the availability of benefits under subparagraph (a). Under subparagraph (b), subparagraph (a) does not apply to contributions to an exempt pension trust unless the participant already was contributing to the trust, or his employer already was contributing to the trust with respect to that individual, before the individual began exercising employment in the State where the services are performed (the “host State”). This condition would be met if either the employee or the employer was contributing to an exempt pension trust that was replaced by the exempt pension trust to which he is contributing. The rule regarding successor trusts would apply if, for example, the employer has been taken over by a company that replaces the existing pension plan with its own plan, rolling membership in the old plan and assets in the old trust over into the new plan and trust.

In addition, under subparagraph (b), the competent authority of the host State must determine that the recognized plan to which a contribution is made in the other Contracting State generally corresponds to the plan in the host State. Subparagraph (c) enumerates plans that are considered to “generally correspond” such that they are automatically eligible for treaty benefits under paragraph 2(a). The competent authorities may agree that distributions from other plans that generally meet similar criteria to those applicable to other plans established under their respective laws also qualify for the benefits of paragraph 2(a).

In the United States, the plans that are automatically eligible for benefits under paragraph 2 include a French pension or other retirement arrangement organized under the French social security legislation.

In France, the plans that are automatically eligible for benefits under paragraph 2 include qualified plans under section 401(a) of the Internal Revenue Code, individual retirement plans (including individual retirement plans that are part of a simplified employee pension plan that satisfies section 408(k), individual retirement accounts, individual retirement annuities, and section 408(p) accounts), section 403(a) qualified annuity plans, and section 403(b) plans. Social security or other similar legislation of the United States is also automatically eligible for benefits under paragraph 2. Although not specifically mentioned in the Protocol, Roth IRAs under section 408A are of course a type of individual retirement plan and therefore also automatically eligible for benefits under paragraph 2.

Relationship to other Articles

Paragraph 1 of Article 18 is an exception to the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions) by virtue of paragraph 3(a) of Article 29 as revised by this Protocol. Thus, a U.S. citizen who resides in the United States and receives distributions from a pension plan established in France will be subject to tax solely in France on that distribution.

Paragraph 2 of Article 18 is an exception to the saving clause of paragraph 2 of Article 29 by virtue of paragraph 3(b) of Article 29 as revised by this Protocol, but only
in the case of individuals who are neither citizens of, nor have immigrant status in, the United States. The term "immigrant status" refers to a person admitted to the United States as a permanent resident under U.S. immigration laws (i.e., holding a "green card"). Accordingly, a U.S. resident (who is not a citizen or a green card holder) who is a beneficiary of a French pension plan will not be subject to tax in the United States on the earnings and accretions of, or the contributions made to, a French exempt pension trust with respect to that U.S. resident.

Article IV

Article IV of the Protocol makes changes to Article 19 (Public Remuneration) of the treaty. These changes are necessary because of the revisions made by the Protocol to Article 18 (Pensions).

The Protocol deletes paragraph 2, which deals with the taxation of pensions paid in respect of government services described in paragraph 1. The provisions of new Article 18 now govern the treatment of such pensions.

Paragraph 3 of Article 19 provides cross-references to treaty Articles that apply to remuneration for services performed in connection with a business carried on by a governmental body. The Protocol updates paragraph 3 by deleting the reference to Article 18, and renumbers it paragraph 2.

Article V

The Protocol deletes subparagraph (b)(iv) of paragraph 2 [Paragraph 1 in French language] of Article 24 (Relief From Double Taxation) of the treaty, which allows a U.S. citizen and resident of France a credit equal to the amount of French tax attributable to income dealt with in subparagraph (a) of paragraph 1 of Article 18 (Pensions) that was also subject to tax in the United States. Subparagraph (b)(iv) is rendered obsolete by the provisions of Article 18 as amended by the Protocol.

The Protocol renumbers subparagraphs (b)(v) and (vi) of paragraph 2 [Paragraph 1 in French language] of Article 24 subparagraphs (b)(iv) and (v) respectively to account for the deletion of subparagraph (b)(iv).

The Protocol replaces subparagraph (c) of paragraph 1 [Paragraph 2 in French language] of Article 24 to omit the reference to paragraph 2 of Article 19 (Public Remuneration). This change conforms to revisions made to Article 18 and Article 19 (Public Remuneration) by the Protocol.

Article VI

Article VI of the Protocol makes changes to paragraphs 2 and 3 of Article 29 (Miscellaneous Provisions).
The Protocol revises paragraph 2 of Article 29, which permits the United States to continue to tax as U.S. citizens former citizens whose loss of citizenship had as one of its principal purposes the avoidance of tax, but only for a period of 10 years following such loss. To reflect 1996 amendments to U.S. tax law in this area, the Protocol extends this treatment to former long-term residents whose loss of such status had as one of its principal purposes the avoidance of tax.

Section 877 of the Internal Revenue Code provides for special tax treatment of former U.S. citizens and long-term residents who gave up their citizenship or long-term resident status to avoid U.S. tax. Prior to its amendment by the American Jobs Creation Act of 2004 (AJCA), section 877 applied to individuals that relinquished U.S. citizenship or terminated long-term residency with a principal purpose (i.e., subjective intent) of tax avoidance. An individual was generally presumed to have a tax avoidance purpose if their net worth or average annual net income tax liability exceeded specified thresholds.

The AJCA replaced the subjective determination of tax avoidance as a principal purpose for relinquishment of citizenship or termination of residency with objective rules. Former citizens or long-term residents are now subject to U.S. tax for the 10-year period following loss of such status, unless they fall below certain net income and net worth thresholds or satisfy certain limited exceptions for dual citizens and minors who have had no substantial contact with the U.S.

Thus, section 877 now treats individuals who expatriate and meet the objective tests as having expatriated for tax avoidance purposes. Accordingly, the objective tests in section 877 represent the administrative means by which the United States determines whether a taxpayer has a tax avoidance purpose for purposes of the reservation of taxing rights contained in the last sentence of paragraph 2 of Article 29.

The Protocol also replaces paragraph 3 of Article 29. Paragraph 3 provides exceptions to the saving clause set forth in paragraph 2 of Article 29. The Protocol updates paragraph 3 to account for changes made in Article 18 (Pensions).

**Article VII**

Article VII contains the rules for bringing the Protocol into force and giving effect to its provisions.

Paragraph 1 provides for the ratification of the Convention by both Contracting States according to their constitutional and statutory requirements. Each State must notify the other as soon as its requirements for ratification have been complied with. The Convention will enter into force on the date of the later of such notifications.

In the United States, the process leading to ratification and entry into force is as follows: Once a protocol or treaty has been signed by authorized representatives of the two Contracting States, the Department of State sends the protocol or treaty to the President who formally transmits it to the Senate for its advice and consent to ratification,
which requires approval by two-thirds of the Senators present and voting. Prior to this vote, however, it generally has been the practice of the Senate Committee on Foreign Relations to hold hearings on the protocol or treaty and make a recommendation regarding its approval to the full Senate. Both Government and private sector witnesses may testify at these hearings. After receiving the Senate's advice and consent to ratification, the protocol or treaty is returned to the President for his signature on the ratification document. The President's signature on the document completes the process in the United States.

The date on which a treaty enters into force is not necessarily the date on which its provisions take effect. Paragraphs 2 and 3 contain rules that determine when the provisions of the treaty will have effect.

Under subparagraph (a) of paragraph 2, the provisions of the Protocol relating to taxes withheld at source will have effect with respect to amounts paid or credited on or after the first day of the second month following the date on which the Protocol enters into force. For example, if instruments of ratification are exchanged on April 25 of a given year, the withholding rates specified in paragraph 2 of Article 10 (Dividends) as provided in Article II would be applicable to any dividends paid or credited on or after June 1 of that year.

This rule allows the benefits of the withholding reductions to be put into effect as soon as possible, without waiting until the following year. The delay of one to two months is required to allow sufficient time for withholding agents to be informed about the change in withholding rates. If for some reason a withholding agent withholds at a higher rate than that provided by the Convention (perhaps because it was not able to re-program its computers before the payment is made), a beneficial owner of the income that is a resident of France may make a claim for refund pursuant to section 1464 of the Code.

For all other taxes, subparagraph (b) of paragraph 2 specifies that the Protocol generally will have effect for any taxable period beginning on or after January 1 of the year following entry into force.

Paragraph 3 provides special effective dates with respect to the provisions of Article I, paragraph 2 of the protocol relating to the treatment of fiscally transparent entities. In general, these rules will have effect in respect of taxes withheld at source, for any amount paid or credited on or after February 1, 1996. For all other taxes, subparagraph (b) specifies that the Protocol will have effect for any taxable period beginning on or after January 1, 1996. These dates are when such provisions in the current treaty became effective. These special effective dates do not apply to the portion of Article I that treats a “fonds commun de placement” as a partnership for purposes of U.S. tax benefits under the treaty. That rule, therefore, will be effective in accordance with the general rules of paragraph 2 of Article VII.