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EXPLANATION OF PROPOSED PROTOCOL TO THE INCOME TAX TREATY BETWEEN THE UNITED STATES AND FRANCE

SCHEDULED FOR A HEARING

BEFORE THE

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UNITED STATES SENATE

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INTRODUCTION

This pamphlet describes the proposed protocol to the income tax treaty between the United States and France. The protocol was signed at Paris on January 17, 1984. The protocol would amend the current U.S.-France income tax treaty, which entered into force on July 11, 1968. (The treaty was previously amended by two other protocols, which entered into force on February 21, 1972, and October 27, 1979, respectively.) A public hearing on the proposed protocol is scheduled on April 26, 1984, by the Senate Committee on Foreign Relations.

The primary reason for the negotiation of the proposed protocol was France's introduction, effective January 1, 1982, of a wealth tax on certain assets of French resident individuals and certain assets situated in France of nonresident individuals. France did not impose a wealth tax prior to the introduction of this tax. The proposed protocol generally would exempt from the French wealth tax, retroactive to its introduction, assets situated outside France belonging to U.S. citizens who reside in France for periods of five calendar years or less. Assets situated in France belonging to U.S. citizens and residents generally will be subject to the wealth tax.

In the course of their negotiations concerning the wealth tax issue, the U.S. and French representatives also agreed on a number of other changes to the existing treaty. Among these changes are the reciprocal exemption of interest from source country tax; under the existing treaty, with some exceptions, source country tax generally of up to 10 percent may be imposed on interest. Another change is the inclusion for the first time of an anti-treaty shopping article in the treaty. Some of the changes deal with specific problems which have arisen in the administration of the treaty, while others generally modernize the treaty, bringing it into closer conformity with the 1981 proposed U.S. model income tax treaty.

The first part of the pamphlet is a summary of the principal provisions of the proposed protocol. This is followed in part two by a detailed, article-by-article explanation of the proposed protocol.

I. SUMMARY

The proposed protocol contains the following modifications to the income tax treaty between the United States and France.

(1) French wealth tax.—The proposed protocol would amend the existing treaty to cover the tax on large net wealth (l'impot sur les grandes fortunes) imposed by France, beginning on January 1, 1982, on certain assets of French resident individuals and certain assets situated in France of nonresident individuals. The protocol would add a new capital taxation article to the existing treaty allowing the countries to tax the capital of residents of the other, subject to certain limitations. The new article would provide a five-calendar year exemption from the French wealth tax, retroactive to the date of its inception, for assets situated outside France belonging to U.S. citizens residing in France who are not French nationals. U.S. citizens who lose their status as French residents and later become French residents again are entitled to additional five-year exemptions if their periods of French residence are at least three years apart. France would be required to allow as a credit against its wealth tax any allowable U.S. tax imposed on capital of French residents.

(2) Interest.—The proposed protocol would provide a general exemption from tax at source for interest. Under the existing treaty, the rate of source country tax on interest is generally limited to 10 percent, with a full exemption granted only for interest on bank loans. At France's request, the French exemption for interest would apply to interest, which would otherwise be subject to French withholding tax, paid from French sources to U.S. branches of French banks, financial institutions, and credit institutions.

(3) Anti-treaty shopping provision.—The proposed protocol would add a provision to the treaty that generally limits the use of the treaty by corporations to corporations whose shares are publicly traded in France or the United States and corporations controlled by U.S. residents, U.S. citizens, French residents, companies whose shares are publicly traded in France or the United States, the two countries themselves, or any combination of them. The existing treaty does not contain an anti-treaty shopping provision. The proposed anti-treaty shopping provision is similar to those included in the U.S. income tax treaties with New Zealand and Australia, ratified in 1983. It is somewhat less strict than the anti-treaty shopping provision of the 1981 proposed U.S. model income tax treaty (the "U.S. model treaty" or the "U.S. model").

(4) Exchange of information.—The proposed protocol would modify the present exchange of information provision to make clear that persons involved in the administration of taxes, such as Congressional committees with oversight responsibilities with respect to tax matters, and their agents, will have access to information exchanged pursuant to the treaty.

(5) Income from real property.—The proposed protocol would terminate the election provided in the present treaty to investors in real property and natural resources situated in the country not of their residence to have their investments taxed by the situs country on a net basis, that is, as if the investors were engaged in business in the situs country. While current U.S. internal law independently provides a net basis taxation election to nonresident alien individuals and foreign corporations, the statutory election generally may not be made or declined on an annual basis, as the treaty election may be.

(6) Remuneration from ship or aircraft employment.—Under the proposed protocol, remuneration from regular employment on a ship or aircraft operated internationally could be taxed by the employee's country of residence only, rather than, as is generally the case under the existing treaty, by the operator's country of residence only.

(7) Artistes and athletes.—The protocol would adopt, with one significant variation, the U.S. model treaty regime for taxing artistes and athletes. A country could tax an artiste or athlete if he or she earns more than $10,000 (including expense reimbursements) from entertainment-related activities there during the year. The comparable threshold for source country taxation in the U.S. model treaty is $20,000. Special anti-abuse rules would apply where the income from activities of an entertainer accrues to another person. The protocol would eliminate a provision in the present treaty expressly allowing France to tax French public entertainers on income from services performed in the United States.

(8) Teachers and researchers.—Under the proposed protocol, teachers or researchers residing in one country who visit the other for two years or less to teach or conduct research at accredited research institutions would be exempt from tax in the host country on their teaching or research income.

(9) Private pensions and annuities.—The protocol would make reciprocal rules similar to those regarding the tax treatment of U.S. pensions of French residents that are set forth in the notes exchanged when the second protocol to the existing treaty was signed.

(10) Other income.—The protocol would replace the present treaty rule that income not dealt with elsewhere in the treaty is taxable by the source country with the current U.S. model treaty rule that items of income not dealt with elsewhere in the treaty that are derived by a resident of either country are taxable by the country of residence only.

(11) Relief from double taxation.—The proposed protocol would amend in several respects the provisions of the treaty which deal with the avoidance of double taxation. The protocol would modernize the language of the treaty provision setting forth the basic U.S. foreign tax credit rule. The protocol would clarify that capital gains derived by French residents from the disposition of U.S. real property are exempt from French tax. The protocol would provide a rule preventing the double imposition of capital taxes.

Several amendments involve the present treaty rules for avoiding double taxation of U.S. citizens residing in France. First, income earned from personal services performed in the United

States by a U.S. citizen residing in France that is taxable in the United States only by reason of citizenship would no longer be exempt from French tax; under the protocol, France may tax such income and the United States will re-source it as French-source income to the extent necessary to credit the French tax. Second, alimony and annuities paid to a U.S. citizen residing in France would, for the first time, be exempt from French income tax. Third, the proposed protocol would provide generally that U.S.-source income of U.S. citizens residing in France that is subject to French tax under the treaty will be re-sourced as French-source income to the extent necessary to give the recipient a U.S. foreign tax credit sufficient in amount to avoid double taxation of the income; the protocol eliminates the fractional re-sourcing method of the existing treaty. Finally, the protocol would place a 50-percent limitation on the amount of earned income from a partnership accruing to a French resident that may be exempt from French tax; the present treaty so limits the French tax exemption for partnership income accruing to U.S. citizens who are French residents but not for partnership income accruing to French nationals.

(12) Refunds.—The proposed protocol would specifically allow refunds to be made regardless of the statute of limitations or other procedural limitations of the countries.

II. EXPLANATION OF PROPOSED PROTOCOL

A detailed, article-by-article explanation of the proposed protocol to the income tax treaty between the United States and France is presented below.

Article I. French Wealth Tax

In the case of the United States, the present treaty applies to the U.S. Federal income taxes and to the U.S. excise tax on insurance premiums paid to a foreign insurer. (The latter tax is covered, however, only to the extent that the foreign insurer does not reinsure such risks with a company not entitled to the exemption.) In the case of France, the present treaty applies to the various French income taxes, including prepayments or advance payments of these taxes, and the tax on Stock Exchange transactions. Although the United States does not presently impose any documentary tax on the sale or transfer of securities, the present treaty will apply to taxes on sales or transfers of securities that the United States may subsequently impose. The present treaty also contains the provisions generally found in U.S. income tax treaties to the effect that the treaty will apply to substantially similar taxes which either country may subsequently impose.

The proposed protocol would amend the existing treaty to provide that the French tax on large net wealth (l'impot sur les grandes fortunes) is a tax covered by the treaty. This is a new tax, adopted in December 1981 and effective on January 1, 1982. France did not previously impose a wealth tax. The French wealth tax, and the proposed protocol rules governing the imposition of capital taxes generally are discussed in detail under Article 10.

The protocol would also amend the preamble of the present treaty to indicate that the treaty is intended to avoid double taxation of capital as well as income.

Article 2. Income From Real Property

The proposed protocol would terminate the election provided in the present treaty to investors in real property and natural resources situated in the country not of their residence to have their investments taxed on a net basis in the situs country.

Under the present treaty, real property income and natural resources royalties (including gains from the sale or exchange of the property or right giving rise to the royalty, but not including interest on debts secured by encumbrances on the real property or royalty interest) are taxable by the country in which the property or natural resource is located. In addition, a resident of one country may elect to be taxed in the other country on real property income and natural resources royalties as if the resident were engaged in business in the other country. This election may be made or declined annually without restriction. A similar election appears in the U.S. model treaty; however, under the U.S. model, the election, once made, is binding for all subsequent years unless the competent authorities of the two countries agree to allow the taxpayer to terminate the election.

By making the present treaty election, a French resident who owns real property in the United States will be able to claim U.S. tax deductions for depreciation and other expenses to the extent such deductions would be allowed were the French investor engaged in business in the United States. That is, the French investor will be taxed by the United States on his income from U.S. real property on a net basis rather than on a gross basis. Because the present treaty election may be made or revoked on an annual basis, French investors may sometimes have unintended tax planning opportunities. For example, they may elect net basis taxation in the early years of U.S. real property ownership when such taxation may result in lower U.S. tax on their income from U.S. real property than gross taxation because of the effect of accelerated depreciation and other deductions. When the property is fully depreciated, making gross taxation more favorable, they may revoke the election. If other real property is subsequently acquired, the investors may make the election again.

By terminating the treaty election to be taxed on income from real property on a net basis, the proposed protocol will largely eliminate such unintended planning opportunities under the present treaty. While current U.S. internal law independently provides a net basis taxation election to nonresident alien individuals and foreign corporations that own U.S. real property, the making of a second statutory election under U.S. law is restricted once a first election has been revoked (Code secs. 871(d) and 882(d)).

The proposed protocol generally would not change the other rules of the existing treaty governing the taxation of income from real property. However, the protocol clarifies the French tax treatment of capital gains derived by French residents from the disposition of U.S. real property. (See discussion under article II.)

Article 3. Interest

The proposed protocol would amend the treaty to provide a general exemption from tax at source for interest. This reflects the U.S. position on source country taxation of interest, as expressed in the U.S. model. Under a special rule, this exemption would be applied to exempt certain interest paid to French banks operating in the United States from French withholding tax. The protocol also adopts the U.S. model provision limiting the circumstances under which one country may impose tax on interest paid by a resident of the other. The other treaty provisions pertaining to the taxation of interest are modernized by the protocol, bringing the treaty's interest article into closer conformity with the U.S. model.

Under the existing treaty, interest from sources in one country paid to a resident of the other generally is subject to tax by the source country at a rate not in excess of 10 percent of the gross amount of the interest. This generally represents a reduction in the rates of tax otherwise imposed by the United States and France on U.S.- and French-source interest, respectively. The treaty further provides that interest from sources in one country paid to the government of the other country or an instrumentality of that country may not be taxed by the source country. Also, interest from sources in one country on loans granted by any bank which is a resident of the other country may not be taxed in the source country under the treaty.

The protocol would provide a general source country tax exemption for interest derived and beneficially owned by a resident of the other country. Under the protocol, such interest could be taxed only by the beneficial owner's country of residence. This exemption from source country taxation would not apply, however, if the beneficial owner of the interest had a permanent establishment or fixed base in the source country and the interest was attributable to the permanent establishment or fixed base. In that event, the interest would be taxed as business profits (Article 6 of the existing treaty) or as income from the performance of independent personal services (Article 14 of the existing treaty). This limitation on the availability of the exemption is the same limitation, in slightly modernized form, that applies to the reduced rates of source country taxation and specific source country tax exemptions for interest provided in the present treaty.

At France's request, the French exemption from source country tax for interest would apply to certain interest paid by a borrower located in France to a U.S. permanent establishment of a French bank, financial institution, or credit institution. Absent this provision, such interest would be subject to French tax. The protocol would make such interest eligible for the exemption by providing that a permanent establishment in the United States of a French bank or financial or credit institution is to be treated by France, solely for purposes of the exemption from French tax, as a U.S. resident (rather than a French resident) with respect to interest paid on indebtedness that is effectively connected with the permanent establishment in the ordinary course of its business. Without this special rule, the exemption for interest would not apply since the exemption is given effect under the protocol by providing that only the *residence* country may tax interest. The banks that beneficially own the interest in question are generally French residents under the treaty and the French withholding tax on interest (unlike the domestic source withholding taxes of many countries, including the United States) applies to interest paid from domestic sources to residents, as well as to nonresidents. This provision would affect French tax levies on interest only. It would have no effect on U.S. taxes. The provision is intended to facilitate borrowing by French residents from U.S. branches of French financial institutions.

The proposed protocol would retain, with some modernizing changes, the provisions of the existing interest article that define interest and its source and address the issue of non-arm's-length interest charges between parties having a special relationship. Thus, the proposed protocol defines interest as income from indebtedness of every kind, whether or not secured and whether or not carrying a right to participate in profits. In particular, interest includes income from government securities and from bonds or debentures, including premiums or prizes attaching to bonds or debentures.

The protocol makes explicit that penalty charges for late payment are not interest.

Interest generally has its source in a country when the payor is that country's government, a political subdivision, a local authority or a resident of that country. (This rule is consistent with the Internal Revenue Code rule that interest generally is sourced in the country in which the payor is resident.) Where, however, the person paying the interest, whether he is a resident of one of the two countries or not, has in one of the two countries a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and the interest is borne by the permanent establishment or fixed base, the interest will be deemed to have its source in the country in which the permanent establishment or fixed base is situated. Thus, for example, if a Swiss resident has a permanent establishment in France and the Swiss resident incurs indebtedness to a U.S. person for that permanent establishment, and the permanent establishment bears the interest, then the interest will, for purposes of the treaty, have its source in France.

The proposed protocol addresses the issue of non-arm's-length interest charges between parties having a special relationship by providing that the amount of interest for purposes of the treaty will be the amount of arm's-length interest. The amount of interest in excess of the arm's-length interest will be taxable according to the laws of each country, taking into account the other provisions of the treaty (e.g., excess interest paid to a parent corporation may be treated as a dividend under local law and thus entitled to the benefits of Article 9 of the treaty).

The proposed protocol would specifically limit the circumstances under which one country may tax interest paid by a resident of the other. Following the U.S. model treaty, one country would be permitted to tax interest paid by a resident of the other in three situations only: first, if the interest is paid to a resident of the first country; second, if the interest is attributable to a permanent establishment or a fixed base of the beneficial owner of the interest situated in the first country; and, third, if the interest arises in the first country and is not paid to a resident of the other country. Under this provision, the United States, for example, could not tax interest paid by a resident of France to another resident of France except to the extent the interest is attributable to a permanent establishment or fixed base of the beneficial owner in the United States, even if the interest is considered from U.S. sources under the Internal Revenue Code. However, interest paid by a resident of France to a resident of a third country could be taxed by the United States to the extent the interest is considered from U.S. sources under this interest article and the Internal Revenue Code.

Article 4. Independent Personal Services

Under the present treaty, no more than 50 percent of earned income accruing to a U.S. citizen residing in France is eligible for exemption from French tax, even if the income is entirely from U.S. sources and wholly exempt from French tax otherwise under the double taxation relief provisions of the treaty. No comparable limit on eligibility for the French tax exemption is imposed on earned partnership income accruing to a French national residing in France. The protocol would eliminate this inconsistency by extending the 50-percent exemption limit of the present treaty to earned partnership income accruing to French nationals residing in France. This extension is part of the protocol's amendments to the double taxation relief provisions. It is described in greater detail under Article 11.

Article 5. Dependent Personal Services

The proposed protocol would establish a new treaty rule for the taxation of crew members of ships and aircraft.

Under the protocol, remuneration derived by a resident of one country from employment as a regular crew member of a ship or aircraft operated in international traffic may be taxed by that country only.

Under the present treaty, remuneration received for personal services performed as a regular crew member of a ship or aircraft is generally exempt from tax in a country if income from the operation of the ship or aircraft is exempt from tax in that country under the treaty. Generally, under the shipping and air transport article of the treaty, income from the operation of a ship or aircraft is taxable only in the country where the recipient resides.

Thus, the present treaty generally gives the country where the operator of a ship or aircraft operated internationally resides the sole right to tax remuneration for personal services performed as a regular crew member of the ship or aircraft, while the proposed protocol would give the country where the crew member resides such sole right.

The new rule is identical to the corresponding rule in the U.S. model. However, it was also sought by France because, under the present treaty rule, France generally cannot tax remuneration received by a French resident for service as a regular crew member on board a ship or aircraft operated in international traffic by a U.S. resident, even where the remuneration is not taxed by the United States or any other country. This is because the treaty does not have a French saving clause permitting France to tax French residents, notwithstanding the treaty.

Article 6. Artistes and Athletes

The protocol adopts, with one significant variation, the U.S. model rules for the taxation of artistes and athletes.

Under the present treaty, the taxation of artistes and athletes resident in the other country is governed by the general treaty rules for the taxation of independent and dependent personal service income. Under Article 14 of the present treaty (Independent Personal Services), a country may tax an artiste or athlete who is a resident of the other country on his income from independent personal services performed in the first country only if the artiste or athlete is present or maintains a fixed base in the first country for more than 183 days during the fiscal year. Under Article 15 of the present treaty (Dependent Personal Services), a country may tax an artiste or athlete who is a resident of the other country on his remuneration for dependent personal services exercised in the first country if the artiste or athlete is present in the first country for more than 183 days during the fiscal year, the remuneration is paid by a resident of the first country, or the remuneration is borne by a permanent establishment in the first country.

The proposed protocol would provide separate rules for the taxation of income earned by artistes (such as theater, motion picture, radio or television artistes, and musicians) and athletes that differ from the present treaty rules. The new rules are intended, in part, to prevent entertainers and athletes from using the treaty to avoid paying any tax on their income earned in one of the countries.

Under new Article 15A, one country may tax an entertainer who is a resident of the other country on the income from his personal services as an entertainer in the country of performance during any year in which the gross receipts derived by him from such activities, including his reimbursed expenses, exceed $10,000, or its equivalent in French francs. The $10,000 threshold for source country taxation is a departure from the U.S. model treaty which contains a $20,000 threshold.

This rule would work as follows: if a French entertainer, for example, maintained no fixed base in the United States and performed (as an independent contractor) for two days in one taxable year in the United States for total compensation of $9,000, the United States could not tax that income. If, however, that entertainer's total compensation were $11,000, the full $11,000 (less appropriate deductions) would be subject to U.S. tax.

This rule overrides Articles 14 and 15, discussed above. However, if the new rule does not allow source country taxation in a particular case, because the entertainer's gross receipts for the year from that country are $10,000 or less, the entertainer's income from the performance of services may nonetheless be taxable by that source country in accordance with the rules of Article 14 or Article 15, as the case may be.

The proposed new article also provides that where income in respect of personal services performed by an entertainer or athlete accrues not to the entertainer or athlete but rather to another person or entity, that income will be taxable by the country in which the services are performed in any situation where the entertainer or athlete shares directly or indirectly in the profits of the person or entity receiving the income. (This provision would apply notwithstanding Articles 6 and 14 of the present treaty.) For this purpose, participation in the profits of the recipient of the income includes the receipt of deferred compensation, bonuses, fees, dividends, partnership distributions, or other distributions. This provision does not apply if it is established that neither the entertainer or athlete, nor related persons, participate directly or indirectly in the profits of the person or entity receiving the income in any manner. This provision is intended to prevent highly paid performers and athletes from avoiding tax in the country in which they perform by routing the compensation for their services through a third person such as a personal holding company or trust located in a country that would not tax the income.

Article 7. Teachers and Researchers

The protocol would expand slightly the scope of the exemption for visiting teachers and researchers contained in the existing treaty.

The exemption for visiting teachers and researchers contained in the existing treaty is similar to that contained in a number of U.S. income tax treaties negotiated before or during the period in which the existing treaty was negotiated. (This exemption is not a part of the U.S. model treaty.) Under the treaty, a resident of one country is exempt from tax in the other country on income from teaching or research for a period of two years, if he or she is present in the host country for the purpose of teaching or engaging in research at an accredited educational institution. The exemption does not apply to income from research which is undertaken primarily for the benefit of private persons rather than in the public interest.

The protocol would expressly extend the teachers' and researchers' exemption to income from teaching or research at an accredited *research* institution, where the other requirements for the exemption are satisfied.

This provision is intended to make it clear that income earned at the Pasteur Institute in France by visiting U.S. teachers and researchers is exempt from French tax. This provision is consistent with a published ruling issued by the Internal Revenue Service involving the students and trainees article found in the present treaty with France and a number of other U.S. income tax treaties; the ruling construes the limited exemption from U.S. income tax provided under that article to apply to amounts received by residents of the treaty partner countries under the Visiting Fellows Program of the National Institutes of Health in connection with study or research at the Institutes while temporarily present in the United States (Rev. Rul. 80-98, 1980-1 C.B. 133).

Article 8. Private Pensions and Annuities

The existing treaty provides that private pensions, annuities, and alimony derived by residents of one country from the other country are exempt from tax in the other country.

In notes exchanged by the United States and France at the time the second protocol to the present treaty was signed (November 24, 1978), the countries agreed, with respect to the taxation of Americans in France, that contributions to pension, profit-sharing, and other retirement plans which qualify under the Internal Revenue Code will not be considered income to an employee and will be deductible from the income of a self-employed individual, to the extent that such contributions are required by the terms of the plan and are comparable to similar French arrangements. The countries further agreed that payments received by a beneficiary of such plans will be included in income for French tax purposes, to the extent not exempt from French tax under the double taxation relief provisions, at the time when, and to the extent that, such payments are considered gross income under the Internal Revenue Code.

The proposed protocol generally would make reciprocal rules similar to these so that French citizens resident in the United States, as well as U.S. citizens resident in France, can benefit.

Under the proposed protocol, contributions to a pension, profit-sharing or other retirement plan recognized for tax purposes in one country, made by or for an individual resident of the other country who is not a citizen of that second country, will be treated the same way for tax purposes in the second country as contributions made to a retirement plan recognized for tax purposes in the second country would be treated in the second country, provided that the competent authority of the second country agrees that the retirement plan corresponds to one it would recognize for tax purpose. (A retirement plan "recognized" for U.S. tax purposes is one normally exempt from Federal income tax, for example, a Keogh Plan or Individual Retirement Account.) This provision would require the United States to allow a deduction to a French citizen residing in the United States for a contribution to a French retirement plan.

Further, the proposed protocol provides that payments received by the beneficiary of such a retirement plan will be included in income for tax purposes of the beneficiary's country of residence when and to the extent that the payments are considered gross income by the country not of residence. These payments will not be included in the beneficiary's income, however, if they are exempt from tax in the beneficiary's country of residence under the double taxation relief provisions of the treaty. Under this rule, a U.S. citizen residing in France, for example, may be required to include benefits received from a U.S. retirement plan in income for French tax purposes when distributed since, under U.S. law, an employee's benefits from or under a qualified plan or annuity plan generally are includible in income when distributed. However, if the benefits are attributable to services performed while the U.S. citizen's principal place of employment was in the United States (rather than in France or a third country), then the benefits will not be included in income for French tax purposes because such benefits are exempt from French tax under the treaty's double taxation relief article.

Article 9. General Rules of Taxation

The present treaty contains a set of general rules of taxation. One of these rules is that income not dealt with elsewhere in the treaty is taxable by the source country in accordance with its own laws. The proposed protocol would replace this rule with the U.S. model rule that items of income not dealt with elsewhere in the treaty, wherever arising, that are derived by a resident of either country are taxable by the country of residence only.

The protocol would also eliminate the present treaty provision expressly allowing France to tax (subject to the double taxation relief article) its resident public entertainers on personal service income derived from activities or services performed in the United States. France considered this provision no longer to be necessary in light of the new article governing the taxation of artistes and athletes that the proposed protocol would add to the treaty.

The proposed protocol does not change the other general rules of taxation contained in the present treaty.

Article 10. Capital

In general

This article of the protocol sets forth reciprocal treaty rules for the imposition of capital taxes by the two countries. It is similar to the corresponding article of the U.S. model treaty but is more detailed. The protocol was negotiated (and this article included) at the behest of the United States, after France's introduction of a new wealth tax, effective January 1, 1982. The proposed protocol amends the treaty to provide that the new French wealth tax (France did not previously impose a wealth tax) is a covered tax. This article contains a special provision that generally would exempt from the French wealth tax for five calendar years assets situated outside France owned by U.S. citizens who reside in France, beginning in the first calendar year following the acquisition of resident status.

Many countries in addition to France presently impose a capital tax in addition to an income tax. Other countries that impose capital taxes include Argentina, Austria, Denmark, India, Luxembourg, the Netherlands, Norway, Spain, Sweden, Switzerland, and West Germany. The United States does not currently impose a capital tax; thus, the provisions of this new article would have current effect only with respect to the French wealth tax.

Capital taxes are covered by some, but not all, U.S. income tax treaties with countries imposing such taxes.

French wealth tax

The new French tax on large net wealth (l'impot sur les grandes fortunes) is calculated annually as a percentage of an individual's net wealth and is payable in addition to income tax. A family unit is counted as one individual for these purposes. The tax is generally levied on total assets, wherever situated, of individuals whose tax domicile is in France under the French Tax Code. It is levied on assets situated in France only, in the case of other individuals. Assets of corporations and other legal entities are not subject to the tax.

Net wealth for purposes of the tax is the fair market value of an individual's assets. The tax does not apply to art, antiques, up to three-quarters of the value of timberlands, or professional business assets. Professional business assets for this purpose are assets used in a business concern of an individual in the industrial, commercial, artisanal, farming or professional sectors of activity; interests in legal entities such as professional partnerships; and certain farming assets and interests in farming associations.

The tax also does not apply to financial investments in France of persons not domiciled in France. The taxable base is reduced by indebtedness. An exemption from the wealth tax (indexed to inflation) for net wealth below a certain level is provided. For calendar year 1984, the first 3.4 million French francs (approximately $425,000 at April 1984 exchange rates) of an individual's net wealth is exempt.

The French wealth tax is imposed at progressive rates from one-half of one percent to 1.5 percent. In addition, for calendar year

1984, a special exceptional surtax is imposed equal to 8 percent of the pre-surtax wealth tax.

Asset valuation for wealth tax purposes is based on market value as of January 1 of each year. The French Tax Code does not define market value, but the staff understands that the French tax authorities use a measure generally similar to that frequently used by the IRS for fair market value, i.e., the estimated price at which the asset would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. Taxpayers must file a return and pay any wealth tax due for the year before June 15 of the year, if their net wealth on January 1 of the year exceeds the exemption thresholds.

Protocol rules for taxation of capital

The protocol rules governing the taxation of capital generally would permit France, with one exception, to impose its new wealth tax on U.S. persons in conformity with French internal law. Thus, the protocol provides that real property and interests in real property may be taxed in the country where the real property is situated. Interests in real property for this purpose include interests in corporations whose principal assets are real property (excluding real property pertaining to the corporation's industrial, commercial, or agricultural operations). An exemption is also provided for real property pertaining to the performance of independent personal services—it may not be taxed by the situs country under this rule.

Furniture and fixtures also may be taxed in the country where situated. Movable property of a permanent establishment or a fixed base used for the performance of independent personal services may be taxed in the country where the permanent establishment or fixed base is situated. Also, shares or rights in a corporation may be taxed in the country of which the corporation is a resident when the shares or rights entitle their direct or indirect owners, individually or collectively (if ownership is shared with related persons), to at least 25 percent of the corporate earnings.

The protocol provides, however, that ships and aircraft operated internationally and associated movable property may be subject to capital taxes only in the country of which the owner is a resident. Elements of capital not mentioned above belonging to a resident of one country similarly may be subject to capital tax in the residence country alone.

The proposed protocol would provide a special five-calendar-year exemption from the French wealth tax for assets situated outside France belonging to certain U.S. citizens residing in France. This exemption is intended to benefit U.S. citizens who live in France for relatively short periods of time such as employees of multinational corporations transferred abroad on temporary assignment. Under the protocol, assets situated outside France that U.S. citizens residing in France who are not French nationals own on January 1st of each of the five years following the calendar year in which they become French residents are excluded from the wealth tax base of assessment for each of those five years. Thus, for example, if a qualifying U.S. citizen became a resident of France on December 31, 1983, the five-year period would run through January 1, 1988; the non-French assets which the U.S. citizen owned on January 1 of the calendar years 1984, 1985, 1986, 1987, and 1988 would be exempt from the French wealth tax. If the U.S. citizen became a resident of France on January 2, 1984, the exemption period would, in effect, be almost six years long: the U.S. citizen would not be subject to French wealth tax in 1984 on non-French assets because he was not a French resident on January 1, 1984; in addition, the five-year treaty exemption would apply to non-French assets which the U.S. citizen owned on January 1 of the calendar years 1985, 1986, 1987, 1988, and 1989.

The five-year exemption may be available more than once. If a U.S. citizen ceases to be a French resident for at least three years, then becomes a French resident again, another five-year exemption period will begin on January 1 of the year following the calendar year in which the individual again becomes a French resident.

The five-year exemption from the French wealth tax does not apply to assets situated in France. Thus, U.S. citizens who reside in France only temporarily may nonetheless be subject to the wealth tax with respect to certain French-situs assets, to the extent the value of such assets exceeds the threshold exemption provided under French law. Also, U.S. citizens not resident in France may be subject to the wealth tax with respect to French-situs assets.

The protocol would also require France to allow French residents a credit against the French wealth tax for any U.S. tax levied in the future on capital taxable both in the United States under this article and in France. This credit is discussed under Article 11.

The protocol rules governing the taxation of capital, including the five-year exemption from the French wealth tax for certain assets of U.S. citizens residing in France, would be retroactively effective to January 1, 1982, the date of inception of the French wealth tax.

Article 11. Relief from Double Taxation

Introduction

The proposed protocol would amend in several respects the provisions of the treaty which deal with the avoidance of double taxation. The protocol would modernize the language of the treaty provision setting forth the basic U.S. foreign tax credit rule. The protocol would clarify that capital gains derived by French residents from the disposition of U.S. real property are exempt from French tax. The protocol would provide a rule preventing the double imposition of capital taxes.

Certain of the amendments involve the treaty rules for avoiding double taxation of U.S. citizens residing in France. First, income earned from personal services performed in the United States by a U.S. citizen residing in France that is taxable in the United States only by reason of citizenship would no longer be exempt from French tax; under the protocol, France may tax such income and the United States will re-source it as French-source income to the extent necessary to credit the French tax. Second, alimony and annuities paid to a U.S. citizen residing in France would, for the first time, be exempt from French income tax. Third, the proposed protocol would provide generally that U.S.-source income of U.S. citizens residing in France that is subject to French tax under the treaty will be re-sourced as French-source income to the extent necessary to give the recipient a U.S. foreign tax credit sufficient in amount to relieve double taxation of the income; the protocol eliminates the fractional re-sourcing method of the existing treaty. Finally, the proposed protocol would place a 50-percent limitation on the amount of earned income from a partnership accruing to a French resident that may be exempt from French tax; the present treaty so limits the French tax exemption for partnership income accruing to U.S. citizens who are French residents but not for such partnership income accruing to French nationals who are French residents.

General treaty rule for avoiding double taxation—United States

Under the present treaty, the United States generally avoids double taxation of business and investment income of its residents through the foreign tax credit mechanism. The United States is not precluded from amending its foreign tax credit rules without changing the general principle thereof.

The proposed protocol would modernize the language of the treaty provision setting forth this rule, thereby bringing the provision into full conformity with the corresponding provision of the U.S model. As amended, the provision would expressly provide a "deemed paid credit" for French taxes paid on certain dividends; the protocol provides that a U.S. foreign tax credit will be allowed to a U.S. corporation owning at least 10 percent of the voting stock of a corporation which is a resident of France, from which the U.S. corporation receives dividends, in an amount equal to the income tax paid to France by or on behalf of the distributing corporation on the profits out of which the dividends are paid.

General treaty rules for avoiding double taxation—France

Under the present treaty, France agrees to avoid double taxation of its residents subject to U.S. tax on business and other income, except investment income and public entertainers' income, by exempting from its tax any such income which is taxable by the United States under the treaty. This rule does not apply, however, if the French resident is a U.S. citizen and the income is taxable by the United States by reason of his citizenship. The exemption under this provision is "with progression." That is, although the French resident does not pay French tax on the income, the rate of French tax on his remaining income takes into account the excluded income. The notes accompanying the second protocol to the present treaty give the example of a French resident with $20,000 of income, $8,000 of which is exempt from French tax under the treaty. His French tax on the remaining $12,000 will be 60 percent ($12,000/$20,000) of the amount of French tax he would have paid on $20,000 of income.

Under the present treaty, France avoids double tax of investment and public entertainers' income of its residents by allowing a credit against French tax for the U.S. tax imposed on the income. Investment income, for these purposes, consists of dividends, interest, royalties, and certain capital gains. This rule does not apply if the French resident is a U.S. citizen to the extent the income is taxable by the United States by reason of his citizenship.

The proposed protocol generally retains these rules without change. However, the protocol amends the French tax credit rules to provide that capital gains taxable in the United States under Article 12 of the existing treaty that are derived by French residents will no longer be investment income for purposes of the French tax credit rules. This change has the effect of exempting from French tax capital gains subject to U.S. tax under Article 12 that are derived by French residents. The amendment is intended to make clear that capital gains derived by French residents from the disposition of U.S. real property are exempt from French tax under the treaty. Under the present treaty, there is some ambiguity on this issue: it is unclear whether capital gains from the disposition of U.S. real property are treated under the treaty as income from real property and are, therefore, exempt from French tax as business income, or are treated under the treaty as Article 12 capital gains and, are therefore, taxable in France (with a credit for U.S. tax) as investment income.

In addition, the protocol would delete the reference in the French tax credit rules to interest income of French residents taxable in the United States under the treaty. This deletion reflects the general exemption from source country tax for interest that the protocol introduces (see discussion under Article 3). The reference in the French tax credit rules to the Article 22 provision of the present treaty concerning U.S. income of French public entertainers is replaced with a reference to the new artistes and athletes article.

Under the present treaty, the French tax credit for U.S. tax paid on investment and public entertainers' income is allowed against the French income and corporation taxes. The protocol would expressly allow the French tax credit to be used against any identical or substantially similar French taxes which are subsequently imposed in addition to, or in place of, the existing French taxes.

Credit against French wealth tax

As discussed under Articles 1 and 10, the protocol would retroactively extend the treaty's coverage to the recently enacted French tax on large net wealth. The protocol provides reciprocal rules for the taxation of capital limiting the imposition of the French wealth tax and any U.S. capital tax that might be enacted in the future on assets of residents of the other country. The United States does not tax wealth at present.

The protocol provides a rule for the avoidance for double taxation of capital taxable in the United States under the treaty and taxable also in France. Under the protocol, France would allow a French resident a tax credit against the French wealth tax for any tax the United States levies on such capital in accordance with the treaty. The credit could not exceed the French tax that would otherwise be levied on the capital.

U.S. citizens resident in France

The second protocol to the existing treaty thoroughly revised the provisions of the treaty which deal with the avoidance of double taxation. The revision became necessary because France amended its laws to tax U.S. citizens resident in France on their worldwide income, including income from U.S. sources. The United States also taxes its citizens, wherever they may be resident, on their worldwide income. The United States generally allows its citizens a credit against their U.S. income tax liability for foreign income taxes paid, but the credit does not apply to foreign taxes on U.S.-source income. Thus, in the absence of treaty provisions, there would be considerable potential for taxation by both the United States and France of the U.S.-source income of U.S. citizens residing in France.

Under the second protocol, double taxation of the income of U.S. citizens residing in France is generally avoided as follows: France agrees to exempt part of the income from, or to give a partial credit against, its tax. The United States agrees, in turn, to provide a U.S. foreign tax credit for French taxes paid. To assure a sufficient U.S. foreign tax credit, the United States, in certain cases, agrees to treat part of the income taxable in France as if from French sources. These rules generally have the effect of dividing the tax revenue from U.S. citizens resident in France between the U.S. and French Treasuries.

As noted above, some of the amendments to the double taxation relief provisions that the proposed protocol would make involve these special rules.

Income from services performed in the United States

Under the present treaty, France agrees to exempt from its tax income of U.S. citizens who are resident in France to the extent that the income is for services performed (independently or as an employee) in the United States, if certain conditions are met. The United States under its own law treats this income as U.S. source, which would lead to double taxation in the absence of the exemption from French tax provided in the treaty.

The proposed protocol would eliminate the exemption from French tax for income of U.S. citizens residing in France from services performed in the United States to the extent the income is taxable in the United States solely by reason of U.S. citizenship. Under the protocol, France may tax this income. To prevent double taxation of this income, the United States will re-source the income as French-source income to the extent necessary to credit the French tax (re-sourcing is discussed in greater detail below).

Alimony and annuities

Under the present treaty, private pension income of a U.S. citizen residing in France attributable to services performed while the U.S. citizen's principal place of employment was in the United States is exempt from French tax. This rule prevents double taxation of such income which could occur under the U.S. and French systems of worldwide taxation, absent the treaty provision.

The proposed protocol would extend this exemption from French tax to alimony and annuities paid to U.S. citizens residing in France. Under the present treaty, France may tax alimony and annuities paid to U.S. citizens residing in France, and the United States may tax the income also. If the income is from U.S. sources, no U.S. foreign tax credit is allowed and double taxation, therefore, may occur.

Re-sourcing

Under the present treaty, the United States and France divide the tax revenues on investment and public entertainers' income from U.S. sources of a U.S. citizen resident in France basically by treating him as though he were not a U.S. citizen (i.e., as though he were a nonresident alien). This is accomplished by each country allowing limited credits for the other's taxes on the income. The United States reserves a residual right to tax the income on the basis of citizenship which is exercisable if the allowable credit for French tax on the income is less than what the U.S. tax on the U.S. citizen would be.

The present treaty provides that, when a U.S. citizen resident in France receives U.S.-source investment or public entertainers' income, France will give a credit for the amount of tax the United States would have been allowed to collect had the recipient been an nonresident alien. For example, if the U.S. citizen receives a $100 dividend payment from U.S. sources, France agrees to give a credit of $15 (the treaty reduces the source country withholding tax rate on dividends to 15 percent) against its tax on the income. Thus, France, through the credit, gives the United States the first opportunity to tax the income on the basis of its source.

Because the income is U.S. source, the U.S. foreign tax credit limitation would ordinarily prevent a credit against U.S. tax for any remaining French tax on the income (after the French credit for $15). However, under the treaty, as a practical matter, the United States gives France (as the residence country) the next opportunity to tax the income by agreeing to treat part of the income as French-source income, increasing the recipient's foreign tax credit limitation, and thereby allowing French tax on the income to be credited against the individual's U.S. tax liability.

Under the present treaty, certain U.S.-source income of U.S. citizens residing in France (for example, certain capital gains) that is subject to both U.S. tax and French tax, without any partial French tax credit (because U.S. tax is imposed solely by reason of U.S. citizenship), is also re-sourced under this rule to allow the French tax on the income to be credited against the U.S. citizen's U.S. tax liability.

The proposed protocol generally retains the rules just discussed. However, it alters the method by which the income to be treated as French-source income for purposes of these rules is determined.

Under the present treaty, the portion of U.S.-source income which will be re-sourced as French-source income is determined using a fractional method. The numerator of the fraction is the rate of tax at which the United States could tax the income if the recipient were not a U.S. citizen. The denominator is the effective rate of U.S. tax (before reduction by the foreign tax credit and the investment tax credit) on the U.S. citizen's gross income. The difference between the total amount of the U.S. income and the part which retains its character as U.S.-source income is treated as French-source income.

The fractional method for determining the portion of income to be treated as French-source income has sometimes produced harsh results. In certain cases, its application has resulted in too little re-sourcing of U.S.-source income as French income to permit a full U.S. foreign tax credit for French taxes paid on the income by U.S. citizens residing in France. Double taxation of such income has, therefore, occurred.

The protocol would eliminate the fractional method for determining the portion of U.S. income to be re-sourced as French income for these purposes. The protocol generally would provide that U.S. source income subject to French tax of a U.S. citizen residing in France is to be considered French-source income to the extent necessary to permit a full U.S. tax credit for French tax paid on the income.

The new re-sourcing rule would work as follows: Assume that $100 of U.S.-source interest, which the United States may not tax to a resident of France under the interest article of the protocol, is subject to a U.S. tax of $40 by virtue of the beneficial owner being a U.S. citizen and is subject to a French tax of $20 by virtue of the beneficial owner being a resident of France. The United States will re-source enough of the interest as French-source income to credit the full $20 of French tax, which amounts to re-sourcing 50 percent ($20/$40) of the interest.

As another example, assume the U.S.-source income in question is a dividend of $100 from a U.S. corporation (this is investment income under the protocol and is, thus, eligible for a French tax credit). Assume the same respective U.S. and French tax rates as in the first example. France will allow a credit for the $15 of U.S.-source basis tax authorized by the dividend article and will collect a net tax of $5. The United States will re-source enough of the dividend as French-source income to credit the French tax of $5 against the additional U.S. tax of $25 (the excess of the $40 imposed by virtue of citizenship over the $15 imposed by virtue of source). This will require re-sourcing $12.50 of the dividend. The U.S. tax of 40 percent on the $12.50 will be $5, which will be offset by the $5 of credit for French tax paid.

Like the re-sourcing rule of the present treaty, the new re-sourcing rule applies only with respect to income that is included in gross income for purposes of French tax. The new re-sourcing rule does not apply for purposes of determining the amount of any U.S. foreign tax credit for foreign taxes other than the present French income and corporation taxes or any successor taxes. The new re-sourcing rule is expected to produce more equitable results than the fractional method, particularly in cases where the fractional method's use of gross income overstated taxable income by not giving recognition to the possible existence of large deductible expenses.

In the case of U.S.-source investment and public entertainers' income, the protocol specifies that the U.S. tax credit allowed is not to reduce the French tax credit allowed in the first instance for the U.S. tax imposed at source on such income.

Partners

Because the source rules for partnership income under U.S. and French law conflict, there is a possibility of double taxation of income from a U.S. partnership that accrues to French resident partners. The present treaty provides complex rules for avoiding such double taxation. Article 6 of the present treaty provides that a partner is treated as realizing his ratable share of partnership income and losses. That income is generally to be treated as having the same source and character in his hands as in the hands of the partnership, except to the extent that his share of the profits depends on the source of the income (i.e., a special allocation). This provision is a restatement of the U.S. rules for the source of partnership income and overrides the conflicting French rules. It does not apply to guaranteed payments.

By itself, this rule would exempt from French tax (under the general provisions for the avoidance of double taxation) all of the partner's distributive share of partnership income treated as from U.S. sources under U.S. source rules because that amount would be taxable by the United States other than by reason of the U.S. citizenship of the partner. However, the application of this rule is limited by Article 14 of the existing treaty. Article 14 provides, among other things, that the special partnership source rules of the treaty may not result in the exemption from French tax (under the general provisions for avoidance of double taxation) of more than 50 percent of the earned income from a partnership accruing to a U.S. citizen residing in France. Article 14 further provides that if, solely because of the 50-percent limitation, not all of the U.S.-source income of the partner who is a U.S. citizen resident in France is exempt, the amount of partnership earned income from French sources on which France can tax the nonresident partners is to be reduced by the difference between the total U.S.-source partnership income of the resident partner and the amount he is allowed to treat as exempt.

The present Article 14 limitation on the French tax exemption applies only to U.S. citizens residing in France, not to French nationals residing in France. Thus, U.S. citizens residing in France may be taxed by France on up to 50 percent of their U.S.-source partnership income, while French nationals residing in France may obtain a complete exemption from French tax on U.S.-source partnership income. For example, assume a partnership has total profits of $150,000 of which $60,000 is derived from French sources and $90,000 from U.S. sources. The $150,000 is distributed equally among three partners. One is a U.S. resident, one is a U.S. citizen resident in France, and one is a French national resident in France. Each partner's share is $50,000. Of that amount, $20,000 will be of French source and $30,000 of U.S. source in accordance with Articles 6 and 14, discussed above. Under the present Article 14 limitation on the French tax exemption, France is not required to exempt from tax more than one-half, or $25,000, of the share of the U.S. citizen resident in France. Accordingly, France would exempt $25,000 of the U.S. citizen's share, but would exempt $30,000, the entire U.S. portion, of the other French resident's share.

To eliminate this inconsistency in the treatment of French nationals and U.S. citizens residing in France, the protocol would amend Article 14 of the present treaty so that the 50-percent limitation on the French tax exemption for partnership income would apply to all French residents. In the above example, this would result in a parity of treatment between the two French residents. The French national, as well as the U.S. citizen, would be limited to a $25,000 exemption from French tax.

The existing treaty provides a further mechanism to bring the U.S. and French source rules into correspondence, but it requires the consent of the affected partnership. For any taxable year, a partnership may make an election under which the U.S.-source income of a partner resident in France which cannot be treated as exempt because of the treaty's 50-percent limitation on the French tax exemption is treated by the United States as though it were from French (rather than U.S.) sources, increasing the French partner's U.S. foreign tax credit limitation. At the same time, the partnership share of foreign-source income of each of the other partners is correspondingly reduced. (The amount that they will be treated as receiving from domestic sources is correspondingly increased.)

The protocol would make this election available to partnerships with French resident partners whose U.S.-source partnership income cannot be treated as wholly exempt from French tax because of the protocol's extension of the 50-percent exemption limit to French resident nationals. Otherwise, the election is unchanged by the protocol. The protocol retains the present treaty rule that where the partner affected by the 50-percent exemption limit is a U.S. citizen, the election is not to result in a reduction of U.S. tax below what the taxpayer would have incurred without the benefit of deductions or exclusions available solely by reason of his presence or residence outside the United States.

French tax based on use of a residence

Under French law, an individual who is not domiciled in France, and who therefore is not subject to the regular French tax rules, is nevertheless generally subject to French tax if he has the use of an abode in France. The proposed protocol continues the rule in effect under the existing treaty that this tax does not apply to a U.S. resident.

Article 12. Limitation on Benefits

The proposed protocol contains a provision which is intended to limit the benefits of the treaty to persons who are entitled to those benefits by reason of their residence in the United States or France. The present treaty does not contain such a provision. The new provision is somewhat less strict than the corresponding provision of the U.S. model treaty. It is similar to, but not identical to, the limitation of benefits articles included in the recently ratified U.S. income tax treaties with Australia and New Zealand.

The treaty is intended to limit double taxation caused by the interaction of the tax systems of the United States and France as they apply to residents of the two countries. At times, however, residents of third countries attempt to use a treaty. Such use is known as "treaty shopping," and refers to the situation where a person who is not a resident of either country seeks certain benefits under the income tax treaty between the two countries. Under certain circumstances, and without appropriate safeguards, the nonresident is able indirectly to secure these benefits by establishing a corporation (or other entity) in one of the countries which, as a resident of that country, is entitled to the benefits of the treaty. Additionally, it may be possible for the third country resident to repatriate funds to that third country from the entity under favorable conditions (i.e., it may be possible to reduce or eliminate taxes on the repatriation) either through relaxed tax provisions in the distributing country or by passing the funds though other treaty countries (essentially, continuing to treaty shop), until the funds can be repatriated under favorable terms.

As indicated above, the proposed new anti-treaty shopping article of the protocol is intended to limit the benefits of the treaty to bona fide residents of the two countries. This would be accomplished by providing that a person other than an individual (such as a corporation, partnership or trust) is not entitled to the benefits of the treaty unless it satisfies any one of an ownership test, a public company test, or a good business purpose test. Under the ownership test, more than 50 percent of the beneficial interest (in the case of a company, more than 50 percent of the number of shares of each class of shares) in that entity must be owned directly or indirectly by any combination of one or more individual residents of France or the United States, citizens of the United States, publicly traded companies (discussed below), or the governments of the countries (the United States and France) themselves. (The comparable percentage ownership requirement in the U.S. model, Australian, and New Zealand treaties is 75 percent.) This provision would, for example, deny the benefits of the reduced U.S. withholding tax rates on dividends or royalties to a French company that is controlled by individual residents of a third country.

Under the public company test, a company that is a resident of one of the countries and that has substantial and regular trading in its principal class of stock on a recognized stock exchange in the United States or France would be entitled to the benefits of the treaty regardless of where its actual owners reside. In addition, any interest that such a company holds would be a qualifying interest under the 50-percent test above. The term "recognized stock exchange" means any stock exchange registered with the Securities and Exchange Commission as a national securities exchange for the purposes of the Securities Exchange Act of 1934, the NASDAQ system owned by the National Association of Securities Dealers Inc., the French stock exchanges (Bourses de Valeurs) and any other stock exchange agreed upon by the competent authorities of the two countries.

Under the good business purpose text, denial of treaty benefits would not occur if the establishment, acquisition, and maintenance of an entity that is a resident of the United States or France and the conduct of its operations did not have as one of its principal purposes the purpose of obtaining benefits under the treaty. Accordingly, the provision would not apply if it could be shown that there was no treaty shopping motive for forming the company and if its operation did not have as one of its principal purposes the purpose of obtaining the treaty benefits. Thus, the burden of overcoming the treaty shopping rule, as under U.S. tax law generally, would be on the taxpayer claiming treaty benefits.

Article 13. Mutual Agreement Procedure

The existing treaty provides that when the competent authorities, upon request of a resident of one of the countries, reach an agreement to relieve him of double taxation then taxes may be imposed on the income in question and any refund or credit of taxes may be allowed in accordance with the agreement. The proposed protocol would amend this provision to clarify that the agreement can be implemented even if the statute of limitations or other procedural limitations provided by domestic laws would otherwise bar its implementation. This rule would not open the statute of limitations or waive any other procedural limitation for other items on the return except insofar as they are affected, directly or indirectly, by application of the provisions of the treaty.

Article 14. Exchange of Information

Under the exchange of information article of the present treaty, the competent authorities of the two countries are to exchange information which is pertinent to carrying out the provisions of the treaty or to preventing fraud or fiscal evasion with respect to the taxes covered by the treaty. Any information exchanged is to be treated as secret. Permitted disclosure of exchanged information is limited to persons (including courts and administrative bodies) concerned with assessment, collection, enforcement, or prosecution in respect of the taxes to which the treaty applies.

The proposed protocol would amend the language of the present treaty relating to this limitation on disclosure to provide that information exchanged under the treaty may also be disclosed to persons concerned with the administration of, or the determination of appeals in relation to, the taxes to which the treaty applies. This amendment would make clear that persons involved in the administration of taxes, including legislative bodies involved in the oversight of the administration of taxes and their agents, such as the U.S. General Accounting Office, will have access to such exchanged information as they consider necessary to carry out their oversight or other responsibilities. This change would bring the exchange of information provision of the present treaty into closer conformity with that of the U.S. model treaty.

Article 15. Entry into Force

The proposed protocol will enter into force on the first day of the second month following the date of exchange of instruments of ratification. Once in force, the provisions of the protocol dealing with the wealth tax will apply retroactively to capital owned on or after January 1, 1982 (the effective date of the new French wealth tax). The provisions relating to taxes withheld at source will apply to amounts payable on or after the date of entry into force. The provisions relating to other income taxes will apply to taxable years beginning on or after the date of entry into force.

Article 16. Termination

The proposed protocol will remain in force as long as the U.S.-French income tax treaty remains in force.

The present treaty may be terminated by either country giving notice of termination to the other through diplomatic channels at least six months before the end of any calendar year. The proposed protocol provides that, in the event of termination, the treaty would cease to have effect, as regards the French wealth tax, for capital owned on the January 1st of the calendar year following the year in which notice of termination is given by one country to the other.