

TREASURY DEPARTMENT TECHNICAL EXPLANATION OF THE CONVENTION  
BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA  
AND THE GOVERNMENT OF THE FRENCH REPUBLIC FOR  
THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION  
OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL  
SIGNED AT PARIS ON AUGUST 31, 1994

INTRODUCTION

This is a technical explanation of the Convention and accompanying diplomatic notes between the United States and the French Republic signed on August 31, 1994 (the "Convention"). References are made to the Convention between the United States and the French Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and Property, signed on July 28, 1967, as amended by protocols signed in 1970, 1978, 1984, and 1988 (the "1967 Convention"). The Convention replaces the 1967 Convention.

Negotiations took into account the U.S. Treasury Department's current tax treaty policy, the Model Double Taxation Convention on Income and on Capital published by the Organization for Economic Cooperation and Development in 1992 (the "OECD Model"), and recent tax treaties concluded by both countries.

The Technical Explanation is an official guide to the Convention. It reflects the policies behind particular Convention provisions, as well as understandings reached with respect to the application and interpretation of the Convention. References in the technical explanation to "he" or "his" should be read to mean "he" or "she" or "his" or "her."

TABLE OF ARTICLES

Article 1-----	Personal Scope
Article 2-----	Taxes Covered
Article 3-----	General Definitions
Article 4-----	Resident
Article 5-----	Permanent Establishment
Article 6-----	Income from Real Property
Article 7-----	Business Profits
Article 8-----	Shipping and Air Transport
Article 9-----	Associated Enterprises
Article 10-----	Dividends
Article 11-----	Interest
Article 12-----	Royalties
Article 13-----	Gains
Article 14-----	Independent Personal Services
Article 15-----	Dependent Personal Services
Article 16-----	Directors' Fees
Article 17-----	Artistes and Sportsmen

Article 18-----	Pensions
Article 19-----	Public Remuneration
Article 20-----	Teachers and Researchers
Article 21-----	Students and Trainees
Article 22-----	Other Income
Article 23-----	Capital
Article 24-----	Relief from Double Taxation
Article 25-----	Non-Discrimination
Article 26-----	Mutual Agreement Procedure
Article 27-----	Exchange of Information
Article 28-----	Assistance in Collection
Article 29-----	Miscellaneous Provisions
Article 30-----	Limitation on Benefits of the Convention
Article 31-----	Diplomatic and Consular Officers
Article 32-----	Provisions for Implementation
Article 33-----	Entry into Force
Article 34-----	Termination
	Exchange of Diplomatic Notes

## ARTICLE 1 Personal Scope

The Convention follows U.S. and OECD practice by inserting an article referring to the scope of the Convention. Article 1 provides that the Convention is applicable only to residents of the United States or France, except where the Convention otherwise provides. Article 4 (Resident) sets forth rules for determining whether a person is a resident of a Contracting State that govern for all purposes of the Convention. Residents of a Contracting State are not, however, automatically entitled to benefits under the convention; they must also satisfy the requirements of Article 30 (Limitation on Benefits of the Convention).

Certain provisions of the Convention are applicable by their terms to persons who may not be residents of either Contracting State. For example, Article 19 (Public Remuneration) may apply to a citizen of a Contracting State who is a resident of neither, and under Article 27 (Exchange of Information), information may be exchanged with respect to residents of third states.

Provisions describing the relationship between the rules of the Convention, on the one hand, and the laws of the Contracting States and other agreements between the Contracting States, on the other, are found in paragraphs 1 and 8 of Article 29 (Miscellaneous Provisions), and are discussed in connection with that Article. Provisions preserving certain taxing rights of the Contracting States under the "saving clause" are found in paragraphs 2 and 3 of Article 29 (Miscellaneous Provisions). Those provisions are discussed here, because they are an important qualification to the scope of this Article.

As in the 1967 Convention (see paragraph 4 of Article 22 (General Rules of Taxation)), the saving clause in this Convention is, at France's request, unilateral, applying only for United

States tax purposes. Under paragraph 2 of Article 29 (Miscellaneous Provisions), the United States reserves its right, except as provided in paragraph 3 of Article 29, to tax U.S. residents and citizens as provided in the Internal Revenue Code (the "Code"), notwithstanding the provisions of the Convention. If, for example, a French resident performs independent personal services in the United States and the income from the services is not attributable to a fixed base in the United States, Article 14 (Independent Personal Services) would normally prevent the United States from taxing the income. If, however, the French resident is also a citizen of the United States, the saving clause permits the United States to include that income in the worldwide income of the citizen and subject it to tax under the normal Code rules. (For special foreign tax credit rules applicable to the U.S. taxation of certain U.S. income of its citizens resident in France, see paragraph 1(b) of Article 24 (Relief from Double Taxation)).

For the purpose of the saving clause, residence is determined under Article 4 (Resident). Thus, for example, if an individual who is not a U.S. citizen is a resident of the United States under the Code and is also a resident of France under French domestic law, and the rules of Article 4 determine that he is a resident of France, he will be entitled to U.S. benefits under this Convention. The saving clause would not permit the United States to apply its domestic law to that person if it is inconsistent with the Convention.

Under paragraph 2 of Article 29 (Miscellaneous Provisions), the United States also reserves its right to tax former U.S. citizens, whose loss of citizenship had as one of its principal purposes the avoidance of U.S. income tax, for ten years following the loss of citizenship. Such a former citizen is taxable in accordance with the provisions of section 877 of the Code for ten years following the loss of citizenship. This provision is somewhat narrower than in some other U.S. income tax treaties in referring only to the avoidance of income tax and not all taxes; it is similar in that respect, however, to the recent treaties concluded with Germany and the Netherlands.

Subparagraph 3(a) of Article 29 (Miscellaneous Provisions) sets forth certain exceptions to the saving clause, to prevent it from applying where it would contravene provisions of the Convention that are intended to extend U.S. benefits to U.S. citizens and residents. Subparagraph (a) lists certain provisions of the Convention that are applicable to all U.S. citizens and residents, despite the general saving clause rule of paragraph 2. Those provisions provide the following benefits:

(1) Paragraph 2 of Article 9 (Associated Enterprises) grants a corresponding adjustment in certain circumstances and explicitly permits the override of the statute of limitations for the purpose of refunding tax under such a corresponding adjustment.

(2) Subparagraph 3(a) of Article 13 (Capital Gains) limits the taxes imposed at source and residence on gain derived by a resident of one Contracting State from alienating business property of a permanent establishment or fixed base in the other State. This exception preserves the benefit provided by the State of residence.

(3) Subparagraph 1(b) of Article 18 (Pensions) provides that only the paying State may tax social security benefits paid to a resident of the other State. This exception to the saving clause prohibits the United States from taxing French social security payments received by its residents even if they would otherwise be taxable under the Code.

(4) Article 24 (Relief from Double Taxation) confirms the benefit of a foreign tax credit to U.S. citizens and residents.

(5) Article 25 (Non-Discrimination) preserves the benefits of non-discriminatory taxation for an individual who is either a dual national or a French national and a U.S. resident, and for an enterprise that is a U.S. resident and is owned or controlled by French residents.

(6) Article 26 (Mutual Agreement Procedure) may confer benefits on U.S. citizens and residents. For example, it provides that the statute of limitations may be waived for refunds and that the competent authorities are permitted to use a definition of a term that differs from the Code definition.

As with the foreign tax credit, these benefits are intended to be granted by a Contracting State to its citizens and residents.

Subparagraph 3(b) of Article 29 (Miscellaneous Provisions) provides a different set of exceptions to the saving clause. The benefits referred to are granted to certain temporary U.S. residents, but not to U.S. citizens or individuals with immigrant status. The United States will continue to grant these benefits to non-U.S. citizens who come to the United States from France and remain in the United States long enough to become residents under the Code, but do not acquire immigrant status (i.e., they do not become "green card" holders), even if these benefits would not be allowed under the Code. The benefits preserved by this paragraph are the exemptions for the following items of income: government service salaries and pensions under Article 19 (Public Remuneration); certain income of visiting teachers and researchers under Article 20 (Teachers and Researchers); certain income of students and trainees under Article 21 (Students and Trainees); and the income of diplomatic and consular officers under Article 31 (Diplomatic and Consular Officers).

## ARTICLE 2 Taxes Covered

This Article identifies the U.S. and French taxes to which the Convention generally applies. These are referred to collectively in the Convention as "United States tax" and "French tax," respectively. The corresponding article in the 1967 Convention has been updated to reflect the currently applicable tax laws of the two countries.

In the case of the United States, as indicated in subparagraph 1(a), the Covered taxes are the Federal income taxes imposed by the Code, together with the excise taxes imposed on insurance premiums paid to foreign insurers (under Code section 4371) and the excise taxes with respect to the investment income of private foundations (under Code Sections 4940 et seq.). With respect to the excise tax on insurance premiums, the Convention applies only to the extent that the risks covered by such premiums are not reinsured, directly or indirectly, with a person not entitled, under this or any other income tax convention, to exemption from the tax.

Covering the U.S. insurance premiums excise tax effectively exempts from the tax certain premiums received by companies resident in France, subject to the anti-conduit rule for reinsurance described above. Under the Code, the tax is imposed only on premiums that are not attributable to an office or other fixed place of business in the United States or that are exempt by treaty from net-basis U.S. income tax because they are not attributable to a U.S. permanent establishment. Since the Convention covers the tax, and Article 7 (Business Profits) precludes

the United States from subjecting the income of a French enterprise to any covered tax if that income is not attributable to a permanent establishment that the enterprise has in the United States, the tax is effectively waived.

The 1967 Convention, as amended by the 1978 Protocol, covered the insurance premiums excise tax in the same manner. That coverage was preserved in the new Convention only after a review of French law indicated that the income tax imposed by France on French resident insurers results in a burden that is substantial in relation to the U.S. tax on U.S. resident insurers. On the basis of this analysis, U.S. negotiators concluded that it is appropriate to continue to waive the tax in the new Convention.

The Convention does not apply to social security taxes. Those taxes are dealt with in the bilateral Social Security Totalization Agreement, which entered into force on July 1, 1988.

Nor are state and local taxes in the United States covered by the Convention, except for purposes of Article 25 (Non-Discrimination). Article 25 prohibits discriminatory taxation with respect to all taxes, whether or not they are covered taxes under Article 2, and whether they are imposed by the Contracting States, their political subdivisions or local authorities.

Subparagraph 1(b) specifies the existing French taxes that are covered by the Convention. They are all taxes imposed on behalf of the State on income or capital, including the income tax, the company tax, the tax on salaries applicable to business profits or income from independent personal services, and the wealth tax.

The French tax on stock exchange transactions, covered by paragraph 5 of Article 22 (General Rules) of the 1967 Convention, is now covered by paragraph 4 of Article 29 (Miscellaneous Provisions), which also covers any such future taxes by providing that neither State shall impose a stamp or like tax on any transaction in which an order for the purchase, sale, or exchange of securities originates in one Contracting State and is executed through a stock exchange in the other Contracting State.

Paragraph 2 provides that the Convention also will apply to any taxes that are identical or substantially similar to those enumerated in paragraph 1 and that are imposed in addition to, or in place of, the existing taxes after the date of signature of the Convention (August 31, 1994). The paragraph also provides that the U.S. and French competent authorities will notify each other of changes in their taxation laws and of official published material that are of significance to the operation of the Convention.

### ARTICLE 3 General Definitions

Paragraph 1 defines a number of basic terms used in the Convention. It is substantially the same as the corresponding article in the 1967 Convention. The OECD Model language in the introduction of paragraph 1, "unless the context otherwise requires," was deleted, at the suggestion of France, as unnecessary and possibly confusing.

Some terms are not defined in the Convention. The interpretation of such terms is dealt with in paragraph 2. Certain other terms are defined in other articles of the Convention. For example, the term "resident of a Contracting State" is defined in Article 4 (Resident). The term "permanent establishment" is defined in Article 5 (Permanent Establishment) The terms "dividends," "interest," and "royalties" are defined in Articles 10, 11, and 12, respectively.

Subparagraph 1(a) of Article 3 states that the term "Contracting State" means the United States or France, depending on the context in which the term is used.

The terms "United States" and "France" are defined in subparagraphs (b) and (c), respectively. The term "United States" is defined to mean the United States of America. The term does not include Puerto Rico, the Virgin Islands, Guam, or any other U.S. possession or territory. When used geographically, the term includes the states of the United States and the District of Columbia. It also includes the territorial sea adjacent to the states and any area outside that territorial sea to the extent that, under international law, the United States has sovereign rights to explore for and exploit the natural resources of the continental shelf and the waters above it. The term "France" means the French Republic (Metropolitan France and the Overseas Departments of Guadeloupe, Guyana, Martinique, and Reunion). When used geographically, the term includes the French territorial sea and any area outside that territorial sea to the extent that, under international law, France has rights to explore for and exploit the natural resources of the continental shelf and the waters above it.

Subparagraph 1(d) states that the term "person" includes an individual and a company. The definition is illustrative only. It is understood to include also a partnership and, in the case of the United States, an estate or a trust.

The term "company" is defined in subparagraph 1(e) as a body corporate or an entity treated as a body corporate for tax purposes. Since the term "body corporate" is not defined in the Convention, in accordance with paragraph 2 of this Article, it has the meaning that it has under the law of the contracting State whose tax is being applied.

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" are defined in subparagraph 1(f) as an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State.

Subparagraph 1(g) defines the term "international traffic." The term means any transport by a ship or aircraft except when the vessel is operated solely between places within a Contracting State. The exclusion of transport solely between places within a Contracting State means, for example, that the carriage of goods or passengers solely between New York and Chicago by either a U.S. or a French carrier would not be treated as international traffic. The substantive taxing rules of the Convention relating to the taxation of income from transport, principally Article 8 (Shipping and Air Transport), therefore, would not apply to income from such carriage. If the carrier were a French resident (if that were possible under U.S. law), Article 8 would not require the United States to exempt the income. The income would, however, be treated as business profits under Article 7 (Business Profits), and would, therefore, be taxable in the United States only if attributable to a U.S. permanent establishment and then only on a net basis. The gross-basis U.S. tax would not apply under the circumstances described. If, however,

goods or passengers were carried by a French carrier from Le Havre to New York to Chicago, with some of the goods or passengers carried only to New York, and the rest taken to Chicago, the entire transport would be international traffic.

Subparagraphs (h)(i) and (ii) define the term "competent authority" for the United States and France, respectively. The U.S. competent authority is the Secretary of the Treasury or his delegate. The Secretary of the Treasury has delegated the competent authority function to the commissioner of Internal Revenue, who has, in turn, redelegate the authority to the Assistant Commissioner (International). With respect to interpretive issues, the Assistant Commissioner acts with the concurrence of the Associate Chief Counsel (International) of the Internal Revenue Service. In France, the competent authority is the Minister in charge of the budget or his authorized representative.

Paragraph 2 provides that, in the application of the Convention by a Contracting State, any term used but not defined in the Convention will, unless the context requires otherwise, have the meaning it has under the taxation law of the Contracting State whose tax is being applied. The word "taxation" was inserted at the request of France to make clear that, if the same term has differing definitions in different laws, it is the taxation law definition that applies. This is consistent with the U.S. position regarding interpretation of this provision. If the meaning of a term cannot be readily determined under the tax law of a Contracting State, or if there is a conflict between the tax laws of the two States that creates problems in the application of the Convention, the competent authorities may, pursuant to the provisions of Article 26 (Mutual Agreement Procedure), establish a common meaning in order to prevent double taxation or further any other purpose of the Convention. This common meaning need not conform to the meaning of the term under the laws of either Contracting State.

#### ARTICLE 4 Resident

This Article sets forth rules for determining whether a person is a resident of a Contracting State for purposes of the Convention. It modernizes the definition contained in the 1967 Convention.

Determination of residence is important because, as noted in the explanation to Article 1 (Personal Scope), as a general rule, only residents of the Contracting States may claim the benefits of the Convention. The Article 4 definition of residence is used for all purposes of the Convention, including the "saving" clause of paragraph 2 of Article 29 (Miscellaneous Provisions).

The definition of residence looks first to a person's liability to tax as a resident under the respective domestic laws of the Contracting States. A person who, under those laws, is a resident of one Contracting State and not of the other need look no further. For purposes of the Convention, that person is a resident of the State of which he is a resident under domestic law. If, however, a person is resident in both Contracting States under their respective taxation laws, the "tie-breaker" rules of paragraph 3 of the Article assign one State of residence to the person.

Paragraph 1 defines a "resident of a Contracting State." This definition generally incorporates the definitions of residence in U.S. and French domestic law, by defining a resident as a person who, under the laws of a Contracting State, is subject to tax there by reason of his domicile, place of management, place of incorporation, or any other similar criterion.

Paragraph 1 specifies, however, that a person liable to tax only in respect of income from sources within a Contracting State, or, in the case of France, only in respect of capital situated in France, will not be treated as a resident of that Contracting State for purposes of the Convention. Thus, for example, a French consular official in the United States, who may be subject to U.S. tax on U.S. source investment income but is not taxable in the United States on non-U.S. income, would not be considered a resident of the United States for purposes of the Convention.

Subparagraph 2(a) provides rules for determining when a U.S. citizen or a "green card" holder is to be treated by France as a U.S. resident for purposes of enjoying the benefits of the Convention. If such an individual is a resident of both the United States and France under their respective domestic laws, the tie-breaker rules of paragraph 3 of the Article (discussed below) determine a single country of residence for all purposes of the Convention. If, however, the individual is not a resident of France, but is a U.S. citizen or green card holder resident in a third country, France will treat that individual as a resident of the United States only if he has a substantial presence in the United States or if his permanent home or habitual abode is in the United States and not in the third country. In applying the "substantial presence" test for this purpose, France will apply its own 183-day standard, because French tax is at issue.

Subparagraph 2(b) clarifies that the "liable to tax" language of paragraph 1 is not meant to deny residence status, for purposes of treaty benefits, to the Government of a Contracting State or to certain organizations to which that State grants tax-exempt status. Subparagraph 2(b)(i) explicitly includes in the definition of "resident" the Governments themselves, U.S. state and local governments, local authorities, and any agency or instrumentality of those governmental bodies. Subparagraph 2(b)(ii) clarifies that pension trusts, other retirement or employee benefit organizations, and not-for-profit organizations qualify as residents if they meet the conditions specified in that subparagraph. Subparagraph 2(b)(iii) further clarifies that certain investment vehicles are residents of the Contracting State in which they are created or organized, even though the tax on the income they derive may be imposed only or primarily at the level of their shareholders, beneficiaries, or owners. Specific examples of this latter category include U.S. regulated investment companies, real estate investment trusts, real estate mortgage investment conduits, and the French investment entities mentioned in subparagraph (iii). The competent authorities may add further investment entities to this category by mutual agreement. The provisions of subparagraphs 2(b)(i), (ii), and (iii) are clarifications of the U.S. interpretation of the language in paragraph 1. Their inclusion here does not imply a different result in U.S. income tax treaties where this language is not included.

Subparagraph 2(b)(iv) further clarifies that the definition of "resident of a Contracting State" includes a partnership or similar pass-through entity and an estate or trust, but only to the extent that the income derived by such entity is subject to tax in that State as the income of a resident, either in the hands of the entity or in the hands of its partners, beneficiaries, or grantors. A U.S. limited liability company, for example, would be a "similar pass-through entity" for this purpose.



Differences between the U.S. and French domestic laws regarding the taxation of partnership income are responsible for several special treaty provisions. Under U.S. law, an organization taxable as a partnership is not a taxable entity. Thus, the extent to which income received by a partnership is treated as income of a resident of the United States will be determined by the residence of the partners (looking through any partnerships that are themselves partners) rather than by the residence of the partnership itself. Similarly, in France, the tax liability generally is computed at the partnership level, but the tax is imposed on the partners. The United States will, accordingly, generally look through a French partnership and determine residence at the level of the members. The United States will, therefore, give U.S. tax benefits under the Convention only to the extent the members are taxed by France as French residents. However, France may in some cases tax a "societe de personnes," an economic interest group, or a European economic interest group constituted and managed in France at the entity level, independently of the residence of the partners. In such a case, the United States will determine residence at the entity level instead.

In the exchange of diplomatic notes that accompanies the treaty, the United States confirms, at France's request, that it also treats a "societe de personnes," an economic interest group, or a European economic interest group constituted and managed in France and not subject to French company tax as a partnership for purposes of granting U.S. tax benefits under its tax treaties with other countries. This means that a member of such a French entity that is a resident of a third country with which the United States has an income tax treaty in effect may qualify for U.S. tax benefits under that other treaty, although the member will not receive U.S. tax benefits under this Convention. This result merely confirms the United States position on how this treaty provision should be interpreted.

The treatment under the Convention of income received by a trust or estate will be determined by the residence of the person subject to tax on such income, which may be the grantor, the beneficiaries, or the estate or trust itself, depending on the particular circumstances.

If, under the domestic laws of the two Contracting States and thus under paragraph 1, an individual is deemed to be a resident of both Contracting States, a series of tie-breaker rules apply under paragraph 3 to determine a single State of residence for that individual. The first test is where the individual has a permanent home. If that test is inconclusive because the individual has a permanent home available to him in both States, he will be considered to be a resident of the Contracting State where his personal and economic relations are closest, i.e., the location of his "center of vital interests." If that test is also inconclusive, or if he does not have a permanent home available to him in either State, he will be treated as a resident of the Contracting State where he maintains an habitual abode. If he has an habitual abode in both States or in neither of them, he will be treated as a resident of his Contracting State of nationality. If he is a national of both States or of neither, the matter will be considered by the competent authorities, who will assign a single State of residence.

Paragraph 4 addresses dual-residence issues for persons other than individuals. A corporation is treated as a resident of the United States if it is created or organized under the laws of a state of the United States. Under French law, a corporation is treated as a resident of France if it is incorporated in France or has its place of effective management ("siege social effectif")

there. Dual residence, therefore, can arise if a corporation organized in the United States is managed in France. Paragraph A provides that, if a corporation or other person, other than an individual, is resident in both the United States and France under paragraphs 1 and 2, the competent authorities shall seek to determine a single State of residence for that person for purposes of the Convention. If they are unable to reach agreement, that person shall not be considered to be a resident of either the United States or France for purposes of enjoying benefits under the Convention. Such dual residents may be treated as residents of a Contracting State for other purposes of the Convention. For example, if a dual resident corporation pays a dividend to a resident of France, the U.S. paying agent would withhold on that dividend at the appropriate treaty rate, since reduced withholding is a benefit enjoyed by the resident of France, not by the dual resident corporation.

## ARTICLE 5 Permanent Establishment

This Article defines the term "permanent establishment". This definition is significant for several articles of the Convention. Under Article 7 (Business profits), a Contracting State may not tax the business profits of a resident of the other Contracting State unless that resident has a permanent establishment in the first Contracting State. Since the term "fixed base" in Article 14 (Independent Personal Services) is understood by reference to the definition of "permanent establishment," this Article is also relevant for purposes of that Article. Articles 10, 11, and 12, respectively, provide for reduced rates of tax at source on payments of dividends, interest, and royalties, to a resident of the other State when the income is not attributable to a permanent establishment or fixed base of the recipient in the source State. Similarly, Article 22 (Other Income) provides an exemption from source basis taxation only when the income is not attributable to a permanent establishment or fixed base in the source State.

This Article follows closely the OECD Model provisions. However, like other recent U.S. income tax conventions, it adds a rule treating drilling rigs in the same manner as construction sites.

Paragraph 1 provides the basic definition of the term "permanent establishment." As used in the Convention, the term means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Paragraph 2 contains a list of examples of fixed places of business that constitute a permanent establishment. The list includes a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry, and any other place of extraction of natural resources.

Paragraph 3 deals with a building site, a construction or installation project, or an installation or drilling rig or ship used to explore for or to prepare for the extraction of natural resources. The phrase "to prepare for the extraction" is meant to include development wells. Only if the site or project continues, or the drilling equipment is used, for more than twelve months does it constitute a permanent establishment.

The twelve-month test of paragraph 3 applies separately to each individual site or project. The twelve-month period begins when work (including preparatory work carried on by the enterprise) physically begins in a Contracting State. A series of contracts or projects that are interdependent, both commercially and geographically, is to be treated as a single project for purposes of applying the twelve-month threshold test. For example, the construction of a housing development would be considered as a single project even if each house is constructed for a different purchaser. If the twelve-month threshold is exceeded, the site or project constitutes a permanent establishment from its first day. This interpretation of the Article is based on the Commentaries to paragraph 3 of Article 5 of the OECD Model, which contains language almost identical to that in the Convention with respect to construction activities. This interpretation, therefore, conforms to the generally accepted international interpretation of the language in paragraph 3 of Article 5 of the Convention with respect to such activities. It is the U.S. position that drilling rigs, both onshore and offshore, should be treated in the same manner as construction activities. The OECD Commentary notes that the laying of pipelines is considered a construction activity, and drilling activities perform an analogous function. The provisions of the Convention are consistent with that position.

Paragraph 4 contains exceptions to the general rule of paragraph 1 that a fixed place of business through which a business is carried on constitutes a permanent establishment. The paragraph lists a number of activities that may be carried on through a fixed place of business, but that, nevertheless, will not give rise to a permanent establishment. The use of facilities solely to store, display, or deliver merchandise belonging to an enterprise will not constitute a permanent establishment of that enterprise. The maintenance of a stock of goods belonging to an enterprise solely for the purpose of storage, display, or delivery, or solely for the purpose of processing by another enterprise will not give rise to a permanent establishment of the first-mentioned enterprise. The maintenance of a fixed place of business solely for activities that have a preparatory or auxiliary character for the enterprise will not constitute a permanent establishment of the enterprise. Such activities might include, for example, advertising or collecting information. Although none of these activities undertaken separately will give rise to a permanent establishment, the performance of a combination of these activities could do so. However, a combination of the enumerated activities will not give rise to a permanent establishment so long as the resulting overall activity is of a preparatory or auxiliary character. This combination rule is the same as in the OECD Model.

Paragraphs 5 and 6 specify when the use of an agent will give rise to a permanent establishment. Under paragraph 5, an enterprise will be deemed to have a permanent establishment by reason of the activities of a dependent agent of the enterprise if the agent has and habitually exercises an authority to conclude contracts in the name of that enterprise. If, however, the agent's activities are limited to activities specified in paragraph 4, that would not constitute a permanent establishment if carried on by the enterprise through a fixed place of business, those activities will not give rise to a permanent establishment of the enterprise.

The Convention deletes the special rules found in paragraphs 5(b) and 7 of the existing Convention concerning dependent agents who maintain substantial equipment or receive insurance premiums in the other State. Neither of those rules is found in recent U.S. treaties or in the OECD Model treaty, and it was considered more appropriate in the new Convention to apply the general dependent agent rules in all cases.

Paragraph 6 provides that an enterprise will not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through an independent agent, including a broker or general commission agent, if the agent is acting in the ordinary course of his business.

Paragraph 7 clarifies that a company that is a resident of a Contracting State will not be deemed to have a permanent establishment in the other Contracting State merely because it controls, or is controlled by, a company that is a resident of that other Contracting State, or that carries on business in that other Contracting State. The determination of whether or not a company is a permanent establishment of a related company is based solely on the factors described in paragraphs 1 through 6 and not on the ownership or control relationship between the companies.

## ARTICLE 6 Income from Real Property

Paragraph 1 provides that income of a resident of a Contracting State from real property situated in the other Contracting State may be taxed in the State in which the property is situated. The Article does not grant an exclusive taxing right to the situs State, but assigns it the primary right. Like the OECD Model, this paragraph specifies that income from agriculture and forestry is covered by this Article.

Paragraph 2 defines the term "real property" as having the meaning that it has under the domestic law of the situs country. However, paragraph 1 defines it in any case to include property used in agriculture and forestry. In addition, paragraph 2 specifies certain classes of property that, regardless of domestic law definitions are to be included within the meaning of the term for purposes of the Convention. The definition is similar to that in the OECD Model but adds references to options and promises to sell. The two terms overlap for purposes of U.S. law, but French law distinguishes between the two, so France preferred to specify both.

Paragraphs 3 and 4 clarify that this Article applies to income from the use in any form of real property, including leasing, and that it applies to income from the use of real property of an enterprise or in the performance of independent personal services.

This Article is not subject to the provisions of Article 7 (Business Profits) or 14 (Independent Personal Services). The situs State may tax the real property income of a resident of the other Contracting State even in the absence of a permanent establishment or fixed base in the situs State.

Paragraph 5 provides a special rule that permits either Contracting State to impose tax, in accordance with its law, on income derived by a resident of the other Contracting State from a right in any form to enjoy real property owned by a company in which the resident holds an ownership interest. Thus, for example, if a U.S. company owns real property in France and grants time-sharing rights to its shareholders with respect to that property, France may tax the imputed rental value of the use of that property to the same extent that it would do so in the case

of a French resident. (Under French domestic law, an enterprise is taxed on its imputed income based on the property's rental value, but individuals are taxed only their actual income from real property.) Like paragraph 1, this provision applies independently of Articles 7 (Business Profits) and 14 (Independent Personal Services). There is no requirement that the income be attributable to a permanent establishment or fixed base in the State where the property is situated. A similar rule is included in the recent U.S. income tax treaty with Spain.

Paragraph 6 permits a resident of either Contracting State to elect to be taxed on income from real Property situated in the other Contracting State on a net basis. In some cases, French domestic law provides for taxation on a net basis, or taxation net of deemed expenses, without requiring an election. In such a case, which primarily affects forestry, those domestic rules will apply. This provision is intended to permit net basis taxation in cases where it would not otherwise be permitted under domestic law.

## ARTICLE 7 Business Profits

This Article provides rules for the taxation by a Contracting State of the business profits of an enterprise of the other Contracting State. It updates the corresponding Article in the 1967 Convention to correspond more closely to the Current OECD Model.

The general rule, found in paragraph 1, is that business profits of an enterprise of one Contracting State may be taxed by the other Contracting State only if the enterprise carries on business in that other Contracting State through a permanent establishment (as defined in Article 5 (Permanent Establishment)). Where that condition is met, the State in which the permanent establishment is situated may tax only the income of the enterprise that is attributable to the permanent establishment.

Paragraph 2 provides rules for attributing profits to a permanent establishment. A Contracting State may attribute to a permanent establishment the profits that it would have earned had it been an independent entity, engaged in the same or similar activities under the same or similar conditions. The profits attributable to a permanent establishment may be from sources within or without a Contracting State. Thus, for example, items of foreign source income described in section 864(c) (4) (B) of the Code may be attributed to a U.S. permanent establishment of a French enterprise and taxed by the United States under the Convention. The limited "force of attraction" rule in Code section 864(c)(3) is not applicable under the Convention. The concept of "attributable to" in the Convention is, therefore, narrower than the concept of "effectively connected" in section 864(c) of the Code.

The computation of the business profits attributable to a permanent establishment under paragraph 2 is subject to the rules of paragraph 3 regarding deductions for expenses incurred for the purposes of earning the income. Paragraph 3 provides that, in determining the business profits of a permanent establishment, deductions shall be allowed for expenses incurred by the enterprise that are reasonably connected with such profits. Such expenses include executive and general administrative expenses. They also include interest, research and development, and other expenses incurred by the home office, to the extent that they are attributable to the permanent

establishment. Deductions are to be allowed regardless of where the expenses are incurred. Each country may apply its own rules in calculating expenses "reasonably connected" with the profits of the permanent establishment, whether based on allocation or tracing; the United States, therefore, may apply the rules of Treasury Regulation section 1.882-5, where applicable. France may apply its own rules in determining deductions for French company tax, provided that they are consistent with the provisions of paragraph 3.

Paragraph 4 provides a special rule, carried over in large part from the 1967 treaty, concerning partnerships. This paragraph provides that a partner shall be considered to incur income and deductions with respect to his share of the partnership profits or losses as if each item of income or deduction were realized or incurred from the same source and in the same manner as by the partnership. However, if the partnership agreement establishes special allocations of profits or losses, those special allocations will be respected, provided that they have substantial economic effect. This rule is consistent with the treatment of partnership income under U.S. domestic law, but is to be followed by both Contracting States in determining the income or loss derived by residents of that State through a partnership. The rule applies to all partnerships, whether formed under the laws of France, a U.S. state or the District of Columbia, or another jurisdiction. It was introduced in 1979 to resolve apparent differences in the treatment of partners under U.S. and French tax laws, and has been retained to ensure that uniform treatment continues.

Paragraph 5 provides that no business profits will be attributed to a permanent establishment merely because it purchases goods or merchandise for the enterprise of which it is a permanent establishment. This rule refers to a permanent establishment that performs more than one function for the enterprise, including purchasing. For example, the permanent establishment may purchase raw materials for the enterprise's manufacturing operation and sell the manufactured output. While business profits may be attributable to the permanent establishment with respect to its sales activities, no profits are attributable with respect to its purchasing activities. If the sole activity were the purchasing of goods or merchandise for the enterprise, the issue of the attribution of income would not arise, because, under subparagraph 4(d) of Article 5 (Permanent Establishment), there would be no permanent establishment.

Paragraph 6 states that the business profits attributed to a permanent establishment are only those derived from its assets or activities. This clarifies the fact, as noted in connection with paragraph 2 of the Article, that the Code concept of effective connection, with its limited "force of attraction," is not incorporated into the Convention.

Paragraph 7 incorporates the rule of Code section 864(c)(6) into the Convention. It provides that any income or gain attributable to a permanent establishment during its existence is taxable in the Contracting State where the permanent establishment is or was situated, even if the payments are deferred until after the permanent establishment no longer exists. A similar rule was introduced into the 1967 Convention by the 1988 Protocol.

Paragraph 8 explains the relationship between the provisions of Article 7 and other provisions of the Convention. Where business profits include items of income that are dealt with separately under other articles of the Convention, the provisions of those articles will take precedence. In some cases those articles will refer back to Article 7. Thus, for example, the

taxation of interest generally will be determined by the rules of Article 11 (Interest). However, as provided in paragraph 4 of Article 11, if the interest is attributable to a permanent establishment, the provisions of Article 7 will apply instead.

The 1967 Convention contained a definition of the term "business profits" that specifically included income from the leasing of tangible personal property and of films and tapes. That definition has been omitted in the interest of consistency with the OECD Model. However, the result is the same. It is agreed that the leasing of tangible personal property gives rise to business profits taxable under this Article. The rental of films and tapes is now covered under Article 12 (Royalties) but gives rise to copyright royalties exempt from tax at source except to the extent attributable to a permanent establishment or fixed base, in which case this Article or Article 14 (Independent Personal Services) applies.

This Article is subject to the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions). Thus, for example, if a citizen of the United States who is a resident of France derives business profits from the United States that are not attributable to a permanent establishment in the United States, the United States may, subject to the special foreign tax credit rules of subparagraph 1(b) of Article 24 (Relief from Double Taxation), tax those profits as part of the worldwide income of the citizen, notwithstanding the provisions of this Article.

## ARTICLE 8 Shipping and Air Transport

This Article provides rules governing the taxation of profits from the operation of ships and aircraft in international traffic, as that term is defined in subparagraph 1(g) of Article 3 (General Definitions).

Paragraph 1 provides that profits derived by an enterprise of a Contracting State from the operation in international traffic of ships or aircraft shall be taxable only in that Contracting State. By virtue of paragraph 8 of Article 7 (Business Profits), profits of an enterprise of a Contracting State that are dealt with in this Article are exempt from tax by the other Contracting State even if the enterprise has a permanent establishment or fixed base in that other State to which the profits are attributable.

Paragraph 2 defines the scope of income covered by this Article. It differs from the 1967 Convention in not including gains from the alienation of ships and aircraft used in international traffic. However, the same rule applies under paragraph 4 of Article 13 (Capital Gains). Subparagraph 2(a) provides that profits from the operation of ships or aircraft in international traffic include both profits from the rental of ships or aircraft on a full basis (i.e., equipped with crew and supplies) and profits from the rental of ships or aircraft on a bareboat basis (i.e., without crew and supplies) if the ships or aircraft are operated in international traffic by the lessee or if such profits are accessory to international operating income of the lessor. If the profits are accessory to international operating income, the exemption extends to income from domestic operations within the source State.

Subparagraph 2(b) provides that profits from the use, maintenance, or rental of containers

and related equipment used in international traffic are covered by this Article if such profits are accessory to international operating income. Profits from container leasing that do not qualify for exemption at source under this Article fall within the scope of Article 7 (Business Profits) or 14 (Independent Personal Services). Only income that is attributable to a permanent establishment or fixed base that the lessor has in the other Contracting State may be taxed in that other State under Article 7 or 14.

Paragraph 3 clarifies that the provisions of the preceding paragraphs apply to the share of profits derived by an enterprise of a Contracting State from participation in a pool, joint business, or international operating agency.

The 1967 Convention, as amended by the 1978 Protocol, included a limitation of benefits provision within this Article. That provision has been deleted, and shipping and air transport enterprises will be subject to the general limitation on benefits rules of Article 30 (Limitation on Benefits of the Convention).

An exchange of letters signed on the same date as the convention confirms that France will exempt U.S. enterprises engaged in the international operation of ships and aircraft from its "taxe professionnelle" in respect of such operations, as long as French enterprises similarly engaged are not subject to state income taxation in the United States in respect of such operations. This extends the French position taken in the 1984 exchange of notes under the 1967 Convention.

This Article is subject to the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions). The United States, therefore, may tax the shipping or air transport profits of a resident of France if that resident is a citizen of the United States, subject to the special foreign tax credit rules of subparagraph 1(b) of Article 24 (Relief from Double Taxation).

## ARTICLE 9 Associated Enterprises

This Article incorporates into the Convention the general principles of section 482 of the Code. It provides that, when associated enterprises engage in transactions that are not at arm's length, the Contracting States may make appropriate adjustments to the taxable income of such enterprises to reflect the income with respect to such transactions that would have resulted had an arm's-length relationship existed.

Paragraph 1 deals with the case where an enterprise of a Contracting State is associated with an enterprise of the other Contracting State, and those enterprises make arrangements or impose conditions between themselves in their commercial or financial relations that differ from those that would be made between independent persons. Under those circumstances, a Contracting State may adjust the income of its resident enterprise to reflect the profits that would have been taken into account in the absence of such a relationship. The paragraph applies when an enterprise of one Contracting State participates directly or indirectly in the management, control, or capital of an enterprise of the other Contracting State, or when any third person or persons participate directly or indirectly in the management, control, or capital of both. The term



"control" includes any kind of control, whether or not legally enforceable and however exercised or exercisable.

Paragraph 2 provides that, where a Contracting State has made an adjustment that is consistent with the provisions of paragraph 1, and the other Contracting State agrees that the adjustment was appropriate, that other State is obligated to make a corresponding adjustment to the tax liability of the associated enterprise in that State. In determining such adjustments, the Contracting States will take into account the other provisions of the Convention, where relevant. For example, if the effect of a corresponding adjustment is to treat a French subsidiary corporation as having made a distribution of profits to its U.S. parent corporation, the provisions of Article 10 (Dividends) will apply and permit France to impose a 5 percent withholding tax on the deemed dividend. Such adjustments are made in accordance with the provisions of Article 26 (Mutual Agreement Procedure). Accordingly, the competent authorities may consult to resolve any differences in the application of these provisions.

If a corresponding adjustment is made under paragraph 2, it is to be implemented, pursuant to paragraph 2 of Article 26 (Mutual Agreement Procedure), notwithstanding any time limits or other procedural limitations in the law of the Contracting State making the adjustment. Statutory or procedural limitations, however, cannot be Overridden to impose additional tax, because, under paragraph 1 of Article 29 (Miscellaneous Provisions), the Convention cannot provide less favorable treatment than domestic law would provide.

The saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions) does not apply to paragraph 2 of Article 9. Thus, for example, if the United States makes a corresponding adjustment that reduces the tax liability of a U.S. citizen or resident, a refund may be made even if the statute of limitations under U.S. domestic law has expired.

Article 9 of the Convention does not contain a counterpart to the paragraph 3 found in many other U.S. income tax treaties. That paragraph does not grant authority that does not otherwise exist; rather, it merely makes clear that, despite the somewhat limited language in paragraph 1 (i.e., the paragraph does not deal with adjustments to credits), the rights of the Contracting States to apply internal law provisions relating to adjustments between related parties are fully preserved. Such adjustments -- the distribution, apportionment, or allocation of income, deductions, credits or allowances -- are permitted even if they are different from, or go beyond, those authorized by paragraph 1 of the Article, so long as they accord with the general principles of paragraph 1 (i.e., that the adjustment reflects what would have transpired had the related parties been acting at arm's length). Thus, the absence of paragraph 3 in the Convention does not limit either State's right to implement its own statutory rules relating to adjustments intended to reflect transactions between unrelated parties. This conclusion derives from the fact that paragraph 1 of the Article is intended to be illustrative and not restrictive. For example, while paragraph 1 explicitly allows adjustments to deductions in computing taxable income, it does not preclude adjustments to tax credits if such adjustments can be made under internal law, despite the lack of express authority in Article 9 to make such adjustments.

## ARTICLE 10 Dividends

Article 10 provides rules for the taxation of dividends paid by a company that is a resident of one Contracting State to a resident of the other Contracting State. It also provides rules, in paragraph 7, for the imposition of a tax on branch profits.

Paragraph 1 preserves the right of each Contracting State to tax dividends derived by its residents from companies resident in the other Contracting State. In the case of the United States, this is consistent with the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions)

Paragraph 2 limits the right of the source State to tax dividends beneficially owned by a resident of the other Contracting State. The U.S. tax is limited to 5 percent of the gross amount of dividends paid by a U.S. company to a French company that is the direct beneficial owner of least 10 percent of the voting power of the paying company. The term "voting power" as used here has the same meaning that it has for purposes of section 902 of the Code. The French tax is limited to 5 percent of the gross amount of dividends paid by a French company to a U.S. company that is the beneficial owner, directly or indirectly, of at least 10 percent of the capital (i.e., total equity capital) of the paying company. In other cases, the source country tax is limited to 15 percent of the gross amount of the dividend.

The reason for the broader scope of the French provision, that extends the 5 percent rate to indirect owners, is that France extends its dividend tax credit ("avoir fiscal") to U.S. shareholders subject to the 15 percent rate. (See discussion of paragraph 4, below.) France has not agreed to extend that credit to U.S. shareholders who indirectly own 10 percent or more of the capital of the French company paying the dividend. However, it is willing to extend the 5 percent rate to such indirect owners.

Dividends paid by U.S. regulated investment companies ("RICs") and real estate investment trusts ("REITs") and by certain French investment companies ("societes d'investissement a capital variable" or "SICAVS") are not eligible for the reduced rates at source on the same basis as are dividends paid by other companies. Dividends paid by RICs and SICAVs are subject to the 15 percent rate, regardless of the percentage of voting power or capital of the paying company held by the beneficial owner of the dividend. Generally, the reduction of the dividend rate to 5 percent is intended to relieve multiple levels of corporate taxation in cases where the recipient of the dividend holds a substantial interest in the payor. Because RICs, PEITs, and SICAVs are generally not liable to corporate tax with respect to amounts distributed, the rate reduction from 15 to 5 percent cannot be justified by this rationale. Further, it is unlikely that a 10 percent shareholding in a RIC will constitute a 10 percent shareholding in any company from which the dividends originate. Had the French investor purchased shares directly in the U.S. company instead of through a RIC, it would typically qualify for the 15 percent rate, not for the 5 percent rate. In the case of dividends paid by a REIT, the 15 percent rate is available only to individual residents of France holding a less than 10 percent interest in the REIT. In other cases the statutory rate of 30 percent applies. As in the case of investment through a RIC, this is intended to prevent indirect investment in U.S. real property through a REIT from being treated more favorably than investment directly in such real property.

Paragraph 3 confirms that paragraph 2 does not affect the taxation of the profits out of which the dividends are paid.

Paragraph 4 extends to certain U.S. shareholders all or a portion of the dividend tax credit ("avoir fiscal") that is provided under French law to French resident shareholders. Subparagraph 4(a) provides that, where a resident of France would be entitled under French law to a tax credit in respect of dividends paid by a company that is a resident of France, the same amount of credit will be available to certain residents of the United States with respect to such dividends. The credit is, however, subject to deduction of the tax provided for in subparagraph 2(b) from the gross amount of the dividend plus the credit. Subparagraph 4(b) describes the U.S. residents eligible for this credit: individuals, other persons that are not companies, and companies that own less than 10 percent, directly or indirectly, of the capital of the French company paying the dividend. In the case of a RIC, there is a further requirement that more than 80 percent of its shareholders be U.S. citizens or residents. Subparagraph 4(d) provides that a partnership or similar pass-through entity, an estate, or a trust (other than a pension trust, REIT, or other entity described in subparagraph 2(b) (ii) or (iii) of Article 4) is eligible for the credit to the extent that its partners or beneficiaries are eligible. In all such cases, the credit is available only to U.S. persons subject to U.S. income tax on the dividend received from the French company and the credit related to the dividend (subparagraph 4(c)).

In each of the cases mentioned in subparagraphs 4(a) through (d), the tax credit will result in a cash refund from France under its current imputation system. In 1995, the French corporation tax is imposed at 33.33 percent. The "avoir fiscal" is equal to one half of the dividend distributed. The shareholder includes the cash dividend plus the "avoir fiscal" in taxable income and credits the "avoir fiscal" against the tax due. For example, assume that a French corporation has 100 of taxable income, pays 33.33 of tax, and distributes the full 66.67 to individual U.S. shareholders. Under the Convention, the U.S. shareholders will have French dividend income of 100 (66.67 + 33.33), from which France may collect a tax of 15 percent, or 15. However, the shareholders will be entitled to a credit of 33.33 against that 15, resulting in a refund from the French Government of 18.33. Thus the cash dividend, after French tax, will be 85, 66.67 from the French corporation and 18.33 of refund of French tax. This credit provision was introduced into the 1967 Convention by the 1978 Protocol. Since that time, the French corporate tax rate has declined from 50 percent to 33.33 percent. The "avoir fiscal" has remained equal to one-half of the dividend, and thus has increased in relation to the corporate tax from 50 to 100 percent of the tax.

The Convention provides a partial dividend tax credit to certain other classes of U.S. shareholders. Subparagraph 4(e) provides U.S. residents a credit equal to 30/85 of the "avoir fiscal" available to a French resident shareholder in the case of dividends derived and beneficially owned by:

- (1) the United States, a state or local authority of the United States, or any agency or instrumentality of such a governmental body, from the investment of retirement assets;
- (2) a pension trust, retirement or employee benefit organization, or tax-exempt organization described in subparagraph (b)(ii) of Article 4 (Resident); or
- (3) an individual, from investments in a retirement arrangement under which either the contributions are deductible for U.S. tax purposes or U.S. tax on the accumulated earnings is deferred.

The negotiators agreed that these three categories cover all investments by U.S. pension plans or

other arrangements described in Code sections 401(a), 403, 408, and 457. However, the scope of subparagraph 4(e) is not limited to plans and arrangements described in one of these sections. For instance, a plan or arrangement described in Code section 414(d) will qualify for the *avoir fiscal* provided under subparagraph 4(e) if it satisfies the requirements of that subparagraph, even if it is not described in Code section 457. Any other plan or arrangement that satisfies the requirements of subparagraph 4(e) will be entitled to the "*avoir fiscal*" provided under that subparagraph, even if it is not a qualified plan under U.S. domestic law.

As noted above, when a French corporation distributes a dividend of 66.67 out of 100 of pre-tax profit on which it has paid 33.33 of French corporation tax, a French shareholder reports 100 of dividend income and claims an "*avoir fiscal*" of 33.33. In this case, an eligible U.S. shareholder would report dividend income of 66.67 plus 11.76 ( $30/85 \times 33.33$ ), or 78.43. The French tax due would be 15 percent of 78.43, or 11.76, and the cash dividend after French tax would be 66.67. Thus, the tax credit fully offsets the tax otherwise due at the shareholder level in these cases.

The provisions of subparagraph 4(e) apply retroactively, as well as prospectively, to dividends paid on or after the first day of January of 1991. (See paragraph 3(a) of Article 33 (Entry into Force).) The French Government has developed procedures and forms for claiming available refunds.

In each case, the United States will treat the refund of all or a portion of the French company tax as a withholding of the shareholder-level tax. Thus the tax credit is included in the dividend income of the U.S. shareholder, just as a withholding tax on the dividend would be.

Where required by the French tax administration, the beneficial owner of a dividend that qualifies for a French tax credit must show that he is the beneficial owner and that the shareholding does not have as one of its principal purposes the purpose of allowing another person to take advantage of this paragraph 4 of the Convention.

Dividends paid by a French company to a resident of the United States that are not eligible for the credit provided for in subparagraph (a) or (e) of paragraph 4 are exempt from payment of the French prepayment ("*precompte*") otherwise payable by the French corporation with respect to those dividends. The "*precompte*" funds the "*avoir fiscal*" by collecting the company tax on the distribution of profits that did not bear the full company level tax. Thus, all qualifying shareholders receive the same amount of credit; the "*precompte*" corrects for differences in the underlying corporate tax. The Convention waives the "*precompte*" with respect to dividends distributed to U.S. shareholders not entitled to an "*avoir fiscal*." Refunds of the full amount of the "*precompte*" are available to U.S. shareholders not entitled to any dividend tax credit payment. In the case of shareholders entitled to the "*avoir fiscal*" payment described in subparagraph (e) of paragraph 4, a refund also will be granted, but reduced by the amount of that payment. In all cases, the gross amount of refund will be treated as a dividend for purposes of the Convention and will be taxable in France at the rates provided for in paragraph 2.

The competent authorities may consult together and may prescribe rules, together or separately, to implement the provisions of paragraph 4. Such consultations have already taken place under the authority of the 1967 Convention.

The term "dividends" is defined in paragraph 5 to mean income from shares, "jouissance" shares or rights, mining shares, founders' shares, or other rights (not being debt claims) participating in profits, as well as income derived from other rights that is subjected to the same taxation treatment as income from shares by the laws of the Contracting State of which the company making the distribution is a resident. The term "dividends" also includes income from arrangements, including debt obligations, that carry the right to participate in profits or that are determined with reference to profits of the issuer or of one of its associated enterprises, to the extent that such income is characterized as a dividend under the law of the source State. Distributions to directors as compensation for their services are not treated as dividends under this Article, but as directors' fees under Article 16 (Directors' Fees). As such they are taxable in France to the extent that the services are performed in France; they are not in any case eligible for the French dividend tax credit ("avoir fiscal").

The provisions of this Article also apply to beneficial owners of dividends that hold depository receipts in place of the shares themselves. The U.S.-Netherlands Convention also treats depository receipts in this way. (See Point VI of the Understanding to that Convention.) In this Convention such dividends are also eligible for the dividend tax credit to the extent authorized in paragraph 4.

Paragraph 6 excludes from the scope of this Article dividends attributable to a permanent establishment or fixed base of the beneficial owner in the source State. Such dividends will be included in the taxable income of the permanent establishment or fixed base and taxed on a net basis under the rules of Article 7 (Business Profits) or 14 (Independent Personal Services).

Paragraph 7 authorizes the imposition of a second level of tax on branch profits similar to, and at the same rate as, the tax that may be imposed under this Article on dividends paid by a subsidiary corporation in one Contracting State to its parent company in the other Contracting State. The United States tax is imposed on the "dividend equivalent amount" of profits attributable to the U.S. branch of a French company or of income or gain derived by a French company from U.S. real estate on which the company is taxed on a net basis. The term "dividend equivalent amount" is defined in section 884 of the Code. France will impose its branch tax on the amount of after-tax branch profits deemed distributed to the home office in accordance with Article 115 "quingies" of the French tax code. The rate of tax will be 5 percent in each case. The same tax applies to income attributable to a trade or business carried on by a partnership or other pass-through entity in which a company resident in the other Contracting State is a partner.

Paragraph 8 bars one Contracting State from imposing a tax on dividends paid by a company resident in the other Contracting State or on the undistributed profits of such a company, even if the dividends or profits consist wholly or partly of profits or income arising in that first State. Exceptions to this rule apply insofar as dividends are paid to a resident of the first Contracting State or are attributable to a permanent establishment or fixed base situated in the first State. In the former case, the country of residence may tax the dividends by virtue of paragraph 2 of Article 29 (Miscellaneous Provisions). In the latter case, the dividends are taxable by France or the United States under Article 7 (Business profits) or 14 (Independent Personal Services)

Notwithstanding the foregoing limitations on source State taxation of dividends, the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions) permits the United States to tax dividends received by its residents and citizens, subject to the special rules of subparagraph I(b)(ii) of Article 24 (Relief from Double Taxation), as if the Convention had not come into effect.

## ARTICLE 11

### Interest

Article 11 limits the source State taxation of interest beneficially owned by residents of the other Contracting State.

Paragraph 1 grants to each Contracting State the exclusive right to tax interest arising in the other Contracting State that is beneficially owned by residents of the first State. This preserves the exemption at source of interest provided for in the 1967 treaty, as amended by the 1984 Protocol.

The exemption at source provided in this Article also applies to the excess interest, if any, of a U.S. branch of a French company; such excess interest is treated under U.S. law as if paid to the home office.

However, paragraph 2 introduces an exception to the rule of paragraph 1 in the case of interest that is determined with reference to the profits of the issuer of the debt or to the profits of one of its associated enterprises. Interest that is contingent on profits in such a manner is subject to tax at source at a rate not exceeding 15 percent. Thus, such interest will be taxed at the same rate as portfolio dividends, unless the domestic law of the source State provides a lower rate of tax.

Another exception preserves the U.S. right to tax an excess inclusion with respect to a residual interest in a real estate mortgage investment conduit. This provision is in paragraph 6 of Article 29 (Miscellaneous Provisions).

The term "interest" means income from debt claims of every kind, whether or not secured by a mortgage and whether or not carrying a right to participate in profits, as well as any other income treated as income from money lent by the taxation law of the source State. Penalty charges for late payment are excluded from the definition of interest; they may be imposed notwithstanding the exemption or the limitation of tax at source on interest. Income dealt with in Article 10 is also excluded from the definition of interest. Thus, for example, if under domestic law income from a debt obligation carrying the right to participate in profits is considered a dividend, it will also be considered a dividend for purposes of the Convention, notwithstanding the fact that the Convention definition of interest includes income from debt-claims carrying the right to participate in profits. First, however, such income must be characterized as a dividend under domestic law.

Paragraph 4 excludes from the scope of this Article interest attributable to a permanent establishment or fixed base of the creditor in the source State. Such interest will be included in

the taxable income of the permanent establishment or fixed base and taxed on a net basis under the rules of Article 7 (Business Profits) or 14 (Independent Personal Services).

Paragraph 5 contains the source rule for interest. This rule provides that the source of an interest payment generally is the State of residence of the payor, unless the interest is borne by a permanent establishment or fixed base in the other State, in which case the source is assigned to that other State. A source rule is provided because paragraph 1 requires that each Contracting State exempt from tax income “arising in” that State and beneficially owned by a resident of the other State. Interest arising in a third country is dealt with in Article 21 (Other Income). However, since Article 21 also provides for taxation only in the residence State, the result would be the same if this Article dealt with all interest, wherever arising, which would eliminate the need for a source rule. The latter approach has been used in some other recent U.S. treaties; the format used here follows that of the OECD Model.

An exchange of notes, signed on the same date as the Convention, confirms that paragraph 5 does not restrict the ability of either State to tax interest paid by a permanent establishment in that State to any resident of a third State, comparable clarification was included in an exchange of letters accompanying the 1988 Protocol.

Paragraph 6 limits the benefits of this Article to interest amounts that reflect arm's length transactions. If the interest paid exceeds an arm's length amount due to a special relationship between the creditor and the debtor, the excess amount may be taxed under the domestic law of the source State, with due regard to other provisions of the Convention. Thus, for example, if under domestic law, the excess amount is treated as a dividend, the rate provided in Article 10 (Dividends) would apply.

Notwithstanding the foregoing limitations on source state taxation of interest, the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions) permits the United States to tax the interest income of its residents, as defined in Article 4 (Resident) and its citizens, subject to the special rules of subparagraph 1(b) of Article 24 (Relief from Double Taxation), as if the Convention had not come into effect.

## ARTICLE 12

### Royalties

Article 12 limits the source State taxation of royalties beneficially owned by residents of the other Contracting State.

Paragraph 1 preserves each Contracting State's right to tax royalties arising in the other Contracting State that are beneficially owned by residents of the first State. This is consistent with the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions).

Paragraph 2 also permits the source State to tax royalties beneficially owned by a resident of the other Contracting State, but not at a rate of more than 5 percent of the gross amount of the royalties.

Paragraph 3 provides an exception to paragraph 2. The source State may not impose tax on copyright royalties described in subparagraph 4(a) that are beneficially owned by a resident of the other Contracting State.

Paragraph 4 defines the term "royalties." Subparagraph 4(a) includes payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work. It includes payments for the use of, or the right to use, any neighboring right, including reproduction rights and performing rights. The definition in subparagraph 4(a) also covers payments for the use of, or the right to use, any cinematographic film, any sound or picture recording, or any software. The royalties described in this subparagraph are exempt from tax at source in accordance with paragraph 3. The references to neighboring rights and to software simply confirm that both States share the same interpretation of the term "copyright." They are not intended to suggest that the term "copyright," as used in other U.S. treaties (including the present treaty with France), excludes software or neighboring or similar rights.

Subparagraph 4(b) includes payments for the use of, or the right to use, any patent, trademark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial, or scientific experience. Royalties described in subparagraph 4(b) are subject to tax at source at a rate of 5 percent of the gross amount, unless domestic law provides for a lower tax. Subparagraph 4(c) includes gains derived from the alienation of any right or property described in subparagraph 4(a) or (b), to the extent that such gains are contingent on the productivity, use, or further alienation of that right or property. Royalties described in subparagraph 4(c) will be either exempt at source or taxed at a rate not exceeding 5 percent depending on whether they belong under subparagraph 4(a) or 4(b).

Paragraph 5 excludes from the scope of this Article royalties attributable to a permanent establishment or fixed base of the beneficial owner in the source State. Such royalties will be included in the taxable income of the permanent establishment or fixed base and taxed on a net basis under the rules of Article 7 (Business Profits) or 14 (Independent Personal Services).

Paragraph 6 contains the source rule for royalties. Under subparagraph 6(c), royalties are treated as arising in a Contracting State when paid for the use of, or the right to use, property in that State. This place of use rule takes precedence over the rules of subparagraphs 6(a) and 6(b). When subparagraph 6(c) does not apply, because the royalty is for the use of, or the right to use, property in a third State, subparagraph 6(a) provides that the royalties arise in a Contracting State if the payer is a resident of that State within the meaning of Article 4 (Resident). However, as provided in subparagraph 6(b), where the person paying the royalties (whether or not a resident of one of the Contracting States) has in a Contracting State a permanent establishment or fixed base in connection with which the liability to pay royalties was incurred, and the royalties are borne by the permanent establishment or fixed base, then the royalties are deemed to arise in the State in which the permanent establishment or fixed base is situated. This source rule applies also for purposes of Article 24 (Relief from Double Taxation).

Subparagraph 6(d) provides that royalties will be deemed paid no later than the time at which they are taken into account as expenses for tax purposes in the source State. This rule, which also appears in the 1967 Convention, was added as an anti-abuse measure at the request of



France.

Paragraph 7 limits the benefits of this Article to royalty amounts that reflect arm's length transactions. If the royalty paid exceeds an arm's length amount due to a special relationship between the payor and the beneficial owner, the excess amount may be taxed under the domestic law of the source State, with due regard to the other provisions of the Convention. Thus, for example, if under domestic law the excess amount is treated as a dividend, the rate provided in Article 10 (Dividends) would apply.

Notwithstanding the foregoing limitations on source country taxation of royalties, the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions) permits the United States to tax its residents, as defined in Article 4 (Resident), and its citizens, subject to the special rules of subparagraph 1(b) of Article 24 (Relief from Double Taxation), as if the Convention had not come into effect.

## ARTICLE 13

### Gains

Article 13 limits the source State taxation of capital gains derived by residents of the other Contracting State from the alienation of property.

Paragraph 1 preserves the right of each Contracting State to tax gains from the alienation of real property situated in that State. As explained in paragraph 2, paragraph 1 permits the situs State to tax not only gains derived from the alienation of real property referred to in Article 6 (Income from Real Property) that is situated in that State, but also certain other gains that are attributable to real property situated in that State. The United States may tax the gain derived by a resident of France from the alienation of a "U.S. real property interest," as defined in Code section 897, and an interest in a partnership, trust, or estate, to the extent attributable to real property situated in the United States. France may tax the gain derived by a U.S. resident from the alienation of shares or similar rights in a company if 50 percent or more of the company's assets consist of real property situated in France or derive 50 percent or more of their value, directly or indirectly, from such real property. In addition, France may tax such gain from an interest in a partnership, a "societe de personnes," an economic group, or a European economic group (provided in each case that it is not taxed as a company under French law), an estate, or a trust, to the extent attributable to real property situated in France.

Because the definition of "real property situated in a Contracting State" contained in paragraph 2 of Article 13 is specifically limited to Article 13, such definition has no effect on the right to tax income covered in other articles. For example, the inclusion of interests in certain corporations in the definition of real property situated in the other Contracting State for purposes of permitting source country taxation of gains derived from dispositions of such interests under Article 13 does not affect the treatment of dividends paid by such corporations. Such dividends remain subject to the limitations on source country taxation contained in Article 10 (Dividends) and are not governed by the unlimited source country taxation right contained in Article 6 with respect to real property.

In the case of gains from the alienation of movable property, paragraph 3 of Article 13 preserves the source country right to tax in certain circumstances. Subparagraph 3(a) provides that gains from the alienation of movable property forming part of the business property of a permanent establishment or fixed base that an enterprise of a Contracting State has in the other Contracting State, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State. If the removal of such property from a Contracting State is treated by that State as a deemed alienation of the property, that State may tax the gain as of the date of removal (but not any subsequent gain) and the other State may not tax that gain (but only any subsequent gain). For U.S. tax purposes, the taxpayer will carry over the basis of the property and will be required to substantiate its fair market value on the date of removal from France in computing any subsequent gain that becomes taxable in the United States. This provision does not affect the operation of Code section 987 with respect to foreign currency gain or loss on remittances by a qualified business unit of property or currency.

An exchange of notes, signed on the same date as the Convention, acknowledges that the meaning of "business property," as used in subparagraph 3(a), is narrower in some cases than the term "assets," used in paragraph 2, despite the use in French of the same term in both places.

Subparagraph 3(b) permits the taxation of gain attributable to a permanent establishment or fixed base under subparagraph 3(a), even if the permanent establishment or fixed base no longer exists when the payments are made. This parallels the rule of paragraph 7 of Article 7 (Business Profits) and paragraph 2 of Article 14 (Independent Personal Services).

Paragraph 4 provides that gains derived by an enterprise that operates ships or aircraft in international traffic from the alienation of such ships or aircraft or of movable property pertaining to their operation shall be taxable only in the Contracting State of which the enterprise is a resident.

Paragraph 5 provides that gains described in subparagraph of Article 12 (Royalties) may be taxed only in accordance that Article. Thus, the source country will either exempt gains or tax them at not sore than 5 percent, in accordance Article 12 (Royalties)

Paragraph 6 states that, except as provided in paragraph 5, gain from the alienation of any property not referred to in the preceding paragraphs of this Article may be taxed only in the Contracting State of which the person deriving the gain is a resident. Thus, gain from the sale of corporate securities or other tangible personal property not covered by paragraph 3 is exempt from tax at source.

Notwithstanding the foregoing limitations on source State taxation of certain gains, the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions) permits the United States to tax the capital gains of its residents, as defined in Article 4 (Resident), and citizens, subject to the special rules of subparagraph 1(b) of Article 24 (Relief from Double Taxation), as if the Convention had not come into effect.

## Independent Personal Services

The Convention covers different classes of income from personal services in separate articles. Article 14 deals with the general class of income from independent personal services, and Article 15 deals with the general class of dependent personal service income. Exceptions or additions to these general rules are provided for directors' fees (Article 16), performance income of artistes and sportsmen (Article 17), pensions in respect of personal service income (Article 18), salaries and pensions related to government employment and social security benefits (Article 19), the income of visiting teachers and researchers (Article 20), and certain income of students and trainees (Article 21).

Paragraph 1 of Article 14 provides the general rule that a resident of a Contracting State who derives income from the performance of professional services or other activities of an independent character will be exempt from tax by the other Contracting State in respect of that income unless certain conditions are satisfied. The income may be taxed in the other Contracting State only if the services are performed there and the income is attributable to a fixed base regularly available to the resident in that other State for the purpose of performing his services. This Article deals with income from performing services; Article 7 deals with income from furnishing the services of others.

As in the case of Articles 7 (Business Profits) and 13 (Capital Gains), paragraph 2 provides that the income attributable to a fixed base in a Contracting State with respect to services performed there may be taxed by that State even if receipt of the income is deferred until the fixed base no longer exists. If the income was attributable to a fixed base in that State, the tax cannot be avoided by deferring the payment.

If the individual is a U.S. citizen, the United States may, by virtue of the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions), tax his income without regard to the restrictions of this Article, subject to the special rules of subparagraph 1(b) of Article 24 (Relief from Double Taxation).

The term "fixed base" is not defined in the Convention, but its meaning is understood to be analogous to that of the term "permanent establishment," as defined in Article 5 (Permanent Establishment). Therefore, some rules of Article 7 (Business Profits) for attributing income and expenses to a permanent establishment are relevant for attributing income to a fixed base. However, the taxing right conferred by this Article with respect to income from independent personal services is somewhat more limited than that provided in Article 7 for the taxation of business profits. Under both Articles, the income of a resident of one Contracting State must be attributable to a permanent establishment or fixed base in the other State in order for that other State to have a taxing right. Under Article 14, the income also must be attributable to services performed in that other State. Article 7 does not require that all of the activities generating the income be performed in the State where the permanent establishment is located.

Paragraph 3 of Article 13 notes that the term "professional services" includes independent scientific, literary, artistic, educational, and teaching activities, as well as the independent activities of physicians, lawyers, engineers, architects, dentists, and accountants. This list is not meant to be exhaustive. The term includes all personal services performed by an individual for

his own account, whether as a sole proprietor or a partner, where he receives the income and bears the risk of loss arising from the services.

Paragraph 4 contains a special rule that is carried over from the 1967 Convention, as amended by the Protocols of 1978 and 1984. It provides that the earned income derived by a partner in a partnership generally will have the same character and source that it has at the partnership level. Thus, for example, a resident of France (whether or not a U.S. citizen) who is a partner in a U.S. partnership will be considered, for purposes of French income tax, to have received U.S. source income to the extent that his or her distributive share in the partnership profit or loss consists of U.S. source income. However, the paragraph also provides that, for purposes of Article 24 (Relief from Double Taxation), this provision shall not result in France exempting from tax (or giving a credit equal to the French tax on) more than 50 percent of the earned income of the partnership that accrues to the resident of France. This exception to the general principle of the paragraph was provided to preserve the revenues of France in the event that the French office shows a loss or a relatively low profit compared to the resident partner's distributive share of the total partnership income.

For example, if a partnership of two equal partners, one of whom is a resident of France, has \$100,000 of earned income of which \$20,000 is derived from the French office, each partner's share (absent any special allocation) would amount to \$50,000, of which only \$10,000 would be of French source. Under this rule, France is permitted to tax the resident partner on \$25,000 (50 percent of \$50,000). However, the additional income taxable by France (\$15,000) as a result of this special rule will reduce the amount of earned income from French sources otherwise taxable by France to partners who are not residents of France. Thus, in this example, France would not be permitted to tax the \$10,000 of French source income attributable to the nonresident partner. Further, the additional income taxable by France (\$15,000) will be deemed to be from French sources only if the partnership elects to treat it as such and agrees to treat as U.S. source income an equivalent amount of foreign (non-U.S.) income of the partners who are not residents of France. That provision is discussed under Article 24.

## ARTICLE 15 Dependent Personal Services

This Article deals with the taxation of remuneration derived by a resident of a Contracting State as an employee.

Paragraph 1 provides that remuneration derived by an employee who is a resident of a Contracting State generally may be taxed by the other Contracting State only to the extent that the remuneration is derived from an employment exercised in the other Contracting State.

Under paragraph 2, even where the remuneration of a resident of a Contracting State is derived from employment exercised in the other Contracting State, that other State may not tax the remuneration if three conditions are satisfied:

- (1) the individual is present in the other Contracting State for a period or periods not exceeding 183 days in any 12-month period that begins or ends in the taxable year concerned;
- (2) the remuneration is paid by, or on behalf of, an employer who is not a resident of that

other State; and

(3) the remuneration is not borne as a deductible expense by a permanent establishment or fixed base that the employer has in that other State.

For the remuneration to be exempt from tax in the source State, all three conditions must be satisfied. If the first condition is met, the individual generally will become a resident of the State where the services are performed for purposes of its taxation. He may also continue to be a resident of the other State under its law, in which case the tie-breaker rules of Article 4 (Resident) will be applied to determine a single country of residence. Even if Article 4 determines that he is not a resident for treaty purposes of the State where the services are performed, the length of time spent there is sufficient, under paragraph 2, to entitle that country to tax the income from those services. Conditions (2) and (3) are intended to assure that a Contracting State will not be required to allow a deduction to the payor for the amount paid and also to exempt the employee on the amount received. If a foreign employer pays the salary of an employee, but a host-country corporation or permanent establishment reimburses the foreign employer in a deductible payment, neither condition (2) nor (3), as the case may be, will be considered to have been fulfilled.

Paragraph 3 contains a special rule applicable to remuneration for services performed by an individual who is a resident of a Contracting State as an employee aboard a ship or aircraft operated in international traffic. Such remuneration may be taxed only in the Contracting State of residence of the employee if the services are performed as a member of the regular complement of the ship or aircraft. The "regular complement" includes the crew. It may also include others employed by the shipping company to perform services on the ship. The use of the term "regular complement" is intended to clarify that a person who exercises his employment as, for example, an insurance salesman, while aboard a ship or aircraft or a person, such as an entertainer, who boards the ship only during a visit to a particular port, is not covered by this paragraph.

A U.S. citizen resident in France who performs dependent services in the United States and meets the conditions of paragraph 2, or is a crew member on a ship or airline operated in international traffic, is, nevertheless, taxable in the United States on his remuneration by virtue of the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions), subject to the special rule of subparagraph 1(b) of Article 24 (Relief from Double Taxation).

## ARTICLE 16 Directors' Fees

This Article provides that a Contracting State may tax the fees paid by a company that is a resident of that State for services performed in that State by a resident of the other Contracting State in his capacity as a director of the company. This rule is an exception to the more general rules of Articles 14 (Independent Personal Services) and Article 15 (Dependent Personal Services). The State of residence of the corporation may tax nonresident directors without regard to the conditions of Articles 14 and 15, but only with respect to remuneration for services performed in that State and subject to the provisions of Article 25 (Non-Discrimination)

No such provision was included in the 1967 Convention. It is the preferred U.S. policy

not to provide a special rule for directors' fees, but to treat a corporate director in the same manner as any other individual performing personal services; outside directors would be subject to the provisions of Article 14 (Independent Personal Services) and inside directors would be subject to the provisions of Article 15 (Dependent Personal Services). The preferred French position, on the other hand, is that reflected in the OECD Model, in which a resident of one Contracting State who is a director of a corporation that is resident in the other Contracting State is subject to tax in that other State in respect of his directors' fees regardless of where the services are performed. The provision in Article 16 of the Convention represents a compromise between these two positions.

Under French tax law, directors' fees are taxed like dividends, at a rate of 25 percent. For this purpose, directors' fees do not include reimbursed expenses. Under the Convention, directors' fees are explicitly excluded from the definition of dividends to clarify that they do not give rise to the dividend tax credit ("avoir fiscal").

This Article is subject to the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions). Thus, if a U.S. citizen who is a French resident is a director of a U.S. corporation, the United States may tax his full remuneration regardless of the place of performance of his services, subject to the special rules of paragraph 1(b) of Article 24 (Relief from Double Taxation).

## ARTICLE 17 Artistes and Sportsmen

This Article deals with the taxation in a Contracting State of income earned by artistes (i.e., performing artists and other entertainers) and sportsmen who are residents of the other Contracting State for their services as entertainers or sportsmen. The term "sportsmen" was substituted for the term "athletes" in the 1992 revision of the OECD Model to clarify that the term includes participants in golf and tennis tournaments, jockeys, racing drivers, participants in chess and bridge tournaments, and others who might not be considered "athletes" in the traditional sense. The Article applies to the income of an entertainer or sportsman for services performed either on his own behalf or on behalf of another person, whether as an employee of that other person or pursuant to another arrangement. This Article applies, however, only with respect to the income of the performers themselves and, in cases covered by paragraph 2, to income received by certain persons providing the services of the performers. Others involved in an entertainment or athletic event, such as technicians, managers, and coaches, remain subject to the provisions of Articles 14 and 15.

Paragraph 1 provides that income derived by a resident of a Contracting State from personal activities exercised in the other Contracting State as an entertainer or sportsman may be taxed in that other State if the amount of the gross receipts derived by the individual exceeds \$10,000 (or its equivalent in French francs) for the calendar year. The \$10,000 includes expenses reimbursed to the individual or borne on his behalf. If the gross receipts exceed \$10,000, the full amount, not only the excess, may be taxed in the State of performance. The \$10,000 threshold is the same as in the 1967 Convention.

The OECD Model provides for taxation by the State of performance of the remuneration of entertainers or sportsmen with no dollar or time threshold. The United States recognizes that entertainers and sportsmen will typically not meet the fixed base or 183-day tests of Articles 14 and 15, but takes the position that those who earn only modest amounts for their services, as is generally true of members of an orchestra or dance company, for example, are not clearly distinguishable from those who earn other types of personal service income and should be treated under Article 14 or 15, as appropriate. Thus, it prefers to limit this Article to those whose earnings exceed a specified dollar threshold.

Paragraph 1 applies notwithstanding the provisions of Articles 14 (Independent Personal Services) or 15 (Dependent Personal Services). If an individual would otherwise be exempt from tax under those Articles, but is subject to tax under this Article he may be taxed under this Article. However, an entertainer or sportsman who receives less than the \$10,000 threshold amount may, nevertheless, be subject to tax in the host State under Article 14 or 15, provided that the tests for taxability under those Articles are met.

It may not be possible to know until year-end whether the income an entertainer or sportsman derived from performing such services in a Contracting State will exceed the threshold amount. However, nothing in the Convention precludes a Contracting State from withholding tax at the time of payment and refunding the excess, if any.

Income derived from a Contracting State by an entertainer or sportsman who is a resident of the other Contracting State in connection with his activities as such, but from other than an actual performance, such as royalties from record sales and payments for product endorsements, is not covered by this Article. Such income is, however, subject to the provisions of other articles of the Convention, if applicable, such as Article 12 (Royalties) or Article 14 (Independent Personal Services) For example, if an entertainer receives royalty income from the sale of recordings of a concert given in a State, the royalty income would be exempt from source country tax under Article 12, even if the remuneration from the concert itself may have been covered by this Article.

Paragraph 2 is intended to deal with the potential for abuse when income from a performance by an entertainer or sportsman does not accrue to the performer himself, but to another person. Foreign entertainers commonly perform in the United States as employees of, or under contract with, a company or other person. The relationship may truly be one of employee and employer, with no abuse of the tax system intended or realized. On the other hand, the "employer" may be a company established and owned by the performer that is merely acting as the nominal income recipient in respect of the remuneration for the entertainer's performance. In such case, absent the provisions of paragraph 2, the company providing the entertainer's services could escape host State tax because it earns business profits but has no permanent establishment in that State. The income could later be paid out to the entertainer when he no longer has any presence in the State where the income originated.

Paragraph 2 seeks to prevent this type of abuse while at the same time allowing the benefits of the Convention when there is a legitimate employee-employer relationship between the performer and the person providing his services. Under paragraph 2, when the income accrues to a person other than the performer, and the performer (or persons related to him)

participate, directly or indirectly, in the profits of that other person, the income may be taxed in the Contracting State where the performer's services are exercised, without regard to the provisions of the Convention concerning business profits (Article 7) or independent personal services (Article 14). Thus, even if the "employer" has no permanent establishment or fixed base in the host State, its income may be subject to tax there under the provisions of paragraph 2. If the putative "employer" is not a resident of either Contracting State, each Contracting State may impose tax according to its domestic law.

Taxation under paragraph 2 is on the person providing the services of the entertainer or sportsman. This paragraph does not affect the rules of paragraph 1, which apply to the remuneration of the entertainer or sportsman. However, wage or salary payments to the performer would reduce the income taxable to the person providing his services.

For purposes of paragraph 2, income is deemed to accrue to another person (i.e., the person providing the services of the entertainer or sportsman) if that other person has control over, or the right to receive, gross income in respect of the services of the entertainer or sportsman. Direct or indirect participation in the profits of a person includes, but is not limited to, the accrual or receipt of deferred remuneration, bonuses, fees, dividends, partnership income, or other income or distributions.

Paragraph 2 does not apply if it is established that neither the entertainer or sportsman, nor any persons related to the entertainer or sportsman, participate directly or indirectly in the profits of the person providing the services of the entertainer or sportsman. This exception for non-abusive cases is not in the OECD Model, but reflects the U.S. position that the purpose of the paragraph is to prevent abuse of the provisions of Articles 7 (Business Profits) and 14 (Independent Personal Services) in this context.

Paragraph 3 of the Article provides an exception to the rules in paragraphs 1 and 2 in the case of a visit to a Contracting State by an entertainer or sportsman who is a resident of the other Contracting State, if the visit is principally supported, directly or indirectly, by the public funds of his State of residence or of a political subdivision (in the case of the United States) or local authority of that State. In that case, only the Contracting State of which the entertainer or sportsman is a resident may tax his income from those services. Some other recent U.S. treaties, including the treaty with Germany, provide a similar exception.

This Article is subject to the provisions of the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions) Thus, if an entertainer or sportsman who is a resident of France is a citizen of the United States, the United States may tax all of his income from performances in the United States without regard to the provisions of this Article, subject, however, to the special provisions of paragraph 1(b) of Article 24 (Relief from Double Taxation).

## ARTICLE 18

### Pensions

This Article deals with the taxation of private pensions and social security benefits.



Under subparagraph 1(a), private pensions and other similar remuneration derived and beneficially owned by a resident of a Contracting State in consideration of past employment are taxable only in the State of residence of the recipient. This rule applies to both periodic and lump-sum payments. The rule applies to pension payments in consideration of past employment that are paid to a resident of the other Contracting State, whether to the employee or to his or her beneficiary.

Government pensions paid in respect of past government employment are covered under Article 19 (Public Remuneration). However, government payments under the social security legislation of a Contracting State generally are dealt with in subparagraph 1(b) of this Article. This subparagraph provides that benefits may be taxed only by the paying State. It also provides that payments under the social security legislation of France to a resident of France who is a U.S. citizen may be taxed only by France. This additional sentence is necessary because the subparagraph otherwise addresses only payments by one State to residents of the other State.

Paragraph 2 is based on paragraph 5(a) of Article 19 of the 1967 Convention, as amended in 1984, and on the suggested provision set forth in the Commentaries to Article 19 of the 1992 OECD Model. It permits an individual resident of a Contracting State who is not a national of that State to deduct contributions in respect of personal services rendered that are made by or on his behalf to certain pension or other retirement arrangements in the other State, to the same extent that deductions would be permitted in the first State for contributions to such arrangements. The retirement arrangement must be recognized for tax purposes in the other State, and the competent authority of the State permitting the deduction must agree that the arrangement in the other State generally corresponds to an arrangement that is established and maintained and recognized for tax purposes in the first State.

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). In either Contracting State, a retirement arrangement will qualify as "recognized for tax purposes" in that State if contributions to it qualify for tax relief in that State. (This provision is narrower in this respect than is paragraph 4(e) (ii) (cc) of Article 10 (Dividends).)

Paragraph 3 provides that the residence State will follow the rules of the other State as to when retirement benefits from an arrangement that qualifies for the benefits of paragraph 2 are taken into income for purposes of computing the tax liability of the beneficiary. This provision carried over from paragraph 5(b) of Article 19 of the 1967 Convention, as amended in 1984. It was originally introduced in the side letter to the 1978 Protocol for the purpose of providing French benefits to U.S. citizens resident in France. It was included in the text of the Convention, reciprocally, in 1984.

ARTICLE 19  
Public Remuneration

Paragraph 1 deals with the taxation of government compensation. Under subparagraph 1(a), wages, salaries, and similar compensation (other than pensions) paid by the United States, its states or local authorities, or by any government agency or instrumentality to any individual generally are exempt from French tax. However, under subparagraph 1(b), such payments are taxable in France, and only in France if the payee is a resident and national of France and not also a U.S. citizen, and the remuneration is for services performed in France. Thus, for example, if the U.S. Embassy in Paris hires a local resident who is a French national and not a U.S. citizen, the salary paid to that individual will be taxable only by France. However, if the individual is a U.S. citizen or a national of a third country, the wage or salary will be taxable only by the United States. In the converse case, the rule differs because of the unilateral effect of the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions). If the French Embassy in Washington hires a U.S. resident, there will be a U.S. income tax on the remuneration for those services if the individual is a U.S. citizen or holds a green card. In either of such cases, the U.S. may tax the wage or salary received from the French Government under the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions). If that individual is a dual national of the United States and France, subparagraph 1(c) of Article 24 (Relief from Double Taxation) provides that the income for services rendered to the French Government will be treated as French source income for purposes of the U.S. foreign tax credit. Thus, the United States may tax the income but must allow a credit for the French income tax, if any, in accordance with the provisions of Article 24.

Paragraph 2 deals with the taxation of pensions paid in respect of the services described in paragraph 1. The general rule is that the State that pays the pension has the exclusive right to tax it. However, an exception permits the other State to tax when the beneficiary of the pension is a resident and national of that State and not also a national of the first State. The rules of paragraph 2 do not apply to social security benefits and other public pensions that are not in respect of services rendered to the paying government or a political subdivision or local authority thereof; such amounts are taxed exclusively by the source State under the terms of paragraph 1(b) of Article 18 (Pensions). However, paragraph 2 does apply to social security payments to U.S. Government employees for whom the social security system is the retirement plan related to their government service. Thus, in the unusual case where a French resident national (who is not also a U.S. citizen) derives a pension for U.S. Government employment that is paid under the social security system, only France may tax that pension, as provided by paragraph 2(b). This could happen, for example, if the locally hired driver for the U.S. Embassy in Paris referred to earlier were to retire and receive a U.S. pension under social security. Again, in the converse case, the saving clause of paragraph 2 of Article 29 (Miscellaneous Rules) permits the United States to tax a pension paid by France to a U.S. citizen or resident alien; but if the individual is also a French national the United States will treat such a pension as French source income under subparagraph 1 (c) of Article 24 (Relief from Double Taxation) and allow a foreign tax credit for the French tax paid with respect to that income.

As provided in paragraph 3, the rules of paragraphs 1 and 2 are not applicable when the remuneration is for services performed in connection with a business carried on by a governmental body. In such cases, the rules that apply are the same as those applicable to private sector remuneration and pensions.

## Teachers and Researchers

This Article provides a special two-year exemption of the compensation of certain teachers and/or researchers who are residents of one contracting State and visit the other State to teach or to carry out research. There is no provision in the OECD Model dealing with professors or teachers. It is not standard U.S. treaty policy to provide benefits to visiting teachers by treaty. When, however, the treaty partner wishes to include such a provision, the United States may agree to do so, particularly, as in this case, when an existing Convention with that partner contains a similar provision (see Article 17 of the 1967 Convention).

To qualify, the individual must be a resident of France or the United States immediately before visiting the other Contracting State, and must be invited by the Government or by a university or other recognized educational or research institution in the other State for the primary purpose of teaching or conducting research. In that case, the remuneration for those teaching or research services is exempt in that other State from its income taxes listed in Article 2 (Taxes Covered) for a period of not more than two years from the individual's date of arrival there. A "recognized research institution" would include such research facilities as the National Institutes of Health and the Centers for Disease Control.

The Convention adds the limitation that the benefit of this provision may not be claimed more than once by the same individual.

Paragraph 2 denies the benefit of this exemption of research if the research is undertaken for private rather than in the public interest. For example, the exemption would not apply to a grant from a tax-exempt research organization to search for a cure to a disease if the results of the research become the property of a for-profit company. The exemption would not be denied, however, if the tax-exempt organization licensed the results of the research to a for-profit enterprise in consideration of an arm's length royalty consistent with its tax-exempt status.

This Article is an exception to the saving clause. (See subparagraph 3(b) of Article 29 (Miscellaneous provisions). Thus, the benefits are available to individuals who are not U.S. citizens and do not have immigrant status (a "green card")), even if they would otherwise become U.S. residents under Code section 7701 (b) and Article 4 (Resident).

## ARTICLE 21 Students and Trainees

Paragraph 1 of this Article provides a limited exemption of certain payments derived by an individual who visits one of the Contracting States as a student, to acquire professional training, or as the recipient of a research or study grant from a not-for profit governmental, religious, artistic, cultural, or educational organization, if the individual was a resident of the other Contracting State immediately before such visit.

The individual must visit the other State for the primary purpose of studying, doing research, or acquiring training. Holding a part-time job in addition will not disqualify the individual, but the benefits of this Article are intended for full-time students, researchers, and

trainees. Nor is the exemption available to an individual who visits the other State for the primary purpose of performing research, for example as a research assistant, for another individual who received a research grant from a qualifying tax-exempt organization. The exemption for researchers provided in this Article is restricted to individuals who are themselves grant recipients.

The amounts that may qualify for exemption under this Article are gifts from abroad to cover living expenses and the costs of the study, research, or training; the grant from the not-for-profit organization; and up to 5,000 dollars per year, or the equivalent in French francs, of compensation for personal services. The exemption provided for a grant does not include any element of compensation for services. The exemption of the first 5,000 dollars of compensation is in addition to any personal exemption or deductions permitted under domestic law.

The exemptions continue for the period of time reasonably or customarily required to complete the program of study, research, or training. The same individual may claim the benefits of this Article and of Article 20 (Teachers and Researchers), but the combined period of benefits may not exceed five years.

Paragraph 2 provides benefits to an individual who is either an employee of, or under contract with, an enterprise of a Contracting State and who is temporarily present in the other contracting State for the primary purpose of:

- (1) acquiring technical, professional, or business experience from a person other than his employer, or
- (2) studying at a university or other recognized educational institution in that other State.

Such an individual will be exempt from tax by that other State on up to 8,000 dollars, or the equivalent in French francs, of compensation for his personal services. If the compensation exceeds \$8,000, the excess is taxable under the domestic law of the host State. The exemption of the first \$8,000 of compensation is in addition to any personal exemption and deductions permitted under domestic law.

This exemption is available only for a period of 12 consecutive months. If the period of training exceeds 12 months, any compensation derived after that time period is taxable in accordance with the domestic law of the host State. The purpose of the exemption is to permit companies that are residents of a Contracting State to send employees to the other contracting State for training, while continuing to pay them a modest salary, without subjecting the individual to a tax liability in the other State on those payments. In the absence of such a provision, the payments would be considered compensation for services rendered in the other State and would be fully taxable there.

Because of the exception to the saving clause in subparagraph 3(b) of Article 29 (Miscellaneous provisions), the saving clause does not apply with respect to a person entitled to U.S. benefits under the provisions of this Article if that person is not a U.S. citizen and does not have immigrant status in the United States. Thus, for example, a French resident who visits the United States as a student or professor and becomes a U.S. resident by virtue of staying more than 183 days would be exempt from U.S. tax in accordance with this Article, even if he ceased to be a resident of France under its rules, as long as he is not a U.S. citizen and does not have

immigrant status in the United States (a "green card"). The saving clause does apply to U.S. citizens and resident aliens who have immigrant status in the United States.

## ARTICLE 22 Other Income

This Article provides the rules for the taxation of items of income not dealt with in the other articles of the Convention. An item of income is "dealt with" in an article when an item in the same category is a subject of the article, whether or not any treaty benefit is granted to that item of income. This Article applies to classes of income that are not dealt with elsewhere, such as, for example, alimony, annuities, child support payments and lottery winnings. In addition, it applies to income from sources in third States that is of the same class as income dealt within another article of the Convention, where that other article deals only with such income from sources within a Contracting State.

Paragraph 1 contains the general rule that such items of income will be taxable only in the State of residence of the beneficial owner. This exclusive right of taxation applies whether or not the residence State exercises its right to tax the income.

Paragraph 2 contains an exception to the general rule of paragraph 1 for income, other than income from real property, that is attributable to a permanent establishment or fixed base maintained in a Contracting State by a resident of the other Contracting State. The taxation of such income is governed by the provisions of Articles 7 (Business Profits) and 14 (Independent Personal Services). Thus, in general, third-country income that is attributable to a permanent establishment maintained in the United States by a resident of France would be taxable by the United States.

The exception to the general rule of paragraph 2 for income from real property provides that, even if such property is part of the property of a permanent establishment or fixed base in a Contracting State, that State may not tax income from the property if neither the Situs of the property nor the residence of the owner is in that State. For example, if a French resident derives income from real property located outside the United States that is attributable to the resident's permanent establishment or fixed base in the United States, only France and not the United States may tax that income. This special rule for foreign-situs real property is consistent with the general rule, also reflected in Articles 6 (Income from Real Property) and 23 (Capital), that only the situs and residence States may tax real property and real property income.

This Article is subject to the saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions). Thus, the United States may tax the income of a French resident not dealt with elsewhere in the Convention, if that Individual is a citizen of the United States.

## ARTICLE 23 Capital

This Article specifies the circumstances in which a contracting State may impose tax on

capital owned by a resident of the other Contracting State. Since the United States does not impose taxes on capital, the only capital tax now covered by the Convention is the wealth tax imposed by France.

Paragraph 5 of this Article provides the general rule that capital owned by a resident of a contracting State may be taxed only by that Contracting State. Paragraphs 1 through 4 are exceptions to this general rule.

Paragraph 1 provides that capital represented by real property (as defined in Article 6 (Income from Real Property)) that is located in a contracting State may be taxed by that Contracting State, including such property owned by a resident of the other State. The same rule applies to shares or other Interests in a company whose assets consist at least 50 percent of such property, or derive at least 50 percent of their value, directly or indirectly, from such property, and to an interest in a person other than an individual or company to the extent that the assets of that person consist of real property or derive their value, directly or indirectly, from real property.

Paragraph 2 permits a contracting State to tax an individual on capital represented by shares or other rights (other than those covered by paragraph 1 in a company that is a resident of that State if the individual owns a substantial interest in the company. For this purpose a substantial interest is one that gives the right to 25 percent or more of the corporate earnings; It includes the interests of the individual and any related persons.

Under paragraph 3, capital represented by movable property that is part of the business property of a permanent establishment or fixed base maintained in one contracting State by a resident of the other may be taxed by the State where the permanent establishment or fixed base is located. As explained in the exchange of notes, the meaning of "business property" may be narrower than the meaning of "assets" used in paragraph 1, notwithstanding the use of the single French term "actif" to translate both concepts.

Ships and aircraft operated in international traffic by an enterprise of a contracting State, and movable property related to such operations, such as containers and trailers, are taxable only by the State in which the operating enterprise is resident.

All other elements of capital owned by a resident of a Contracting State are exempt from tax by the other contracting State. This includes capital represented by corporate shares owned by individuals that do not constitute a "substantial interest," as defined in paragraph 2, and shares owned by a corporation in a subsidiary or other corporation.

Paragraph 6 provides a special rule limiting the application of the French wealth tax to U.S. citizens (other than French nationals) who become residents of France. This provision was introduced in the 1984 Protocol to the 1967 convention. It allows such individuals to exclude assets situated outside of France from the base of assessment of the wealth tax for each of the first five years after the individual becomes a resident of France. This benefit may be claimed more than once, but only if the individual ceases to be a resident of France for at least three years before again becoming a resident of France.

ARTICLE 24  
Relief From Double Taxation

This Article describes the manner in which each Contracting State undertakes to relieve double taxation. The United States uses the foreign tax credit method exclusively. France uses a combination of foreign tax credit and exemption methods. The provisions of this Article are more complicated than in most U.S. income tax treaties, because they include special relief provisions for U.S. citizens resident in France. The format of the Article has been revised, but the provisions are substantially the same as in the 1967 Convention (as amended by subsequent Protocols).

In subparagraph 1(a), the United States agrees to allow its citizens and residents to credit against their U.S. income tax the income taxes paid or accrued to France. Subparagraph 1(a) also provides for a deemed-paid credit, consistent with section 902 of the Code, to a U.S. corporation in respect of dividends received from a French corporation in which the U.S. corporation owns at least 10 percent of the voting power. The deemed-paid credit is for the tax paid by the French corporation on the portion of the profits that is distributed as dividends to the U.S. parent company.

The credits provided under the Convention are allowed in accordance with the provisions and subject to the limitations of U.S. law, as that law may be amended over time, so long as the general principle of this Article, i.e., the allowance of a credit, is retained. Thus, although the Convention provides for a foreign tax credit, the terms of the credit are determined by the provisions of the U.S. statutory credit at the time a credit is given. The limitations of U.S. law generally limit the credit against U.S. tax to the amount of U.S. tax due with respect to net foreign source income within the relevant foreign tax credit limitation category (see Code section 904(a)). Nothing in the Convention prevents the limitation of the U.S. credit from being applied on an overall or per-country basis or on some variation thereof.

Subparagraph 1(b) provides special rules to avoid the double taxation of U.S. citizens who are residents of France. Under subparagraph 2(a)(iii), France agrees to credit the U.S. tax paid, but only for the amount of tax that the United States could impose under the Convention on a resident of France who is not a citizen of the United States. Under subparagraph 1(b), the United States agrees that, where additional U.S. tax is due solely by reason of citizenship, it will credit the French tax imposed on the basis of residence to the extent that the French tax exceeds the tax that the United States may impose on the basis of source (i.e., net of the credit allowed by France). Under subparagraph 2(b), France shares the burden of avoiding double taxation of U.S. citizens resident in France by exempting from French tax certain items of U.S. source income of such citizens that would otherwise be subject to French tax.

Subparagraph 1(b) also provides that certain U.S. source income will be treated as French source income to permit the additional credit to fit within the foreign tax credit limitation of Code Section 904. This resourcing provision applies only to items of income that are included in gross income for French tax purposes, and it cannot be used in determining the foreign tax credit limitation applicable to income taxes paid to any other country.

The following simplified example illustrates how subparagraph 1(b) works. The U.S. tax on a dividend paid by a U.S. corporation to a portfolio investor resident in France is limited by Article 10 (Dividends) of the Convention to 15 percent. The United States, therefore, will impose a tax of 15 on a dividend of 100, and France will allow a tax credit of 15. Suppose that the French individual income tax due is 22 percent. In that case, the net tax payable to France will be 7. However, assume that this individual is a U.S. citizen and, therefore, liable to U.S. tax of 22 percent. In the absence of a special relief provision, the individual's total tax would be 35: 28 to the United States, with no foreign tax credit because the dividend is from U.S. sources, and 7 to France. Under subparagraph 1(b), the 7 of French tax is credited against the 28 of U.S. tax, reducing the combined burden to 28, the higher of the two taxes. In this example, in order to credit the French tax of 7 at a U.S. rate of 28, 25 of the dividend would be treated as from French sources so that the 7 of French tax could be claimed as a foreign tax credit ( $7/28 \times 100$ ). Additional examples of the calculation of this additional credit are provided in IRS Publication 901 on U.S. tax treaties.

Subparagraph 1(c) contains another special rule, designed to avoid double taxation of French Government employees performing government services in the United States where those employees are dual nationals, i.e., U.S. citizens as well as nationals of France. Under the saving clause of paragraph 2 of Article 29 (Miscellaneous provisions), such individuals are subject to U.S. tax as U.S. citizens. However, subparagraph 1(c) provides that the remuneration paid by the French Government will be treated as French source income, so that the French tax on that remuneration will be allowed as a foreign tax credit up to the amount of the U.S. tax liability. A similar provision appears in paragraph 3 of Article 16 (Governmental Functions) of the 1967 Convention. That provision is drafted reciprocally, but it has no effect in the reverse case, since France does not tax on the basis of citizenship.

Subparagraph 1(d) preserves from the 1967 Convention, as amended in 1924, a re-sourcing rule that permits a partnership with an individual French resident partner to elect to treat as French source income any earned income that is taxable by France solely by reason of the 50-percent threshold provided in paragraph A of Article 14. If such an election is made, however, any additional French source income it creates will reduce other non-U.S. source earned income of the partnership that would otherwise be allocated to partners who are not residents of France, starting with other French source earned income and then reducing earned income from third countries. The foreign source income so reduced is treated as U.S. source income for foreign tax credit purposes. If there is not enough other foreign source earned income to fully offset the amount of U.S. source earned income re-sourced as French income, the excess is carried forward and reduces other foreign source earned income in future years. If one or more of the partners resident in France is a U.S. citizen, this provision may not be used to reduce the U.S. tax below what the U.S. taxpayer's liability would be before taking into account the foreign earned income exclusion of section 911. The election must be made by the partnership and is binding on all partners.

Subparagraph 1(e) provides that, for the purposes of this Article, the French income tax and company tax described in subparagraphs (b)(i) and (ii) of paragraph 1 of Article 2 are considered income taxes and thus eligible for the U.S. foreign tax credit, as are any identical or substantially similar taxes imposed after the date of signature of the Convention.



Paragraph 2 establishes the methods by which France relieves double taxation of its residents who have U.S. source income. French law generally provides for an exemption from tax of business profits earned abroad by a French company and an exemption of 95 percent of the dividends received by a French company from its foreign subsidiaries. Those exemptions are preserved in the Convention. In other cases, France avoids double taxation in the Convention by granting a foreign tax credit. However, in some cases the amount of credit is equivalent to the French tax otherwise due and, therefore, amounts to exemption of that income from French tax. In other cases, the credit is limited to the U.S. tax imposed on the income, up to the amount authorized in the relevant article of the Convention (without regard to the saving clause). The credit is also limited to the French tax attributable to such income.

In general, under the Convention, France exempts from tax (i.e., gives a credit equal to the French tax on) U.S. source dividends, interest, royalties, capital gains on real property, directors' fees, compensation of entertainers and sportsmen, and income from independent personal services. In the case of independent personal services income, the effective exemption is subject to the 50-percent limit provided in paragraph 4 of Article 14 with respect to partnership earned income. These rules are provided in subparagraphs (a)(ii) and (iii) of paragraph 2. Where the French tax is imposed at graduated rates, the exempt income is taken into account in determining the rate applicable to the non-exempt portion. (See subparagraph 2(d)(ii)(bb).) Other income is generally subject to French tax with a credit for the U.S. tax paid, up to the amount of tax that the United States may impose under the relevant article of the Convention (without regard to the saving clause that permits taxation of U.S. citizens and residents under U.S. domestic law rules), and limited to the French tax attributable to such income. This rule is provided in subparagraph 2(a)(i).

However, as noted above, France shares the responsibility of avoiding double taxation of U.S. citizens who are residents of France. It does so by exempting certain additional items of U.S. source income of such individuals. Those additional items, listed in subparagraph 2(b), include certain U.S. source dividends, interest, and royalties; capital gains from the alienation of the assets generating such dividends, interest, and royalties; profit or gain from trading in options or futures on a public U.S. options or futures market; private pensions attributable to periods of employment during which services were rendered principally in the United States; income of teachers, researchers, students, and trainees that would be exempt from U.S. tax under the Convention if derived by a U.S. resident who was not a U.S. citizen, and U.S. source alimony and annuities. To benefit from these additional exemptions, the individual must provide certification upon request by the French competent authority, demonstrating that he has complied with his U.S. income tax obligations. This provision corresponds to the provision introduced into the 1967 Convention by the 1978 Protocol, as subsequently modified by the 1984 and 1988 Protocols.

Subparagraph 2(c) provides that France will allow a foreign tax credit against its tax on capital for any capital tax that the United States may impose in the future, up to the amount of the French capital tax. This provision applies in addition to paragraph 6 of Article 23 (Capital), which excludes certain non-French assets from the wealth tax in the case of U.S. citizens.

Subparagraph 2(e) clarifies that the Convention does not prevent France from applying three provisions of its domestic law with respect to French residents. These clarifications are

added to prevent any uncertainty that might arise from the absence of a saving clause with respect to French taxation of its residents. The first subparagraph establishes that France may continue to allow domestic companies to elect to be taxed on a worldwide basis, with a foreign tax credit, instead of applying its general territorial system of exempting foreign business income. The second subparagraph refers to the provision of French domestic law that permits business losses of foreign branch or subsidiary operations to be taken into account, but requires the inclusion of profits of such operations to recover those losses. The third refers to cases in which France requires a French parent company to be taxed currently on the earnings of a foreign subsidiary, whether or not such earnings are distributed. The purpose of the latter provisions is analogous to the purpose of the U.S. subpart F legislation, but France uses a different approach to identify low-taxed passive income.

## ARTICLE 25 Non-Discrimination

This Article assures that nationals and residents of a Contracting State will not be subject to discriminatory taxation in the other Contracting State. It also provides for non-discriminatory taxation of residents of the taxing State with respect to deductions for amounts paid to residents of the other State. Finally, this Article prohibits a Contracting State from imposing discriminatory taxation upon its resident companies that are owned, partly or wholly, by residents of the other State.

Paragraph 1 provides that a national of one Contracting State who is a resident of the other Contracting State may not be subject to taxation or connected requirements in the other State that are different from, or more burdensome than, the taxes and connected requirements imposed upon a national and resident of that other State in the same circumstances. The term "national" here refers to individual citizens. The fact that this paragraph, unlike the OECD Model, applies only to residents of one of the Contracting States is not intended to suggest a different result. Neither Contracting State imposes discriminatory taxation on individuals resident in third States based on their nationality. Since the paragraph is limited to residents of the Contracting States it was not necessary to add the usual clarification that U.S. citizens resident in third countries are not "in the same circumstances" with respect to U.S. tax as French nationals resident in third countries.

Paragraph 2 of the Article provides that a permanent establishment in a Contracting State of an enterprise of the other Contracting State may not be less favorably taxed in the first State than an enterprise of that first State carrying on the same activities. This provision does not prevent either Contracting State from imposing the branch profits tax described in paragraph 5 of Article 10 (Dividends). Nor does it obligate a Contracting State to grant to a resident of the other Contracting State any tax allowances, reliefs, or similar benefits that it grants to its own residents on account of their civil status or family responsibilities. Thus, if an individual resident in France owns a French enterprise that has a permanent establishment in the United States, in determining income tax on the profits attributable to the permanent establishment, the United States is not obligated to allow to the French resident the personal allowances for himself and his family which would be allowed if the permanent establishment were a sole proprietorship owned and operated by a U.S. resident.

Section 1446 of the code imposes on any partnership that has income effectively connected with a U.S. trade or business the obligation to withhold tax on amounts allocable to a foreign partner. In the context of the Convention, this obligation applies with respect to a French resident partner's share of the partnership income attributable to a U.S. permanent establishment. There is no similar Obligation with respect to the distributive shares of U.S. resident partners. It is understood, however, that this distinction is not a form of discrimination within the meaning of paragraph 2 of the Article, but, like other withholding on payments to nonresident aliens or foreign entities, is merely a reasonable method for the collection of tax from persons who are not continually present in the United States, and as to whom it may otherwise be difficult for the United States to enforce its tax jurisdiction. The tax withheld under section 1446 is a tentative tax. If it exceeds the final liability, the partner may file a U.S. tax return claiming a refund of the excess.

Paragraph 3 prohibits discrimination in the allowance of deductions. When an enterprise of a Contracting State pays interest, royalties, or other disbursements to a resident of the other Contracting State, the first Contracting State must allow a deduction for those payments in computing the taxable profits of the enterprise, under the same conditions as if the payment had been made to a resident of the first Contracting State. An exception to this rule is provided for cases where the provisions of paragraph 1 of Article 9 (Associated Enterprises), paragraph 6 of Article 11 (Interest), or paragraph 7 of Article 12 (Royalties) apply, because all of these provisions permit the denial of deductions in certain circumstances in respect of transactions between related persons. The term "other disbursements" is understood to include a reasonable amount of executive and general administrative expenses, research and development expenses, and other expenses incurred for the benefit of a group of related persons that includes the person incurring the expense.

Paragraph 3 also provides that any debts of an enterprise of a Contracting State to a resident of the other Contracting State are deductible in the first Contracting State in computing the capital tax of the enterprise, under the same conditions as if the debt had been contracted to a resident of the first-mentioned Contracting State. Although the United States does not now impose a national tax on capital, this Article applies to taxes imposed at all levels of government. This provision may, therefore, be relevant to state and local taxes on capital, such as real property taxes, imposed on enterprises.

In addition, paragraph 3 provides that the French rules to prevent "earnings stripping", imposed by Article 212 of the French tax code or any substantially similar successor statute, will not be considered contrary to the non-discrimination rules of this Article as long as they are applied consistently with the arm's length standard described in paragraph 1 of Article 9 (Associated Enterprises). The negotiators agreed that a similar proviso is not necessary on the U.S. side, since the U.S. rules against "earnings stripping" imposed under Code section 163(j) were designed to be consistent with the arm's length standard.

Paragraph 4 prohibits a Contracting State from subjecting an enterprise of that State that is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State to taxation or connected requirements that are other or more burdensome than the taxation or connected requirements imposed on other similar enterprises in the first

State.

As in the case of its other treaties, the United States takes the position that the provisions of Code section 367(e)(2) regarding the taxation of corporations on certain distributions in liquidation to foreign parent corporations are not contrary to paragraph 4 of the Article. It takes the same position with respect to its rules providing that a corporation with nonresident alien shareholders is not eligible to make an election to be an "S" corporation.

As noted above, notwithstanding the specification of taxes covered by the Convention in Article 2 (Taxes Covered), for purposes of providing non-discrimination protection, this Article applies to taxes of every kind and description imposed by a Contracting State or by a political subdivision or local authority thereof. Customs duties are not considered to be taxes for this purpose.

The saving clause of paragraph 2 of Article 29 (Miscellaneous Provisions) does not apply to this Article, by virtue of the exceptions in paragraph 3 of Article 29. Therefore, a U.S. citizen who is resident in France may claim protection against discrimination in the United States under this Article.

## ARTICLE 26 Mutual Agreement Procedure

This Article provides for cooperation between the competent authorities of the Contracting States, as defined in subparagraph 1(h) of Article 3 (General Definitions), to resolve disputes that may arise under the Convention and to resolve cases of double taxation not provided for in the Convention. The Article also provides for the possible use of arbitration to resolve disputes that cannot be settled by the competent authorities.

Paragraph 1 provides that, where a person considers that the actions of one or both Contracting States will result for him in taxation not in accordance with the Convention, he may present his case to the competent authority of his State of residence or nationality. It is not necessary for the taxpayer to have fully exhausted the remedies provided under the national laws of the Contracting States before presenting a case to the competent authorities. The paragraph provides that a case must be presented to the competent authorities no later than three years from the notification of the assessment which gives rise to the taxation not in accordance with the provisions of the Convention. The three-year period begins to run when the later formal notification of the assessment is issued. Thus, if the Internal Revenue Service makes a section 482 adjustment to a taxpayer's 1994 return and in 1996 sends the statutory notice of deficiency that results in double taxation, the taxpayer has until 1999 to present his case to the competent authority. When the case results from the combined action of the tax authorities in the two Contracting States, the three-year period begins to run when the formal notification of the second action is given.

Paragraph 2 provides that, if the competent authority of the Contracting State to which the case is presented considers the case to have merit but cannot reach a unilateral solution, it shall seek agreement with the competent authority of the other Contracting State so as to avoid

taxation not in accordance with the Convention. If agreement is reached under this provision, it is to be implemented even if implementation is otherwise barred by the statute of limitations or by some other procedural limitation, such as a closing agreement. Because, under paragraph 1 of Article 29 (Miscellaneous Provisions), the Convention cannot operate to increase a taxpayer's liability, time or other procedural limitations can be overridden only for the purpose of making refunds and not to impose additional tax.

Paragraph 3 authorizes the competent authorities to seek to resolve difficulties or doubts that may arise as to the application or interpretation of the Convention. The paragraph includes a non-exhaustive list of examples of matters about which the competent authorities may reach agreement. They may agree to the same attribution of profits between a company resident in one Contracting State and its permanent establishment in the other Contracting State, to the same allocation of income, deductions, credits, or allowances between a company resident in one Contracting State and an associated enterprise, and to common rules as to the source of items of income. In each case, the agreement may refer to a past or future, as well as to the current, tax year. This permits, for example, entering into advance pricing agreements. They may also agree to adjust the money amounts referred to in Articles 17 (Artists and Sportsmen) and 21 (Students and Trainees) to reflect economic or monetary developments, such as changes in the cost of living.

If cases arise that are not covered by the Convention but that would result in double taxation of income, the competent authorities may also seek to resolve those issues to avoid the double taxation. An example of such a case might be double taxation arising from a transfer pricing adjustment between two permanent establishments of a third-country resident, one in the United States and one in France. Since no resident of a Contracting State is involved in the case, the Convention does not, by its terms, apply, but the competent authorities may, nevertheless, use the authority of the Convention to seek to prevent the double taxation.

Paragraph 4 provides that the competent authorities or their representatives may meet or otherwise communicate directly with each other for the purpose of reaching agreement under this Article. Agreements reached by the competent authorities under this paragraph need not conform to the domestic law provisions of either Contracting State.

Paragraph 5 introduces an arbitration procedure based on the comparable provision in the U.S. income tax treaty with Germany. It provides that, where the competent authorities have been unable to resolve a disagreement regarding the application or interpretation of the Convention, the disagreement may be submitted for arbitration, by mutual consent of the competent authorities and the taxpayer. Nothing in the provision requires that a case be submitted for arbitration. If a case is submitted to an arbitration board, the board's decision in that case will be binding on both Contracting States, as well as on the taxpayer, with respect to that case. The arbitration procedures, including the composition of the arbitration board, shall be agreed upon in diplomatic notes to be exchanged after consultation between the competent authorities. It is expected that such procedures will ensure that arbitration will not generally be available where matters of either State's tax policy or domestic law are involved. This paragraph shall not apply until the date specified in such notes. A principal purpose of deferring the effective date of this provision is to permit the evaluation of relevant experience, such as under the U.S. convention with Germany.

ARTICLE 27  
Exchange of Information

This Article provides for the exchange of information between the competent authorities of the Contracting States. The information to be exchanged is that necessary for carrying out the provisions of the Convention or the domestic laws of the United States or France concerning the taxes covered by the Convention. For this purpose, the Convention covers all taxes imposed at the national level. Information may be exchanged with respect to a covered tax, even if the transaction to which the information relates is a purely domestic transaction in the requesting State and, therefore, the exchange is not made for the purpose of carrying out the Convention. However, exchange of information with respect to domestic law is authorized only insofar as the taxation under those domestic laws is not contrary to the Convention.

Paragraph 1 states that information exchange is not restricted by Article 1 (General scope). This means, for example, that information may be requested and provided under this Article with respect to persons who are not residents of either Contracting State. For instance, if a third-country resident has a permanent establishment in France that engages in transactions with a U.S. enterprise, the United States could request information with respect to that permanent establishment, even though it is not a resident of either Contracting State. Similarly, if a third-country resident maintains a bank account in France, and the Internal Revenue Service has reason to believe that funds in that account should have been reported for U.S. tax purposes but have not been so reported, information can be requested from France with respect to that person's account.

Paragraph 1 also provides assurances that any information exchanged will be treated as secret, subject to the same disclosure constraints as information obtained under the laws of the requesting State. Information received may be disclosed only to persons, including courts and administrative bodies, concerned with the assessment, collection, administration, enforcement, prosecution, or determination of appeals in respect of the taxes covered by the Convention (within the meaning of paragraph 5 of this Article) to which the information relates. The information must be used by these persons in connection with these designated functions. Persons concerned with the administration of taxes in the United States include legislative bodies, such as the tax-writing committees of Congress and the General Accounting Office. Information may be received and used by these bodies only in the performance of their role in overseeing the administration of U.S. tax laws. Information received may be disclosed in public court proceedings or in judicial decisions.

Paragraph 2 explains that the obligations undertaken in paragraph 1 to exchange information do not require a Contracting State to carry out administrative measures that are at variance with the laws or administrative practice of either State. Nor does that paragraph require a Contracting State to supply information not obtainable under the laws or administrative practice of either State or to disclose trade secrets or other information, the disclosure of which would be contrary to public policy. Either Contracting State may, however, at its discretion, subject to the limitations of the paragraph and its domestic law, provide information that it is not obligated to provide under the provisions of this paragraph.

Paragraph 3 contemplates that the exchange of information may be on a routine basis, by specific request concerning a particular case, or the spontaneous exchange of information that comes to the attention of one competent authority and is believed to be of use to the other competent authority. There is an active exchange of information between the French and U.S. competent authorities, involving each of these kinds of exchanges, under the 1967 Convention.

Paragraph 4 provides that, when information is requested by a Contracting State in accordance with this Article, the other Contracting State is obligated to obtain the requested information as if the tax in question were the tax of the requested State, even if that State has no direct tax interest in the case to which the request relates. The paragraph further provides that the requesting State may specify the form in which information is to be provided (e.g., depositions of witnesses and authenticated copies of unedited original documents) so that the information is usable in the judicial proceedings of the requesting State. The requested State shall, if possible, provide the Information in the form requested, to the same extent that it can obtain information in that form under its own laws and administrative practices with respect to its own taxes.

Subparagraph 4(c) confirms that representatives of either Contracting State will be permitted to enter the other State to interview taxpayers and review and copy records, provided that the taxpayers involved and the competent authority of the requested State consent in any given case. The subparagraph further provides that such inquiries will not be considered audits for purposes of French tax law. French law does not presently permit on-site audits by foreign tax officials. The U.S. negotiators did not believe it appropriate for such a restriction to apply unilaterally. Accordingly, the implementation of this provision requires an exchange of diplomatic notes in which both States agree to allow such inquiries on a reciprocal basis.

Paragraph 5 states that the exchange of information may pertain to all taxes imposed by the national government. Customs duties are not considered taxes for this purpose. Information with respect to taxes imposed by political subdivisions may only be exchanged to the extent that it is relevant to determining the national taxes covered (e.g., verifying the deduction of a State income tax from income subject to Federal income tax)

## ARTICLE 28 Assistance in Collection

This Article provides for limited mutual assistance in the collection of taxes covered by the Convention. It was introduced in the original U.S.-France income tax treaty, signed in 1939, and has remained substantially unchanged since that time.

Paragraph 1 provides the basic agreement that each Contracting State will assist the other in the collection of taxes to which the Convention applies, plus interest, costs, and additions to those taxes and related fines that are not penal in character. This assistance will be furnished with respect to revenue claims that have been finally determined and are definitively due, according to the laws of the requesting State.

In such cases, as provided in paragraph 2, the requested State will accept the revenue

claim of the requesting State as if it were its own, and will enforce it and collect the tax due in the same manner as permitted under its laws with respect to its own revenue claims.

Paragraph 3 requires the requesting State to provide the requested State with copies of any documentation required under the laws of the former State to establish that the revenue claims have been finally determined.

Paragraph 4 provides that, when the revenue claim has not been finally determined, the requested State will take whatever measures of conservancy are authorized under its laws for the enforcement of its own taxes.

Paragraph 5 provides that the assistance authorized by this Article will not be granted with respect to citizens, companies, or other entities of the requested State. An exception is made if the competent authorities of the two States agree that a reduction of tax granted to such a person under the Convention has been enjoyed by a person or persons not entitled to such benefits, or in the case of France, where the dividend tax credit “avoir fiscal”) provided for in paragraph 4 of Article 10 (Dividends) to a U.S. citizen, company, or other entity, has been enjoyed by some other person not intended to benefit from that provision. This exception is new to the Article. It is consistent with the intent of the Contracting States to limit treaty benefits to qualified persons, as expressed in Article 30 (Limitation on Benefits of the Convention) and of the articles of other recent U.S. tax conventions with respect to limitations on benefits.

## ARTICLE 29 Miscellaneous Provisions

Paragraphs 1 through 3 of this Article cover provisions typically found in Article 1 of U.S. income tax treaties, concerning the relationship between the Convention and domestic tax laws, the saving clause permitting domestic law taxation of residents and citizens, and exceptions to the saving clause. Paragraphs 4 through 7 contain assorted provisions that do not fit squarely in any other article. Paragraph 8 also relates to paragraph 1 and concerns the relationship between the convention and other international agreements.

Subparagraph 1(a) establishes that the Convention does not create an independent U.S. taxing right in cases where domestic tax law does not provide such a right. No provision in the Convention may restrict any benefit accorded by the Code. Thus, for example, if a deduction would be allowed under the Code in computing the taxable income of a resident of France, the deduction will be available to that person in computing income under the treaty. In addition, a right to tax given by the treaty cannot be exercised by the United States unless that right also exists under the Code. A taxpayer may always rely on the Code treatment. In the case of France, this rule applies with respect to U.S. citizens and residents, with certain exceptions. In France, a treaty takes precedence over domestic law. Thus, France was concerned that agreeing to this rule could cause unintended results in some cases. The exceptions are intended to preserve the French statutory right to tax when the Convention provides for exemption in the United States (e.g., in the case of certain teachers who are U.S. citizens resident in France) or to prevent double benefits under French domestic law and the Convention (e.g., in the case of double taxation relief).



A taxpayer may not, in any case, pick and choose among Code and treaty provisions in an inconsistent manner in order to minimize tax. For example, assume a resident of France has three separate businesses in the United States, one a permanent establishment under the Convention, and the other two trades or businesses under the Code but not permanent establishments under the Convention. The permanent establishment is profitable, one of the other businesses is profitable, and the other incurs a loss. Under the Convention, the income of the permanent establishment is subject to U.S. tax but both the profit and loss of the other two businesses are ignored. Under the Code, all three would be taxable. The loss would be offset against the profits of the two profitable ventures. The taxpayer may not invoke the Convention to exclude the profits of the profitable trade or business and invoke the Code to claim the loss against the profit of the permanent establishment. (See Rev. Rul. 84-17, 1984-1 C.B. 308.) However, if the taxpayer invokes the Code for the taxation of all three ventures, he would not be precluded from invoking the Convention with respect, for example, to any U.S. source dividend income that is not effectively connected with any of his business activities in the United States.

Subparagraph 1(b) establishes that the Convention will not restrict any benefit provided under another agreement between the Contracting States. Paragraph 8 modifies that rule with respect to certain obligations undertaken by the Contracting States under other agreements. Paragraph a provides that, notwithstanding any other agreement to which the Contracting States may be parties, a dispute concerning whether a measure falls within the scope of this Convention shall be considered only by the competent authorities of the Contracting States as defined under subparagraph 1(h) of Article 3 (General Definitions), and the procedures under this Convention exclusively shall apply to the dispute. Thus, dispute resolution procedures provided in trade, investment, or other agreements between the Contracting States shall not apply for the purpose of determining the scope of the Convention.

Paragraph 8 further provides that, unless the competent authorities agree that a taxation measure is not within the scope of this Convention, the non-discrimination obligations of this Convention exclusively shall apply with respect to that measure, except for such national treatment or most-favored-nation ("MFN") obligations as may apply to trade in goods under the General Agreement on Tariffs and Trade ("GATT") No national treatment or MFN obligation under any other agreement shall apply with respect to that measure. Thus, any national treatment and MFN obligations undertaken by the Contracting States under agreements other than the Convention shall not apply to a taxation measure, with the exception of GATT as applicable to trade in goods. For purposes of paragraph 8, a "measure" is defined as a law, regulation, rule, procedure, decision, administrative action, or any other form of measure.

Paragraphs 2 and 3 of Article 29, concerning the saving clause, are discussed in connection with Article 1 (Personal Scope).

Paragraph 4 provides that there shall not be imposed a stamp tax or similar transaction tax on the trading of stocks or securities on a stock exchange in a Contracting State when the order for purchase, sale, or exchange originates in the other Contracting State. This provision replaces paragraph 5 of Article 22 of the 1967 Convention, which similarly exempted from the French tax on stock exchange transactions those transactions that originate in the United States. In addition, because the French tax was a covered tax under the 1967 Convention, it also could

not be imposed on any transaction originated by a U.S. resident outside of the United States (unless there was a permanent establishment or fixed base in France). Although the French tax is not a covered tax under the new treaty, France has amended its law and now exempts all transactions entered into by nonresident individuals and foreign corporations, both for domestic law and treaty purposes. The current treatment will, therefore, continue to apply even in the rare case of a transaction originated by a U.S. resident outside of the United States.

Paragraph 5 prohibits a Contracting State from imputing income to a resident of the other Contracting State based on the rental value of housing that the resident owns in the first-mentioned State. This provision, which appeared as paragraph 5 of Article 23 of the 1967 Convention, relates to a provision of French tax law (Article 164 of the General Tax Code) that permits France to impose tax in certain circumstances on a multiple of the rental value of housing, if that is greater than reported income.

Paragraph 6 permits the United States to impose its statutory rate of tax (currently 30 percent) on an excess inclusion with respect to a residual interest of a French resident in a real estate mortgage investment conduit, notwithstanding the rule of Article 11 (Interest) that generally exempts interest from taxation at source.

Paragraph 7 incorporates two provisions formerly included in a 1978 exchange of letters. Both provide French tax benefits to U.S. citizens resident in France. First, income other than capital gain arising from the exercise of stock options with respect to shares of U.S. companies will be taxable income in France when and to the extent that it is treated as ordinary income for U.S. tax purposes. Second, U.S. state and local income taxes paid with respect to personal service income and other business income (except certain business income exempt from French income tax) will be deductible as business expenses in computing French income tax.

Paragraph 8 is discussed above in connection with subparagraph 1(b).

### ARTICLE 30 Limitation on Benefits of the Convention

Article 30 addresses the problem of "treaty shopping" by limiting the source basis tax benefits of the Convention to those residents of the other Contracting State that have a substantial business nexus with, or otherwise have a significant business purpose for residing in, the other Contracting State. In a typical case of treaty shopping, a resident of a third State might establish an entity resident in a Contracting State for the purpose of deriving income from the other Contracting State and claiming treaty benefits with respect to that income. Article 30 limits the Convention to those persons whose residence in a Contracting State is unlikely to have been motivated by the existence of the Convention. Absent Article 30, the entity generally would be entitled to benefits under the Convention as a resident of a Contracting State, although the entity might be denied those benefits as a result of limitations (e.g., business purpose, substance-over-form, step transaction or conduit principles or other anti-avoidance rules) applicable to the transaction or arrangement under the domestic law of the source State. Article 30 and the anti-abuse provisions of domestic law complement each other, as Article 30 generally determines whether an entity has a sufficient nexus to the Contracting State to be treated as a resident for

treaty purposes, while domestic anti-abuse provisions determine whether a particular transaction should be recast in accordance with the substance of the transaction.

The structure of the Article is as follows: Paragraph 1 lists a series of attributes, any one of which will make the person a resident entitled to the benefits of the Convention in the other Contracting State. These are essentially objective tests. Paragraph 2 introduces an alternative test, under which a resident of a Contracting State that does not qualify under paragraph 1 may claim treaty benefits with respect to those items of income connected with the active conduct of a trade or business in the other Contracting State. Paragraph 3 provides that benefits are available to a resident of a Contracting State that is a headquarters company for a multinational corporate group, as defined in subparagraph 6(h). Paragraph 4 provides for limited so-called "derivative benefits" with respect to dividends, interest, and royalties to a company resident in the other Contracting State that satisfies modified ownership and base erosion tests in which ownership by residents of member states of the European Union is taken into account. Paragraph 5 limits treaty benefits in certain "triangular" cases. Paragraph 6 defines terms used in this Article. Paragraph 7 provides that the benefits of the Convention shall be allowed to a resident of a Contracting State that does not satisfy any of the preceding paragraphs if the competent authority of the other Contracting State decides, on the basis of Certain factors, that benefits should be granted in that case. Paragraph 8 provides that the competent authorities of the two States may consult together on the application of this Article.

Under paragraph 1, the first two categories of persons that qualify for Convention benefits are

- (1) individual residents of a Contracting State, and
- (2) the Contracting States, political subdivisions (in the case of the United States) or local authorities thereof, or agencies or instrumentalities of such a State, subdivision, or authority.

It is most unlikely that persons falling into these two categories can be used to derive treaty-benefited income, as the beneficial owner of the income, on behalf of a third-country person. If an individual is receiving income as a nominee on behalf of a third-country resident, benefits will be denied with respect to those items of income under the articles of the Convention that grant the benefit, because of the requirements in those articles that the beneficial owner of the income be a resident of a Contracting State.

Under subparagraph 1(c)(j), a company that is a resident of a Contracting State is entitled to treaty benefits from the other contracting State if there is substantial and regular trading in its principal class of shares on one or more recognized stock exchanges. The term "recognized stock exchange" is defined in subparagraph 6(e) to mean, in the United States, the NASDAQ System and any stock exchange registered as a national securities exchange with the Securities and Exchange Commission, and, in France, the French stock exchanges controlled by the "Commission des operations de bourse." In addition, the stock exchanges of Amsterdam, Brussels, Frankfurt, Hamburg, London, Madrid, Milan, Sydney, Tokyo, and Toronto are recognized stock exchanges, and the competent authorities are authorized to add other stock exchanges on which they both agree.

Under subparagraph 1(c)(ii), a company will qualify for benefits, even if its own shares are not publicly traded, if more than 50 percent of the aggregate vote and value of its shares is

owned, directly or indirectly, by any combination of the following categories of persons:

- (1) publicly traded companies that satisfy subparagraph 1(c)(i);
- (2) the governments, agencies, or instrumentalities referred to in subparagraph i(b); and
- (3) any companies of which persons referred to in subparagraph 1(b) own more than 50 percent of the aggregate vote and value of the shares.

Under subparagraph 1(c)(iii), a company will qualify for benefits if it satisfies an alternative ownership test. The alternative test is comprised of two parts. The first part is the same as that of subparagraph 1(c)(ii), except that "more than 50 percent" is lowered to "at least 30 percent." The second part requires that there be sufficient ownership, directly or indirectly, by any combination of specified owners to bring the total ownership under the two parts to at least 70 percent of the aggregate vote and value of the company's shares. The specified owners are:

- (1) publicly traded companies that are residents of either Contracting State or of one or more member states of the European Union;
- (2) the Contracting States, political subdivisions (in the case of the United States) or local authorities thereof, or agencies or instrumentalities of such a State, subdivision, or authority;
- (3) companies of which more than 50 percent of the vote and value of the shares is owned by:

- (a) the Contracting States, political subdivisions (in the case of the United States) or local authorities thereof, agencies or instrumentalities of such a State, subdivision, or authority,

- (b) member states of the European Union, political subdivisions or local authorities thereof, or agencies or instrumentalities of such member states, Subdivisions or authorities; or

- (c) companies more than 50 percent owned by the member states of the European Union, political subdivisions or local authorities thereof, or agencies or instrumentalities of such member states.

This subparagraph recognizes that there may be, particularly within regional groupings like the European Union joint ventures between private and government owners from different countries that should be entitled to treaty benefits because the purpose of their multi-country ownership is not to derive tax treaty benefits but to accomplish an international business purpose.

If benefits are sought under subparagraph 1(c)(i) or (ii) in case involving indirect ownership, all companies in the chain of ownership must be residents of a Contracting State or of a member state of the European Union, as defined in subparagraph 6(d). This requirement is stated in subparagraph 6(a).

For purposes of subparagraph 1(c)(iii) and elsewhere in this Article, references to a "resident of a member state of the European Union" mean a person that would be entitled to the benefits of a comprehensive income tax convention in force between that member state of the European Union and the United States (when the United States is the State providing benefits) under a comprehensive limitation on benefits article that includes provisions similar to those of subparagraphs 1(c) and 1(d) and paragraph 2 of this Article. If there is no such convention or if it does not contain such a comprehensive limitation on benefits article, the person must be a person that would be entitled to the benefits of this Convention under paragraph 1 if such person were a resident of France or the United States, as applicable.

Subparagraph 1(d) provides another two-part test, referring to ownership and "base erosion," both parts of which must be met for entitlement to benefits under this subparagraph. Under the ownership portion, benefits will be granted to a resident of a Contracting State other than an individual if less than 50 percent of the beneficial interest in the person (or, in the Case of a corporation, less than 50 percent of the vote and value of each class of its shares) is owned, directly or indirectly, by persons who are not entitled to benefits under the tests of paragraph 1 and are not U.S. citizens. For example, if the shares of a French company are more than 50 percent owned by another French company that is wholly owned by residents of a third country that are not U.S. citizens, that French company would not pass the ownership test, because more than 50 percent of its shares is indirectly owned by the third-country residents.

The second or "base erosion" part of this test itself has two parts, of which it is sufficient to satisfy either one. Either

(a) less than 50 percent of the person's gross income may be used, directly or indirectly, to make deductible payments to persons that are not eligible for benefits under the tests of paragraph 1 and are not U.S. citizens, or

(b) less than 70 percent of such gross income may be used to make deductible payments to persons mentioned in (a) and less than 30 percent may be used to make deductible payments to persons that are neither mentioned in (a) nor residents of member states of the European Union.

The rationale for the two-part test of subparagraph 1(d) is that, since treaty benefits can be indirectly enjoyed not only by equity holders of an entity, but also by that entity's various classes of obligees (such as lenders, licensors, service providers, insurers and reinsurers, and others), simply requiring substantial ownership of the entity by treaty country residents or U.S. citizens will not prevent such benefits from inuring substantially to third-country residents. It is also necessary to require that the entity's deductible payments be made in substantial part to treaty country residents or to U.S. citizens. For example, a third-country resident could lend funds to a French-owned French corporation to be reloaned to the United States. The U.S. source interest income of the French corporation would be exempt from U.S. withholding tax under Article 11 (Interest) of the Convention. While the French corporation would be subject to French corporation income tax, its taxable income could be reduced to near zero by the deductible interest paid to the third-country resident. If, under a convention between France and the third country, that interest is exempt from French tax, the U.S. treaty benefit with respect to the U.S. source interest income will have flowed to the third-country resident inappropriately, with no reciprocal benefit to the United States from the third country.

Subparagraphs 1(e) and 1(f) provide that pension organizations, not-for-profit organizations, and certain investment entities that are residents of a Contracting State under Article 4 (Resident) are entitled to benefits from the other Contracting State if more than half of their beneficiaries, members, participants, or owners are persons entitled, under this Article, to the benefits of the Convention. Note that, under paragraph 4(b) (iii) of Article 10 (Dividends), a regulated investment company must satisfy a more stringent test, requiring that at least 80 percent of the investors be U.S. residents or citizens, to qualify for the benefit of the French tax credit ("avoir fiscal") provided in that paragraph. If a RIC were to meet the test of this paragraph of Article 30, but not the test of subparagraph 4(b)(iii) of Article 10, it would nevertheless be

eligible for the benefits of paragraph 2 of Article 10.

The provisions of paragraph 1 are intended to be self-executing. Unlike a claim under the provisions of paragraph 7, discussed below, a claim of benefits under this paragraph does not require advance competent authority ruling or approval. The tax authorities may, of course, on review, determine that the taxpayer has improperly interpreted the paragraph and is not entitled to the benefits claimed.

Paragraph 2 provides a test for eligibility for benefits that looks not solely at objective characteristics of the person deriving the income, but at the nature of the activity engaged in by that person and the connection between the income and that activity. This is the so-called "active trade or business" test. Under this test, a resident of a Contracting State deriving income from the other Contracting State is entitled to the benefits of the Convention with respect to that income if the person is engaged in an active trade or business (as defined in subparagraph 6(g)) in his State of residence, the item of income in question is derived in connection with, or is incidental to, that trade or business, and that trade or business is substantial in relation to the income-generating activity in the other State.

The business of making or managing investments will not be considered an active trade or business for the purposes of paragraph 2 unless carried on by a bank or insurance company engaged in banking or insurance activities. Income is considered derived "in Connection" with an active trade or business if, for example, the activity that generates the income is "upstream," "downstream," or parallel to the active trade or business. Thus, if the U.S. activity of a French manufacturer consisted of selling its products or the same sort of products in the United States or providing inputs to the French manufacturer, the U.S. income would be considered connected with the French business. Income is considered "incidental" to a business if, for example, it arises from the short-term investment of the working capital of the business.

The determination as to whether a trade or business in one Contracting State is "substantial" in relation to the activity carried on in the other Contracting State is based on the facts and circumstances of each case.

In addition to the rule that the determination of substantiality will be made on the specific facts and circumstances, subparagraph 2(b) provides a safe harbor standard. Under the safe harbor, the activity in a Contracting State will be deemed substantial if the ratios of assets used in that State, gross income derived from that State, and payroll expense for services performed in that State to assets, gross income and payroll expense for services in the other Contracting State each exceed 7.5 percent and the average of the three ratios exceeds 10 percent. These ratios are the same as in the U.S. -Netherlands income tax treaty. The paragraph makes it clear, as does the explanation of the comparable provision in the U.S. -Netherlands treaty, that assets, gross income, and payroll expense are taken into account in Computing these ratios only to the extent that the company deriving the income has an ownership interest in the company resident in the other Contracting State that generates the income. Thus, for example, a French manufacturer that derives income from the sale in the United States through unrelated distributors of goods it produces in France will satisfy the substantiality requirement with respect to that income without the need to calculate the ratios.

Paragraph 2 is applied separately for each item of income derived by a resident of one Contracting State from the other Contracting State. It differs in this respect from paragraph 1. A resident of a Contracting State that qualifies for treaty benefits under paragraph 1 qualifies with respect to all income derived from the other Contracting State. If a person qualifies for benefits under paragraph 1, no inquiry need be made into qualification for benefits under paragraph 2.

Paragraph 3 provides that a resident of a Contracting State is entitled to the benefits of the Convention if that person functions as a headquarters company for a multinational corporate group. A person is considered a headquarters company for this purpose only if several conditions, specified in subparagraph 6(h), are satisfied. The person seeking such treatment must perform in its State of residence a substantial portion of the overall supervision and administration of the group, which may include, but cannot be principally, group financing. The person must have, and exercise, independent discretionary authority to carry out these functions. It must be subject to the same income taxation rules in its residence State as are persons engaged in the active conduct of a trade or business, as described above in connection with the active business test under paragraph 2. Because France does not presently subject headquarters companies to the same income tax rules that apply to active trades or businesses, this last requirement will prevent French headquarters companies from claiming benefits under paragraph 3 unless French law is changed in a manner that satisfies the requirements of this paragraph.

Either for the taxable year concerned, or as an average for the preceding four years, the activities and gross income of the corporate group that the headquarters company supervises and administers must be spread sufficiently among several countries. The group must consist of corporations resident in, and engaged in an active business in, at least five countries, and the income derived in the Contracting State of which the headquarters company is not a resident must be derived in connection with, or be incidental to, that active business. The business activities carried on in each of the five countries or groupings of countries must generate at least 10 percent of the gross income of the group. The business activities carried on in any one country other than the Contracting State where the headquarters company resides may not generate 50 percent or more of the gross income of the group. Moreover, no more than 25 percent of the headquarters company's gross income may be derived from the other Contracting State.

The competent authorities may by mutual agreement determine transition rules for newly established business operations, newly established corporate groups or newly established headquarters companies. A similar provision appears in the recent United States-Netherlands income tax convention.

Paragraph 4 grants treaty benefits under Articles 10 (Dividends), 11 (Interest), and 12 (Royalties) to a company resident in one of the Contracting States that does not meet the standards of the preceding paragraphs but that does meet special ownership and base erosion tests. For this purpose, the base erosion test is the same as described in subparagraphs 1(d)(i) and (ii). The ownership test is that more than 30 percent of the aggregate Vote and value of the company's shares must be owned, directly or indirectly, by qualified persons that are resident in the Contracting State of which the company is resident, and more than 70 percent of its shares must be owned, directly or indirectly, by such qualified persons, U.S. citizens, or residents of member states of the European Union (as defined in subparagraph 6(d)).

Paragraph 5 addresses the so-called "triangular case," in which a resident of France derives profits through a permanent establishment in a third country that imposes little or no income tax liability on those profits, and the profits are exempt from French tax under its territorial system of taxing business profits. The Contracting States agreed that it would be inappropriate to grant treaty benefits with respect to income derived in such a case. Therefore, paragraph 5 denies any treaty benefit if the combined tax in France and the third country is less than 60 percent of the tax that would be imposed in France if the income were earned there and were not attributable to the permanent establishment in the third country. Paragraph 5 further provides that any dividends, interest, or royalties derived in such a case shall be subject to a tax at source under domestic law, but at a rate not exceeding 15 percent of the gross amount. The paragraph is drafted reciprocally, but has no application with respect to the United States, because the United States does not exempt the profits of a U.S. company attributable to its foreign permanent establishments.

In the case of a French resident with a permanent establishment in a third country, the provisions of paragraph 5 do not apply if the profits of the permanent establishment are taxed in the United States, i.e., under the subpart F provisions of the Internal Revenue Code, or in France, under the provisions of section 209B of the French tax code. (The reference to subpart F was intended to refer to subpart F of part III of subchapter N of chapter 1 of subtitle A of the Internal Revenue Code.) It was considered appropriate to take the subpart F provisions into account because of the restrictions on abuse under French domestic law.

Nor do the provisions of paragraph 5 apply if the income derived from the other Contracting State is derived from an active trade or business in the third country. The business of making or managing investments is not an active trade or business for this purpose unless the activities are banking or insurance activities carried on by a bank or insurance company.

Paragraph 6 defines key terms used in this Article, most of which are discussed above in connection with the relevant paragraphs.

Paragraph 7 provides that a resident of a contracting State that does not otherwise qualify for the benefits of the Convention under this Article may nevertheless request that the competent authority of the other Contracting State grant it the benefits of the Convention. If the competent authority of the other Contracting State determines that the establishment, acquisition, or maintenance of such person and the conduct of its operations did not have as one of its principal purposes the obtaining of benefits under the Convention, or that it would be inappropriate to deny the benefits of the Convention to such person, it is required to grant benefits in that case. The competent authority will consult with the competent authority of the other State before denying benefits under this paragraph. It is anticipated that, in making its determination, the competent authority will take into account such factors as those enumerated in the Understanding to Article 26 of the U.S.-Netherlands Convention concerning the corresponding provision of that Article.

Paragraph 8 provides additional authority to the competent authorities (in addition to that of Article 26 (Mutual Agreement procedure)) to consult together to develop a common application of the provisions of this Article.



ARTICLE 31  
Diplomatic and Consular Officers

Paragraph 1 provides that any fiscal privileges to which diplomatic or consular officials are entitled under general provisions of international law or under special agreements will apply notwithstanding any provisions to the contrary in the Convention.

If, however, because of such privileges, income or capital is not taxed in the receiving State, paragraph 2 grants to the sending State the right to tax the income or capital.

Under paragraph 3, an individual who is a member of a diplomatic mission or consular post of a Contracting State, whether situated in the other Contracting State or in a third country, will be deemed to be a resident of the sending State if two conditions are met:

1) in accordance with international law, the individual is not subject to tax in the receiving State in respect of income from sources outside that State or in respect of capital situated outside that State, and

(2) the individual is liable to tax in the sending State on worldwide income and capital in the same manner as residents of that State. Residence as determined under this paragraph will apply notwithstanding any result to the contrary from the application to such individual of the rules of Article 4 (Residence).

The saving clause of paragraph 2 of Article 29 does not apply to benefits available under this Article to an individual who is neither a citizen of, nor has immigrant status in, the United States.

ARTICLE 32  
Provisions for Implementation

This Article establishes that the competent authorities may prescribe rules and procedures, jointly or separately, for the implementation of the provisions of the Convention, such as the reduced withholding taxes at source on dividends, interest, and royalties beneficially owned by a resident of the other Contracting State.

Paragraph 2 specifically authorizes a contracting State to require residents of the other State claiming the benefits of the Convention to present a form including the relevant information, such as the type and amount of income or capital and the residence of the taxpayer. The competent authorities may also require certification by the tax administration of the residence State, in an agreed form and manner. Such certification might consist of confirming that the beneficial owner of the income filed a return and paid tax as required of a resident of that State.

The procedures described above will be implemented by competent authority agreement pursuant to Article 26 (Mutual Agreement Procedure). The competent authorities may also establish, either unilaterally or by mutual agreement, other procedures for the implementation of the provisions of the Convention.

This Article was included at the request of France. Such procedures are considered by the United States to be implicitly authorized by treaties, but France preferred to include an explicit authorization.

### ARTICLE 33 Entry into Force

Article 33 provides that the Contracting States will notify each other when their constitutional and statutory requirements for the entry into force of the Convention have been completed. For the United States, the delivery of the signed instrument of ratification constitutes such notice. On the date of receipt of the later of such notifications, the Convention will enter into force.

Once the Convention is in force, its taxing provisions take effect as of different dates. In general, the provisions concerning taxes withheld at source on dividends, interest, and royalties, and the U.S. excise tax on insurance premiums paid to foreign insurers, will be effective for amounts paid or credited on or after the first day of the second month after entry into force. For example, if the Convention enters into force on June 30, 1995, those provisions will apply for amounts paid or credited on or after August 1, 1995. However, as mentioned in subparagraph 3(a), the provisions of paragraph 4 of Article 10 (Dividends), concerning the French dividend tax credit, have effect for dividends paid or credited on or after January 1, 1991. Similarly, the provisions of Article 12 (Royalties) have effect for royalties paid or credited on or after January 1, 1991. The latter rule does not affect U.S. taxation of royalties, since it has been consistent with the current wording.

For other income taxes, the Convention is effective for taxable periods beginning on or after the first day of January of the year after entry into force. In the above example, that would be January 1, 1996. For other taxes, e.g., the French wealth tax or the French tax on stock exchange transactions, the Convention applies to taxable events occurring on or after the first day of January of the year following entry into force.

As explained in subparagraph 3(b), the provisions of Article 26 (Mutual Agreement Procedure) apply with respect to any cases presented to the competent authorities after the Convention enters into force, even if the cases involve taxable periods prior to the entry into force. This is consistent with the usual U.S. and French positions on this point.

The provisions of the 1967 Convention, and the four subsequent protocols and accompanying exchanges of letters that amended that Convention, will cease to have effect from the date on which the corresponding provisions of this Convention take effect.

### ARTICLE 34 Termination

The Convention will remain in affect indefinitely unless it is terminated by one of the

Contracting States in accordance with the provisions of this Article. Either Contracting State may terminate the Convention at any time after five years from the date on which it enters into force, provided that notice has been given through diplomatic channels at least six months before the end of a calendar year. In such case the provisions of the Convention generally will cease to apply as of the following January 1. The requirement of six months' notice before the end of a calendar year is unchanged from the 1967 Convention.

If notice of termination is given as described above, the provisions of the Convention concerning taxes withheld at source on dividends, interest, and royalties, and the U.S. excise tax on insurance premiums paid to foreign insurers, will cease to apply for amounts paid or credited on or after the first day of January following the expiration of the six-month period. The provisions concerning other taxes will cease to apply:

(1) in the case of taxes on income, for taxable periods beginning on or after the first day of January following the six-month period, and

(2) in the case of other taxes, for taxable events occurring on or after the first day of January following the six-month period.

#### EXCHANGE OF DIPLOMATIC NOTES

Two exchanges of diplomatic notes accompany the Convention and explain certain points of the Convention. Those points are discussed above in connection with the provisions to which they relate.