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PROTOCOL AMENDING THE INCOME TAX CONVENTION  
WITH FRANCE (TREATY DOC. 109-4)

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MARCH 27, 2006.—Ordered to be printed

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Mr. LUGAR, from the Committee on Foreign Relations,  
submitted the following

REPORT

[To accompany Treaty Doc. 109-4]

The Committee on Foreign Relations, to which was referred the Protocol Amending the Convention Between 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, signed at Washington on December 8, 2004, having considered the same, reports favorably thereon and recommends that the Senate give its advice and consent to ratification thereof, as set forth in this report and the accompanying resolution of ratification.

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I. PURPOSE

The principal purposes of the existing income tax treaty between the United States and France<sup>1</sup> and the proposed protocol amending the treaty are to reduce or eliminate double taxation of income

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<sup>1</sup>All references to the treaty between the United States and France are to the Convention Between 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, signed at Paris on August 31, 1994.

earned by residents of either country from sources within the other country and to prevent avoidance or evasion of the taxes of the two countries. The existing treaty and proposed protocol also are intended to continue to promote close economic cooperation between the two countries and to eliminate possible barriers to trade and investment caused by overlapping taxing jurisdictions of the two countries.

## II. BACKGROUND

The proposed protocol was signed at Washington on December 8, 2004. The proposed protocol would amend the U.S.-France income tax treaty, which was signed at Paris on August 31, 1994.

The proposed protocol was transmitted to the Senate for advice and consent to its ratification on September 28, 2005 (see Treaty Doc. 109-4). The Committee on Foreign Relations held a public hearing on the proposed protocol on February 2, 2006.

## III. SUMMARY

The proposed protocol amends six articles of the existing treaty. The treaty is broadly similar to other U.S. income tax treaties, the 1996 U.S. model income tax treaty (the "U.S. model"), and the 1992 model income tax treaty of the Organization for Economic Cooperation and Development, as updated (the "OECD model"), with some substantive deviations from these treaties and models.

The proposed protocol would revise Article 4 (Resident) of the current treaty to clarify the meaning of "resident" in certain cases and address the treatment of cross-border investments made through partnerships and other similar forms of entity.

The proposed protocol would amend Article 10 (Dividends) of the existing treaty by expanding the class of shareholders eligible for the treaty's 15-percent rate of U.S. withholding tax on dividends from real estate investment trusts ("REITs"). The provisions of the proposed protocol in this regard are similar to those included in other recent U.S. income tax treaties and protocols.

The proposed protocol replaces Article 18 (Pensions) of the current treaty, and provides rules for the taxation of pensions and social security benefits. The proposed protocol also makes changes to Article 19 (Public Remuneration) of the current treaty in coordination with the changes made to Article 18 (Pensions). Under the proposed protocol, the taxation of pensions paid by a treaty country (or political subdivision or local authority) for services rendered to such country (or political subdivision or local authority) is governed by the provisions of Article 18, regardless of whether the services are rendered in connection with a governmental function or a business carried on by such country. In addition, the proposed protocol would make technical conforming changes to Article 24 (Relief From Double Taxation) of the existing treaty, to reflect the changes that would be made by the proposed protocol to Article 18 (Pensions) and Article 19 (Public Remuneration) of the treaty, as described above.

The proposed protocol expands the "saving clause" provision in Article 29 (Miscellaneous Provisions) of the existing treaty to allow the United States to tax former long-term residents whose termi-

nation of residency has as one of its principal purposes the avoidance of tax. This provision allows the United States to apply amendments made in 1996 to the special tax rules under section 877 of the Internal Revenue Code.

#### IV. ENTRY INTO FORCE

The proposed protocol will enter into force upon the exchange of instruments of ratification. The effective dates of the protocol's provisions, however, vary.

The proposed protocol will have effect with respect to taxes withheld at source for amounts paid or credited on or after the first day of the second month next following the date on which the proposed protocol enters into force. With respect to other taxes, the proposed protocol will have effect for taxable periods beginning on or after the first of January in the year following the date on which the proposed protocol enters into force.

Additionally, a special effective date would apply with respect to the provisions of Article I (Resident) of the proposed protocol dealing with fiscally transparent entities, making these provisions generally retroactive to the effective date of the existing treaty. Under this special rule, these provisions, except to the extent that they treat a *fonds commun de placement* as a partnership for purposes of U.S. tax benefits under the treaty, would have effect with respect to taxes withheld at source for amounts paid or credited on or after February 1, 1996. For other taxes, these provisions would have effect for taxable years beginning on or after January 1, 1996.

#### V. COMMITTEE ACTION

The Committee on Foreign Relations held a public hearing on the proposed protocol with France (Treaty Doc. 109-4) on February 2, 2006. The hearing was chaired by Senator Lugar.<sup>2</sup> The committee considered the proposed protocol at its business meeting on March 14, 2006, and ordered the proposed protocol with France favorably reported by voice vote, with a quorum present and without objection.

#### VI. COMMITTEE COMMENTS

On balance, the Committee on Foreign Relations believes that the proposed protocol with France is in the interest of the United States and urges that the Senate act promptly to give advice and consent to ratification. The committee has taken note of certain issues raised by the proposed protocol and believes that the following comments may be useful to Treasury Department officials in providing guidance on these matters should they arise in the course of future treaty negotiations.

##### A. EXPATRIATION TO AVOID TAX BY FORMER U.S. CITIZENS AND LONG-TERM RESIDENTS

There is a potential conflict between the special expatriation tax regime of U.S. internal law and the proposed treaty. Under U.S.

<sup>2</sup>The transcript of this hearing ("Tax Treaties," February 2, 2006, S. Hrg. 109-308) has been printed and is available at <http://www.gpoaccess.gov/congress/senate/foreignrelations/index.html>.

law, former U.S. citizens or long-term residents who relinquish U.S. citizenship or terminate U.S. residency may be subject to a special set of income, estate, and gift tax rules for the 10-year period following such loss of status. These rules mainly have the effect of expanding the scope of income and wealth transfers that are subject to taxation by the United States, such that the individual is subject to U.S. tax on a somewhat broader basis than other non-resident aliens, but still on a narrower basis than a current U.S. citizen or resident.

The saving clause of the proposed protocol applies to former U.S. citizens and long-term residents whose loss of citizenship or termination of residency status had as one of its principal purposes the avoidance of U.S. tax. The saving clause states that the determination is made according to the laws of the country of which the person was a citizen or long-term resident.

Under U.S. law, the subjective “principal purposes of tax avoidance” formulation in determining whether the special tax regime may apply to individuals who expatriate was made obsolete by the American Jobs Creation Act of 2004 (AJCA) (Section 804 of P.L. 108–357). AJCA replaced the subjective determinations of tax-avoidance purpose with objective rules for determining the applicability of the special tax regime.

Prior to AJCA, for purposes of determining the applicability of the regime, an individual who relinquished citizenship or terminated residency was generally treated as having done so with a principal purpose of tax avoidance if the individual’s average Federal income tax liability or net worth exceeded certain monetary thresholds. However, the law allowed for subjective determinations of tax-avoidance purpose based on the relevant facts and circumstances. Certain categories of individuals, including a very limited class of dual residents or citizens, could avoid being deemed to have a tax avoidance purpose for relinquishing citizenship or terminating residency by submitting a ruling request to the IRS for a determination as to whether the relinquishment of citizenship or termination of residency had as one of its principal purposes the avoidance of U.S. income, estate or gift taxes.

AJCA eliminated these subjective determinations of tax-avoidance purpose and replaced them with objective rules. Under the regime as amended by AJCA, a former citizen or former long-term resident is subject to the special income, estate, and gift tax rules for expatriates unless the individual: (1) establishes that his or her average annual net income tax liability for the five preceding years does not exceed \$124,000 (adjusted for inflation after 2004) and his or her net worth is less than \$2 million, or alternatively satisfies limited, objective exceptions for dual citizens and minors who have had no substantial contact with the United States; and (2) certifies under penalties of perjury that he or she has complied with all Federal tax obligations for the preceding five years and provides such evidence of compliance as the Treasury Secretary may require. Thus, as a result of AJCA, the application of the expatriation tax regime no longer turns on determinations of whether a person had a principal purpose of tax avoidance, as it often did prior to AJCA.

The Treasury Department's Technical Explanation notes that under the proposed protocol, the determination of whether there was a principal purpose of tax avoidance with respect to former citizens or long-term residents of the United States is made under the laws of the United States. The Technical Explanation further states that the new objective tests "represent the administrative means by which the United States determines whether a taxpayer has a tax avoidance purpose." Thus, although the proposed protocol employs the now-obsolete concept of a tax-avoidance purpose, the Technical Explanation maintains that this language should be understood as fully preserving U.S. taxing jurisdiction under the expatriation tax rules in their current form.

#### *Committee Conclusions*

The committee is concerned that the proposed protocol contains outdated language with respect to determination of whether individuals who relinquished U.S. citizenship or terminated U.S. residency did so with a "principal purpose of tax avoidance." The committee believes that bilateral tax treaties should reflect current U.S. domestic tax law.

The committee recognizes that the proposed protocol was largely completed before AJCA was enacted, and therefore that incorporation of the AJCA's objective tests into the protocol would have required significant renegotiation. Further, the committee understands that, as noted in the Technical Explanation, since the "principal purpose of tax avoidance" determination is made under U.S. law, such determination will be made according to the objective criteria contained in the AJCA.

Under these circumstances, the committee is satisfied that, under the proposed protocol, the "principal purpose of tax avoidance" determination in the saving clause will be made by applying the objective criteria enacted in the AJCA. However, the committee expects that future treaties and protocols will remove the "principal purpose of tax avoidance" language, and simply provide that former citizens or long-term residents of the United States will be taxed in accordance with the laws of the United States.

#### B. U.S. MODEL INCOME TAX TREATY

It has been longstanding practice for the Treasury Department to maintain, and update as necessary, a model income tax treaty that reflects the current policies of the United States pertaining to income tax treaties. The U.S. policies on income tax treaties are contained in the U.S. model. Some of the purposes of the U.S. model are explained by the Treasury Department in its Technical Explanation of the U.S. model:

[T]he Model is not intended to represent an ideal United States income tax treaty. Rather, a principal function of the Model is to facilitate negotiations by helping the negotiators identify differences between income tax policies in the two countries. In this regard, the Model can be especially valuable with respect to the many countries that are conversant with the OECD Model. . . . Another purpose of the Model and the Technical Explanation is to provide a

basic explanation of U.S. treaty policy for all interested parties, regardless of whether they are prospective treaty partners.<sup>3</sup>

U.S. model tax treaties provide a framework for U.S. treaty policy. These models provide helpful information to taxpayers, the Congress, and foreign governments as to U.S. policies on often complicated treaty matters. For purposes of clarity and transparency in this area, the U.S. model tax treaties should reflect the most current positions on U.S. treaty policy. Periodically updating the U.S. model tax treaties to reflect changes, revisions, developments, and the viewpoints of Congress with regard to U.S. treaty policy would ensure that the model treaties remain meaningful and relevant.

With assistance from the staff of the Joint Committee on Taxation, the Senate Committee on Foreign Relations reviews tax treaties negotiated and signed by the Treasury Department before advice and consent to ratification by the full Senate is considered. The U.S. model is important as part of this review process because it helps the Senate determine the administration's most recent treaty policy and understand the reasons for diverging from the U.S. model in a particular tax treaty. To the extent that a particular tax treaty adheres to the U.S. model, transparency of the policies encompassed in the tax treaty is increased and the risk of technical flaws and unintended consequences resulting from the tax treaty is reduced.

#### *Committee Conclusions*

The committee recognizes that tax treaties often diverge from the U.S. model due to, among other things, the unique characteristics of the legal and tax systems of treaty partners, the outcome of negotiations with treaty partners, and recent developments in U.S. treaty policy. However, even without taking into account the central features of tax treaties that predictably diverge from the U.S. model (e.g., withholding rates, limitation on benefits, exchange of information), the technical provisions of recent U.S. tax treaties have increasingly diverged from the U.S. model. The important purposes served by the U.S. model tax treaty are undermined if that model does not accurately reflect current U.S. positions. The committee notes with approval the intention of the Treasury Department to update the U.S. model treaty<sup>4</sup> and strongly encourages the Treasury Department to complete the update soon. In the process of revising the U.S. model, the committee expects the Treasury Department to consult with the committee generally, and specifically regarding the potential implications for U.S. trade and revenue of the policies and provisions reflected in the new model.

## VII. BUDGET IMPACT

The committee has been informed by the staff of the Joint Committee on Taxation that it has assessed the likely impact of the proposed protocol to the income tax treaty between the United

<sup>3</sup>Treasury Department, Technical Explanation of the United States Model Income Tax Convention, at 3 (September 20, 1996).

<sup>4</sup>Testimony of Patricia Brown, Deputy International Tax Counsel, United States Department of the Treasury, before the Senate Committee on Foreign Relations on Pending Income Tax Agreements, February 2, 2006.

States and France. The Joint Committee staff estimates that the proposed protocol will cause a negligible change in Federal budget receipts during the fiscal year 2006–2015 period.

#### VIII. EXPLANATION OF PROPOSED PROTOCOL

A detailed, article-by-article explanation of the proposed protocol between the United States and France can be found in the pamphlet of the Joint Committee on Taxation entitled *Explanation of Proposed Protocol to the Income Tax Treaty Between the United States and France (JCX–2–06)*, January 26, 2006.

#### IX. TEXT OF RESOLUTION OF ADVICE AND CONSENT TO RATIFICATION

*Resolved (two-thirds of the Senators present concurring therein),* That the Senate advise and consent to the ratification of the Protocol Amending the Convention Between the United States of America and France for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income of August 31, 1994, signed at Washington on December 8, 2004 (Treaty Doc. 109–4).