

2009 TREATY DEVELOPMENTS

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This column discusses recent developments with respect to U.S. tax treaties. This year, the U.S. has signed a protocol amending its treaty with France, and its 1999 treaty with Italy has at long last been ratified by the Italian parliament. Both agreements make extensive revisions to the previously-existing-source taxation, mutual agreement, and limitation-on-benefits provisions. In addition, the United States has recently initialed a new treaty with Hungary including a comprehensive limitations on benefits provision. Finally, the United States has recently stepped up its efforts to prevent offshore tax evasion, as evidenced by the modified exchange-of-information provisions in its treaties with Luxembourg and Switzerland and a new tax exchange information agreement with Gibraltar.

Rather than providing a comprehensive review of the changes made by these new agreements, this column explores aspects that are primarily of interest to corporate rather than individual taxpayers.

Protocol to the U.S. treaty with France

On 1/13/09, the United States signed a protocol to its 1994 income tax treaty with France (the 1994 Treaty).¹ The protocol was ratified by the French Senate on July 20 but has yet to be ratified by the U.S. Senate. The protocol will have effect with respect to taxes withheld at source on the first day of January of the year the protocol enters into force and with respect to all other taxes on the first day of January of the following year.²

Definition of resident. The protocol revises Article 4 of the 1994 Treaty, which defines residents of each country. The most significant change is to the provision addressing fiscally transparent entities. As revised by the protocol, the treaty for the most part no

longer assigns residency to fiscally transparent entities themselves; instead, it tests whether income derived through such entities is derived by a resident of one of the countries.

When an item of income is derived through an entity that is fiscally transparent under the laws of either country, it is considered to be derived by a resident of a country to the extent the country treats the income as income of a resident for purposes of its tax law—so long as the fiscally transparent entity is formed in one of the countries or a country that has entered into a satisfactory exchange of information agreement with the source country.³ With respect to “French qualified partnerships,” income paid from the United States must be *currently* included in the income of a partner who is a resident of France under the treaty in order to be derived by a resident of France.⁴ Regardless of these provisions, however, France may still tax an entity that has its place of effective management and is subject to tax in France, even if the United States views it as fiscally transparent.⁵

Taxation at source. The protocol eliminates source taxation for dividends paid from subsidiaries to shareholders meeting an 80% control test—applied differently depending on whether the shareholder is a U.S. or French company—but only if the controlling shareholder qualifies for treaty benefits under specific provisions of the limitation on benefits article. Corporate shareholders qualifying for treaty benefits under the same provisions of the limitation on benefits article are exempt from the application of the U.S. branch profits tax and the equivalent French taxing regime. Limitations on the reduction of source taxation similar to those applicable to dividends from U.S. real estate investment trusts (REITs) are also extended to dividends from certain French entities: the “société d’investissement immobilier cotée” (SIIC) and the “société de placement à prépondérance immobilière à capital variable” (SPPICAV).⁶

In addition, the protocol eliminates entirely source taxation on royalties.⁷

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