



## The new Income and Capital Gains Tax Treaty between France and the United Kingdom dated 19 June 2008

April 2009

The ratification process has begun in France.

The draft law authorising the approval of the new Double Tax Treaty ("the New DTT") between France and the UK was lodged with the French Senate on 4 March 2009. In France, by virtue of Article 53 of the French Constitution, no DTT may be ratified or approved other than in accordance with a law. Once the law authorising ratification or approval has been adopted by Parliament, the DTT may be ratified or approved by the signatories and can come into force.

The DTT signed in London on 19 June 2008 will come into force and replace the current DTT ("the Current DTT") which has been in place since 22 May 1968. The whole process has been lengthy as much of the negotiations began between the two countries in 1990. These negotiations gave rise to a draft treaty which was aborted on 20 January 2004.

In contrast to the 2004 version, the New DTT is more in line with the OECD Model Treaty principles ("the OECD Model Treaty") and with the internal law of each country. In this issue of French Tax News we reproduce in English the preamble to the law which summarises the principal provisions of the articles of the New DTT and also, where appropriate, we have made some comments.

### I. The general scope of the New DTT

#### Article 1 - Personal scope

The New DTT is to apply to persons who are resident in one or both of the Contracting States. This definition is in accordance with the OECD Model Treaty. The New DTT fills the hole in the Current DTT which does not define clearly to whom the treaty applies.

#### Article 2 - Taxes covered

Article 2, completed by Point 1 of the protocol to the treaty, sets out the taxes covered by the New DTT. The list of taxes has been brought up to date and completed. Social contribution on corporation tax; tax on salaries; and social contributions (ie "CSG" and "CRDS" notably) have thus been added to the list of French taxes covered.

#### Article 3 - General definitions

This article, in the usual way, sets out the definitions necessary in order to interpret terms used in the treaty.

Article 3.2 also sets out that tax law is to prevail over other fields of law in interpreting any terms not defined in the treaty.

Point 2 of the protocol to the treaty expressly excludes certain British territories from the scope of the New DTT (in particular the Channel Islands, the Isle of Man and Gibraltar).

## Article 4 - Residence

The notion of residence is an essential criterion in deciding which of the two countries has a right to tax.

In the first instance, residence is determined on application of the internal legislation of each of the Contracting States. When an individual has dual residence, successive criteria apply, namely permanent home, centre of vital interests (personal and economic), principal place of abode, nationality and agreement between the appropriate authorities (article 4.2). For companies, the criterion retained is the place of effective management in order to ascertain residence in a potential conflict (article 4.3)

One of the principal innovations of the New DTT with regard to the Current DTT is to enlarge the notion of resident to include groups of persons (ie "partnerships"). In accordance with article 4.4, the term "resident of a Contracting State" shall include where that Contracting State is France any partnership, group of persons or any other similar entity which has its place of effective management in France, which is subject to tax in France and all of whose shareholders, associates or members are, pursuant to the tax laws of France, personally liable to tax therein in respect of their shares of the profits of that partnership, group of persons or other similar entity. Hence, a French group of persons ("société de personnes") which is regarded as fiscally "translucent" to emphasise the fact that they really do have a tax identity is clearly covered by the New DTT.

This article confirms the French analysis by which a "société de personnes" is a fiscal subject even if the entity is taxed in the hands of its shareholders (see on this our 10-2008 French Tax News regarding taxation of partnerships in France).

Article 4.5, inspired by the OECD Report on partnerships, contains articles concerning transparent partnerships, and permits such entities to be recognised (when certain conditions are satisfied) in France (if France implemented such structures) or in a third country. However, where the partnership is situated in a third country, France will allow the New DTT to apply only if the third country where the entity is established has also concluded with France an agreement containing a provision of the exchange of information with a view to the prevention of tax evasion.

In order to avoid potential conflict, this clause follows OECD recommendations as regards partnerships by stating that, where the treaty applies, the tax status of the partnership in question will be determined by the qualification given to it by the State in which the shareholders are resident.

The provisions of the New DTT in respect of partnerships marks a significant development in the French position regarding how tax treaties are applied in respect of foreign partnerships. Until now, the French position was singular in that France refused to recognise the transparency of foreign partnerships. With the New DTT France now seems to have taken the majority position. The transparency of UK, and to a certain extent foreign partnerships could be recognised from a French tax point of view.

## Article 5 - Permanent establishment

The notion of "permanent establishment" conforms with that set out in the OECD Model Treaty.

In comparison with the Current DTT, Article 4.7 concerning permanent establishments of insurance companies has been abolished.

Point 3 of the protocol to the treaty states that where a partnership (ie a "transparent group of persons" from a French tax viewpoint) which is not a resident of a Contracting State has a permanent establishment in a Contracting State, that permanent establishment should be regarded as a permanent establishment in that State of each member of the partnership who is entitled to the benefits of the Convention.

## II. Rules regarding taxation of income

### Article 6 - Income from immovable property

Article 6, in accordance with the OECD Model Treaty, provides that income derived from immovable property (including income from agricultural or forestry property) situated in a Contracting State may be taxed in that State.

The term "Immovable Property" is to have the meaning which it has under the law of the Contracting State in which the property in question is situated.

Further, and this is new, reference is made to "trusts" which hold real estate from which income and capital gains are derived. Pursuant to article 6.5 "where shares or other rights in a company, other legal person, partnership, trust or any similar body, give an entitlement to enjoy immovable property situated in a Contracting State and held by that company, other legal person, partnership, trust or similar body, income derived from the direct use, letting, or use in any other form of that entitlement to enjoy, may be taxed in that State notwithstanding the provisions of article 7".

## Article 7 - Business Profits

The profits of an enterprise of a Contracting State should be taxable only in that State unless the enterprise carries on a business in the other Contracting State through a permanent establishment situated therein. In such a case, the profits of the enterprise may be taxed in that other Contracting State but only so much of them as is attributable to that permanent establishment.

In comparison with the Current DTT, the New DTT contains a new provision which will have consequences on the taxation of real estate gains made in France by UK companies.

In accordance with Article 7.7 "where profits include items of income or capital gains which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article".

From now on, a UK company which sells a property in France will be taxable in France even if it has no permanent establishment there (ie taxation will occur in the country where the real estate is situated). The gains would be taxed under Article 14 of the New DTT (ie taxation of real estate gains in the country in which the real estate is situated). Whether or not the UK company has a permanent establishment in France will be irrelevant in application of Article 14.

Under the Current DTT, real estate capital gains made in France by UK companies are dealt with under Article 6 of the Treaty (ie they are taxable in France if the company has a permanent establishment in France). As a general rule, simple ownership of real estate in France does not constitute a permanent establishment.

## Article 8 - International Transport

As regards income derived from international transport, Article 8 maintains the principle of exclusive taxation in the country in which the operator of the business is resident. Rail transport has been included within the scope of this Article. Further, it is also set out in Article 8 that the article applies to income derived from the hiring of unstaffed aircraft or from containers, when these operations are ancillary to international transport activities.

## Article 9 - Channel Tunnel

This article largely remains unchanged. It deals with the individual taxation of French and British concessions involved in the Channel Tunnel, in their own countries of residence.

## Article 10 - Associated Enterprises

In accordance with the OECD Model Treaty, this Article deals with transfer pricing issues between associated companies.

## Article 11 - Dividends

In accordance with the Current DTT, Article 11 of the new DTT sets out the principle that dividends should be taxable in the country in which their beneficiary is resident, subject to the source country having a right to apply withholding tax in certain cases.

In domestic French tax law, dividends paid to non-residents are subject to withholding tax at 25% or 18% in respect of dividends paid to individuals resident in an EU member State, Iceland or Norway (subject to tax treaty).

On application of the New DTT, French withholding tax may not exceed 15% of the gross amount of the dividend, provided that the person who receives the dividend is its effective beneficiary.

However, for dividends paid to holding companies (direct or indirect participation of at least 10%) the New DTT provides that only the country of residence of the effective beneficiary may tax, in line with EU law as of 2009. Hence, the New DTT provides for the total exemption from withholding tax of dividends paid by a company resident in France to a company resident in the UK which controls it.

The New DTT maintains a rate of 15% in other cases, particularly in respect of dividends paid to pension funds.

The definition of dividends is taken from the OECD Model Treaty. However, in order to provide clarity as regards the tax treatment applicable to disguised or occult distributions, the New DTT makes it clear that the definition of dividends covers income treated as a distribution by the tax law of the Contracting State of which the company making the distribution is a resident (income subject to the tax regime applicable to the distribution of benefits).

The New DTT also sets out specific codes regarding real estate funds.

An anti-abuse clause (paragraph 6) has also been included.

## **Article 12 - Interest**

This article concerns the taxation of interest and, largely, remains unchanged and provides that interest will be taxed exclusively in the country in which the effective beneficiary is resident. Article 12 of the New DTT now contains an anti-abuse clause.

## **Article 13 - Royalties**

Article 13 of the New DTT, like the Current DTT, provides for exclusive taxation of royalties in the country of residence of the effective beneficiary. However, the definition of "royalties" is considerably reduced in line with the OECD Model Treaty, since remuneration for the use or assignment of use of industrial, commercial or scientific work is excluded as are gains made from the sale or exchange of such assets. Any such payments will now be dealt with in accordance with Article 7 as business profits.

## **Article 14 - Capital Gains**

This Article sets out the regime applicable to capital gains. The principle is in line with the OECD Model Treaty and provides for taxation of real estate gains in the country in which the real estate is situated, including, as we have seen, when such gains are realised by a company.

From a French viewpoint, British real estate gains are also taxable in France, double taxation being avoided by application of a tax credit equal to the amount of the UK tax due.

Article 14 is completed by provisions which allow who, in particular France, is to apply its internal legislation to the sale of shares in companies, "partnerships" or trusts which are principally real estate holding entities, and allows such gains to be assimilated to real estate gains.

Gains from the alienation of movable property will in principle be taxable only in the country in which the seller is resident unless they can be related to a permanent establishment which this party has in a Contracting State.

The New DTT contains no provisions regarding substantial shareholdings, unlike Article 13.4 of the Current DTT which provides that the alienation of a substantial shareholding of 25% or more is to be taxable in the country in which the company whose shares were being transferred is resident, subject to certain conditions.

Paragraph 6 contains an anti-abuse provision which gives guarantees to both States that they may tax previous residents on gains that they made in the 6 years prior to their departure from the State in question.

## **Article 15 - Income from employment**

Article 15 concerns the taxation of salaried income and largely reflects the OECD Model Treaty. It is stated in paragraph 4 that the regime applicable to salaried employment is also applicable to the exercise of management or executive functions in certain companies mentioned in Article 62 of the French Tax Code (eg companies subject to French corporation tax).

## **Article 16 - Directors' fees**

The terms of this article are the same as those in the Current DTT and provide that directors' fees and similar payments derived by a resident of one of the Contracting States in his capacity as a member of the Board of Directors of a company which is a resident of the other Contracting State, may be taxed in that other State.

## **Article 17 - Artists and sportsmen**

Article 17 relates to artists and sportsmen and sets out the usual provisions in comparison with other tax treaties entered into by France. The article provides for income of artists and sportsmen to be

taxed non exclusively in the State in which the individual carries out his activity, including where income is paid to someone other than the artist or sportsman. However, when the activity is principally financed by public funds from a State in which the artist/sportsman is resident, then income arising will be taxable only in that State.

### **Article 18 - Pensions**

This article provides that pensions and other similar remuneration paid in consideration of past employment to a resident of a Contracting State should be taxable only in that State.

### **Article 19 - Government service**

Article 19 describes the tax regime applicable to remuneration and pensions due to an individual in respect of services rendered to one of the Contracting States. The article conforms to the OECD Model Treaty article by stating, in broad terms, that such income will be taxed exclusively in the Contracting State which makes the payment, subject to specific cases where the beneficiary of such income is a national of the State in which he resides.

### **Article 20 - Teachers and researchers**

Article 20 exempts from tax in the country in which the activities are exercised, payments made to an individual who visits one of the Contracting States for a period not exceeding two years for the purpose of teaching or engaging in research at an official recognised body. Remuneration paid to these individuals remains taxable during this period in their previous State of residence. However, where this State does not apply tax, the remuneration paid will be taxable in the State in which the activity is exercised.

### **Article 21 - Students**

Article 21 allows sums paid to students to be exempt from tax subject to certain conditions.

### **Article 22 - Offshore activities**

Article 22 repeats the provisions relating to activities carried out offshore, and which were set out in a protocol of 12 June 1996 to the Current DTT.

## **Article 23 - Other Income**

Article 23 concerns the tax regime applicable to income which has not been otherwise dealt with in the preceding articles of the New DTT. In accordance with the usual rule, such income, aside from income paid out of trusts or the estates of deceased persons, is to be taxable only in the country of residence of the beneficiary, when that person is the effective beneficiary, unless such income can be related to a permanent establishment which the beneficiary possesses in the other Contracting State.

The Article contains two anti-abuse clauses (paragraphs 3 and 4).

## **III. Means of avoiding double taxation**

### **Article 24 - Elimination of double taxation**

Article 24 sets out the means of eliminating double taxation.

France retains a combination of two methods currently used to avoid double taxation as regards income emanating from the UK and paid to a resident of France.

As far as company income is concerned, the New DTT maintains the principle of exemption in France as regards profits taxable only in the UK, to the extent that such profits are exempt from corporation tax on application of French domestic tax law.

In other cases, double taxation of income arising in the UK and paid to residents of France is eliminated by application of a tax credit applied to the French tax due, the amount of the tax credit depending on the type of income in question.

A tax credit equal to the amount of tax paid in the UK but limited to the amount of French tax attributable to the same income (where the UK tax exceeds French tax), applies in respect of the following income: benefits and gains realised by permanent establishments of corporate entities, dividends, capital gains from the alienation of real estate or from the transfer of shares in real estate holding companies, remuneration derived in respect of an employment exercised aboard a ship, aircraft or railway vehicle, remuneration paid to company directors and income paid to artists and sportsmen.

A tax credit equal to the amount of the French tax attributable to the income will apply to all other forms of income (provided that the resident of France is subject to UK tax in respect of such income).

On the UK side, the tax credit method also applies.

## IV. Various

### Article 25 - Non-discrimination

Article 25 comprises a non-discrimination clause as regards individuals and corporate entities.

As far as individuals are concerned, the non-discrimination clause in the New DTT is much more narrowly drawn. Under the Current DTT, nationals (ie British or French) may benefit from the non-discrimination clause even if they are not resident in France or in the UK.

This concerns, in particular, British nationals living in Monaco who, on application of the principles set out in the French Bisio case, may invoke the current non-discrimination clause in order to avoid income taxation in France on the basis of three times the letting value of any real estate used in France. When the New DTT comes into force, they will no longer be able to benefit from this protection and will potentially become liable to tax in France, unless the non-discrimination principles and principles of freedom of movement set out in the Treaty of Rome come to their assistance (see on this 04-2008 French Tax News on Article 164 C of the French Tax Code). Another solution may lie in the fact that case law recognises that non-discrimination clauses are to be read independently of the rest of the provisions of any DTT, and in particular independently of Article 1 which sets out that the treaty applies to residents of either of the two Contracting States. Taken on its own, Article 25 could, in fact, apply to nationals who are not residents of France or of the UK since it refers to nationals and not to residents alone.

Further, under certain conditions, paragraphs 6 and 7 of Article 25 will allow contributions made to a mandatory or complementary pension scheme to be deductible where paid by an individual resident in one State to pension scheme situated in another Contracting State.

### Article 26 - Mutual agreement procedure

Paragraph 5 makes it possible for taxpayers to take advantage of an arbitration process where the appropriate authorities in each of the two contracting States have not been able to come to some agreement two years after the case has been presented to the competent authority.

### Article 27 - Exchange of information

Article 27 allows for exchange of information between the two Contracting States. In accordance with this clause, exchange of information is no longer limited to the taxes covered by the New DTT, but to any tax whatsoever.

### Article 28 - Diplomatic and consular officials

Article 28 refers to the fiscal privileges of members of diplomatic missions and their personal domestic staff, or members of consular posts, and members of permanent missions to international organisations.

The provisions are in accordance with those set out in the OECD Model Treaty.

In particular, the New DTT states that the fiscal privileges which benefit these individuals will not be affected by the treaty.

### Article 29 - Miscellaneous rules

Article 29 sets out two special provisions designed to avoid double tax exemption which certain UK tax residents might benefit from on application of the UK remittance basis regime.

Article 29 provides that any tax relief which France may give in accordance with the New DTT will apply only to the part of income received which is effectively taxed in the UK (this rule does not apply in respect of business profits and dividends).

Further, an exemption from French wealth tax is implemented in connection with non French sited assets and as regards UK nationals who do not have French nationality and who take up residence in France, for the first five years following their installation in France. The same provision also figures in tax treaties in

force with various countries such as Germany, Austria, United States and Italy.

A similar provision already exists in domestic French legislation as regards any individual who transferred tax residence to France as of 6 August 2008, provided the individual was tax resident abroad for the previous five years. Unlike exemptions provided by other DTTs this provision applies also to French nationals.

## **Article 30 - Implementation of the treaty**

Article 30 sets out the mode of application of the New DTT. It also states the declarations or statements that any person claiming its benefits may be required to make to one of the Contracting States (notably as regards residence).

## **Articles 31 and 32 - Entry into force and termination**

The last articles of the New DTT deal with its entry into force in the usual way. The New DTT will enter into force as soon as each of the Contracting States has notified the other of the completion of the procedures required by law for the bringing into force of the treaty. This has not yet occurred.

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