PROTOCOL TO THE FRANCE-U.S. TAX TREATY ENTERS INTO FORCE

January 20, 2010

To Our Clients and Friends:

On December 23, 2009, the protocol to the existing France-U.S. income tax treaty signed on January 13, 2009 (the "Protocol") entered into force, following ratification by both France and the United States. We have briefly described below the most significant changes made to the treaty by the Protocol.

RESIDENCE

The Protocol modifies the residency rules for certain French investment vehicles and fiscally transparent entities:

- Automatic French tax residence is granted to SIICs (*sociétés d'investissements immobiliers cotées*) and SPPICAVs (*sociétés de placement à prépondérance immobilière à capital variable*), which are French real estate investment vehicles.
- The Protocol modifies the rules applicable to fiscally transparent entities. Income derived through a fiscally transparent entity established in France, the U.S. or a third country will generally be treated as derived by a resident of France or the U.S. to the extent such income is treated as income of the resident by the country of residence, provided that, in the case of income derived through an entity established in a third country, such country has signed an exchange of information agreement with the source country. This additional requirement for entities established in a third country is a departure from other U.S. tax treaties and the prior France-U.S. income tax treaty in the case of U.S. source income.
- The Protocol clarifies that, for purposes of the above rule, a "French qualified partnership," which encompasses French partnerships (*sociétés de personnes*) that meet certain requirements, will be treated as fiscally transparent with respect to income paid from the U.S.

DIVIDENDS

A zero rate of withholding is introduced for dividends paid by a subsidiary to a parent company, provided that:

- the parent company has owned, directly or indirectly, 80% or more of the voting power of the subsidiary (in the case of the U.S.) or the share capital of the subsidiary (in the case of France) for the 12-month period ending on the date the dividend is declared; and
- the parent company satisfies certain requirements under the LOB provision or obtains a competent authority determination.

The reduced withholding tax rates on other dividends are maintained at 5% if the recipient is a 10% corporate shareholder and 15% in all other cases. Special rules apply to dividends paid by certain specific vehicles, such as French SICAVs, SIICs or SPPICAVs, or U.S. REITs or RICs.

BRANCH PROFITS TAX

An exemption from branch profits tax is introduced, subject to the satisfaction of the same LOB provision requirements or competent authority determination applicable to the dividend withholding tax exemption; otherwise, the rate continues to be 5%.

ROYALTIES

The Protocol eliminates withholding tax on cross-border royalty payments. Formerly, the rate was 5%.

LIMITATION ON BENEFITS

The Protocol generally strengthens the LOB provision and tightens the eligibility for treaty benefits. In particular:

- The Protocol imposes heightened restrictions on the application of the publicly traded test and the ownership/base erosion test. The active trade or business test is also modified.
- The Protocol eliminates the headquarters company test and the alternative ownership test for companies. Instead, the Protocol introduces a new "equivalent beneficiaries" test that allows a company that is a resident of France or the U.S. to be eligible for treaty benefits if (i) at least 95% of its shares are owned by no more than seven "equivalent beneficiaries" (i.e., residents of an E.U. member state or a country that is a party to NAFTA that meet certain conditions) and (ii) a base erosion test is met.

Existing structures should be carefully reviewed in light of the new LOB provision, as they will be tested under this new provision from the date the Protocol becomes effective.

BINDING ARBITRATION

The Protocol provides for an arbitration procedure when the competent authorities are unable to agree on the elimination of double taxation under the mutual agreement procedure within a two-year period, and certain other conditions are met. This new arbitration procedure is available for cases under consideration as of, as well as for cases arising after, the entry into force of the Protocol. The arbitration decision is binding on France and the U.S. if the decision is accepted by the taxpayer.

The France-U.S. income tax treaty is the first tax treaty signed by France with a mandatory binding arbitration provision; the U.S. has recently entered into three tax treaties (with Belgium, Germany and Canada) containing such a provision. The rules and procedures relating to arbitration are further detailed in a Memorandum of Understanding signed with respect to the Protocol.

EXCHANGE OF INFORMATION

This clause has been updated and generally follows the corresponding parts of the OECD model tax treaty. We note that the scope of the exchange of information clause has been widened: in addition to not being limited to treaty residents, it is no longer restricted to taxes covered by the treaty. Moreover, a state cannot decline to supply information solely on the basis of bank secrecy.

EFFECTIVE DATE

The changes affecting the withholding tax provisions are applicable to payments made on or after January 1, 2009. The other changes are effective as of January 1, 2010.

Please feel free to contact us with any questions.

Paris

Pierre-Pascal Bruneau
+33 1 40 73 13 35
ppbruneau@debevoise.com

Eric Bérengier
+33 1 40 73 12 70
eberengier@debevoise.com

New York

Gary Friedman
+1 212 909 6261
gmfriedman@debevoise.com

London

Cécile Beurrier
+44 20 7786 9146
cbeurrier@debevoise.com