

---

PROTOCOL AMENDING THE ESTATE, INHERITANCE, AND  
GIFT TAX CONVENTION WITH FRANCE (TREATY DOC.  
109-7)

---

MARCH 27, 2006.—Ordered to be printed

---

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

REPORT

[To accompany Treaty Doc. 109-7]

The Committee on Foreign Relations, to which was referred the Protocol Amending the Convention Between the United States of America and the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates, Inheritances, and Gifts, 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.

CONTENTS

	Page
I. Purpose .....	1
II. Background .....	2
III. Summary .....	2
IV. Entry Into Force .....	2
V. Committee Action .....	3
VI. Committee Comments .....	3
VII. Budget Impact .....	5
VIII. Explanation of Proposed Protocol .....	5
IX. Text of Resolution of Advice and Consent to Ratification .....	6

I. PURPOSE

The principal purpose of the estate, inheritance, and gift tax treaty between the United States and France<sup>1</sup> and the proposed

---

<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 Estates, Inheritances, and Gifts, signed at Washington on November 24, 1978.

protocol is to reduce or eliminate double taxation in connection with estate, inheritance, and gift taxes. One of the general principles of the treaty and the proposed protocol is that the country in which a donor or decedent was domiciled may tax the estate or gifts of that individual on a worldwide basis, but must credit tax paid to the other country with respect to certain types of property located in such other country. Specifically, immovable property, certain business assets, and partnership interests attributable to such property are taxable in the country in which such property is situated.

## II. BACKGROUND

The proposed protocol was signed at Washington on December 8, 2004. It would amend the U.S.-France estate, inheritance, and gift tax treaty, which was signed at Washington on November 24, 1978.

The proposed protocol was transmitted to the Senate for advice and consent to its ratification on November 4, 2005 (see Treaty Doc. 109-7). The Committee on Foreign Relations held a public hearing on the proposed protocol on February 2, 2006.

## III. SUMMARY

The proposed protocol would make several updates and other modifications to the treaty. Among other updates, the proposed protocol would add a "saving clause," which would protect the right of the United States to apply its estate and gift tax rules to U.S. citizens, as well as to certain former U.S. citizens and long-term residents.

The proposed protocol also would provide a pro rata unified credit to the estate of an individual domiciled in France (other than a U.S. citizen) for purposes of computing the U.S. estate tax due. An estate eligible for this provision would be entitled to a portion of the full, generally applicable credit, based on the ratio of the value of the estate's U.S.-situated assets to the value of its worldwide assets.

In addition, the proposed protocol would provide a limited U.S. estate tax marital deduction in cases in which the surviving spouse is not a U.S. citizen. This provision would apply in the case of certain small estates. The proposed protocol also would add new limits to the situs-based taxation of certain inter-spousal transfers of non-community property.

## IV. ENTRY INTO FORCE

The proposed protocol will enter into force upon the exchange of instruments of ratification and would have effect with respect to deaths occurring and gifts made after that date.

A special retroactive effective date applies with respect to the provisions of the proposed protocol relating to the pro rata unified credit and the limited U.S. estate tax marital deduction. The proposed protocol provides that these provisions would have effect with respect to deaths occurring and gifts made after November 10, 1988, notwithstanding any limitation imposed under internal law on the assessment, reassessment, or refund with respect to a person's or estate's return, and provided that any return or claim for

refund asserting the benefits of the proposed protocol is filed before the date that is one year after the first day of the second month following the date on which the proposed protocol enters into force, or within the otherwise applicable period for filing such claims under internal law.

Additionally, the saving clause applies to any such claim for refund. Where an estate, prior to entry into force of the proposed protocol, was allowed a marital deduction for a transfer to a qualified domestic trust under Internal Revenue Code section 2056A(d), such estate may elect to treat the qualified domestic trust as if it had never been established in order to claim the benefits of paragraph 3 of Article 11 or paragraph 3 of Article 12, as long as it does so within the time for filing a claim for refund referred to above. Where such an election is made, the property is treated as having been transferred to the surviving spouse at the time of the decedent's death for all purposes of the treaty.

#### V. COMMITTEE ACTION

The Committee on Foreign Relations held a public hearing on the proposed protocol with France (Treaty Doc. 109–7) 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.

##### 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 protocol. Under U.S. 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.

---

<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>.

The saving clause of the proposed treaty 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 this language would include “the irrebuttable presumptions based on average annual net income tax liability and net worth under section 877 [of the Internal Revenue Code],” and 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.

#### VII. BUDGET IMPACT

The committee has been informed by the staff of the Joint Committee on Taxation that it has assessed the likely budget impact of the proposed protocol to the estate, inheritance, and gift tax treaty between the United 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 Estate, Inheritance, and Gift Tax Treaty Between the United States and France (JCX–3–06)*, 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 the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates, Inheritances, and Gifts of November 24, 1978, signed at Washington on December 8, 2004 (Treaty Doc. 109–7).

