

February 2011



The new tax treaty between France and the UK came into force on 18/12/2009. It is applicable in France for the tax year starting 1/1/2010 and in the UK for the tax year starting 6/4/2010.

RE: INTERNATIONAL TAX TREATIES SUBJECT: NEW UK-FRANCE DOUBLE TAXATION AGREEMENT

We take a look here, article by article, at the significant changes introduced by the new treaty from 2010.

Many things remain unchanged from the previous treaty, including:

- ▶ Residence tie break rules;
- ▶ Taxation in the country of origin of government pensions, property income or business profits;
- ▶ Taxation in the country of residence of interest, dividends, royalties or capital gains on securities.

The main changes actually result from the new method of elimination of double taxation in France on income taxable in the UK (Art 24). A tax credit corresponding either to the French tax or to the UK tax, depending on the nature of the income, now applies. This is less favourable than the previous exemption with progression method (*règle du taux effectif*). You will see that it also closed certain loopholes on UK properties' gains or airline pilots' salaries.

TAXES COVERED

Art 2 §1 exhaustively defines the UK taxes covered by the treaty as income tax, corporation tax and capital gains tax.

On the other hand, the French tax list is longer and not exhaustive. It includes notably the *Contribution Sociale Généralisée* (CSG) and *Contribution au Remboursement de la Dette Sociale* (CRDS), which did not exist when the 1968 treaty was drawn up. Wealth tax is not covered by the double taxation treaty as it does not exist in the UK. A general definition of French taxes provides that all taxes collected by the State and the local authorities are covered by the treaty.

PARTNERSHIPS

Art 4 §4 provides that a French partnership or civil company (*société de personne transparente*) can be resident for the purposes of the treaty. § 5 solves problems of qualification of profits as income of the partners or income of the partnership for 6 different scenarios and states whether the income is eligible for the benefits of the convention or not.

REAL ESTATE INCOME

Art 6 §5 provides that income derived from a property held via a company, a partnership or a trust qualifies as property income. This addition is in line with French practice and

enables income derived from a property owned personally or via a legal entity to be taxed in the same way.

BUSINESS INCOME

Art 7 §7 provides that when business profits include income or gains (real estate gains for instance) especially covered by another article of the tax treaty, the provisions of the other article are applicable. This provision, together with Art 14 providing for taxation of real estate gains in the country where the property is located, closes a loophole in the current treaty which, in the right circumstances, enables a UK company with no permanent establishment in France to escape French tax on French property gains as exempt business profits (Hallminster jurisprudence).

DIVIDENDS

Art 11

The 15% withholding tax does not apply to dividends paid to a mother company (10% shareholding minimum).

§5 provides that when a person owns more than 10% of the share capital of a real estate investment structure, income distributions are subject to a retention tax at source as per domestic law. This new clause aims to avoid the country where a property is located losing its right to tax the property income because of the interposition of a real estate company.

CAPITAL GAINS

Art 14 § 6 provides that each country may tax the gains of an individual who has been resident at any time during the 6 tax years before the sale of an asset. This paragraph aims to allow for the application of UK domestic law to gains by persons who were previously UK residents, as per the UK 'exit tax' system. Although the exit tax no longer exists in France, the bilateral character of this clause nevertheless protects the future.

INCOME FROM EMPLOYMENT

Art 15 § 4 clarifies the wording 'salaried employment' to include in particular management and executive functions (*gerance* or *direction*) other than those of member of a board of director covered by article 16 re Director's fees (*jetons de presence*). Income from employment is taxable where the activity is carried out, while director's fees are taxable in the country where the company is resident.



WEALTH TAX EXEMPTION OF FOREIGN ASSETS

Tax treaties with Germany, Austria, Canada, Spain, USA, Italy and now UK provide for an exemption of foreign assets for wealth tax purposes. This partial exemption from wealth tax has been generalized by article 121 of the Loi de Modernisation de l'Economie to anyone, irrespective of nationality, who has relocated to France since 6th August 2008, provided they were non residents for a period of at least 5 years.

TRUST INCOME

Art 23 §1 provides that income paid out of trusts is excluded from the benefit of the double taxation agreement. This aims to preserve the UK right to tax trust income at source, while the right of France to tax such income is not questioned.

ELIMINATION OF DOUBLE TAXATIONS

Art 24 §3 provides that double taxation of UK-source income is eliminated in France by a tax credit equal either to the French tax or the UK tax, depending on the nature of the income.

This is less favourable than the previous exemption with progression method (*règle du taux effectif*).

It closes 1968 treaty's loopholes for owners of UK properties or airline pilots notably, where the UK income could largely escape tax on both sides of the Channel.

Remunerations of employment carried out in the UK, salaries paid by a UK airline company, UK company directors' fees or UK property capital gains received by a resident of France, previously regarded as exempt in France, will now be treated as fully taxable in France with a tax credit equivalent to the tax paid in the UK, limited to the amount of French tax.

On the other hand, UK rental income or government pensions (taxable in the UK by treaty) will be treated as taxable in France with a tax credit equal to the amount of the French tax, provided the resident of France is subject to UK tax in respect of such income.

Moreover, while under the exemption with progression previous method, the exempt income was taken into account after deduction of UK tax, the UK tax cannot be deducted from the income with the tax credit method.

On the UK side, the double taxation of French source income is eliminated via a tax credit equal to the French tax.

NON DISCRIMINATION CLAUSE

Under **Art.25**, the non discrimination clause applies only for nationals resident in either France or the UK, but not elsewhere in the world as under the previous treaty.



PARTIAL EXEMPTION FROM WEALTH TAX

Under Art.29 §3 British nationals who are not also French nationals are liable for wealth tax on their French located assets only, all assets outside of France being exempt, for the first 5 full years after becoming a resident of France, provided they have not been resident of France during the previous 3 years.

TERRITORIES COVERED

Protocol §2 expressly excludes the Channel Islands, the Isle of Man, Gibraltar, the UK Sovereign base areas in Cyprus and any other overseas country or territory having special relations with the UK from the benefits provided by the treaty. This exclusion was only implicit in the 1968 treaty.

CLAUSES OF NULLITY AGAINST ABUSIVE USE OF THE TREATY

Each of the articles relating to dividends, interest, royalties and other income provides that the benefit of the treaty will be refuted if the main purpose - or one of the main purposes - of the beneficiary of the income is to take undue advantage of the rules established by the article.

Taxation is a complex subject.

Full independent advice on the particular facts of a case should be sought.

Kindly note that our firm provides fiscal counsel only to clients for whom we prepare regular tax declarations.