DEPARTMENT OF THE TREASURY
TECHNICAL EXPLANATION OF THE PROTOCOL BETWEEN THE UNITED STATES OF AMERICA AND THE FRENCH REPUBLIC SIGNED AT WASHINGTON ON DECEMBER 8, 2004 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 NOVEMBER 24, 1978

Introduction

This is a technical explanation of the Protocol signed at Washington on December 8, 2004 (the "Protocol"), which amends 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 November 24, 1978 (the "Convention").

This Technical Explanation is an official guide to the Protocol. It explains policies behind particular provisions, as well as understandings reached during the negotiations with respect to the interpretation and application of the Protocol. This technical explanation is not intended to provide a complete guide to the Convention as amended by the Protocol. To the extent that the Convention has not been amended by the Protocol, the Technical Explanation of the Convention remains the official explanation. References in this technical explanation to “he” or “his” should be read to mean “he or she” or “his or her.”

Article I

Article I of the Protocol amends Article 1 (Estates and Gifts Covered) of the Convention by adding a “saving” clause as new paragraph 4. Pursuant to the saving clause, the United States reserves its rights, subject to certain exceptions, to tax certain estates or donors as provided in its internal laws, notwithstanding any provisions of the Convention to the contrary.

First, the United States reserves the right to tax under its domestic law the estate or gift of a U.S. citizen. The United States also retains the right to tax the estate of a decedent or the gift of a donor who, at the time of his death or at the making of the gift, was domiciled (within the meaning of Article 4 (Fiscal Domicile) of the Convention) in the United States. Finally, the

United States retains the right to tax the estate of a decedent or the gift of a donor who, at the time of his death or at the making of the gift, was a former citizen or long-term resident of the United States whose loss of such status had as one of its principal purposes the avoidance of tax, but only for a period of 10 years following such loss.

The provision regarding former citizens and long-term residents is consistent with the United States' reservation of its taxing rights provided for in sections 877, 2107, and 2501(a)(3) and (5) of the Internal Revenue Code. The Protocol provides that 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, which would include, for example, the irrebuttable presumptions based on average annual net income tax liability and net worth under section 877.

Section 877 of the Internal Revenue Code provides for special tax treatment of former U.S. citizens and long-term residents who gave up their citizenship or long-term resident status to avoid U.S. tax. Prior to its amendment by the American Jobs Creation Act of 2004 (AJCA), section 877 applied to individuals that relinquished U.S. citizenship or terminated long-term residency with a principal purpose (i.e., subjective intent) of tax avoidance. An individual was generally presumed to have a tax avoidance purpose if their net worth or average annual net income tax liability exceeded specified thresholds.

The AJCA replaced the subjective determination of tax avoidance as a principal purpose for relinquishment of citizenship or termination of residency with objective rules. Former citizens or long-term residents are now subject to U.S. tax for the 10-year period following loss of such status, unless they fall below certain net income and net worth thresholds or satisfy certain limited exceptions for dual citizens and minors who have had no substantial contact with the U.S.

Thus, section 877 now treats individuals who expatriate and meet the objective tests as having expatriated for tax avoidance purposes. Accordingly, the objective tests in section 877 represent the administrative means by which the United States determines whether a taxpayer has a tax avoidance purpose for purposes of the reservation of taxing rights contained in paragraph 4(a)(iii) of the Convention.

Some provisions of the Convention and Protocol are intended to provide benefits to citizens and residents even if such benefits do not exist under internal law. Article I of the Protocol sets forth certain exceptions to the saving clause that preserve certain obligations of the United States under the Convention. For example, the saving clause will not override the obligation of the United States, in accordance with Article 12 (Exemptions and Credits), to credit taxes paid to France on either a domiciliary or a situs basis.

Article I of the Protocol also provides that the saving clause shall not affect the benefits conferred by the United States under Article 10 (Charitable Exemptions and Deductions), relating to deductions for contributions to charitable organizations, paragraph 2 of Article 11, relating to the marital exclusion for interspousal transfers of certain types of noncommunity property, Article 13 (Time Limitations on Claims for Credit or Refund), Article 14 (Mutual Agreement Procedure), or Article 17 (Diplomatic and Consular Officials).

Finally, Article I of the Protocol also provides that the saving clause shall not affect the benefits conferred by the United States under paragraph 3 of Article 11, relating to a limited estate tax marital deduction when property passes to a spouse who is not a United States citizen. This exception to the saving clause does not apply, however, to former U.S. citizens or long-term residents whose loss of citizenship or residence status had as a principal purpose the avoidance of tax, for a period of 10 years following such loss.

Article II

Article II of the Protocol replaces paragraph 2 of Article 3 (General Definitions) of the Convention and provides that any term not otherwise defined in the Convention shall, unless the context otherwise requires or the competent authorities agree to a common meaning, have the meaning which it has under the law of the Contracting State for the purposes of the taxes to which the Convention applies. The amendment also makes clear that any meaning under the tax laws of such Contracting State will prevail over a meaning given under other laws of that state.

Article III

Article III of the Protocol replaces Article 5 of the existing Convention. Paragraph 1 provides that real property may be taxed in a Contracting State if such property is situated in that State. This is a primary, but not exclusive, taxing right. Nothing in the Convention, for example, precludes the United States from taxing the transfer of French situs real property by an individual domiciled, for purposes of the Convention, in the United States, provided the United States allows a credit for the French tax. Paragraph 4 provides that the rules of paragraph 1 apply to real property of an enterprise and to real property used for the performance of independent personal services. That is, real property may be taxed by the State where it is located, even if different from where the enterprise is located or where the independent personal services are performed.

According to paragraph 2, the term “real property” is defined in accordance with the laws of the Contracting State in which such property is situated, but it does not include claims secured by real property (such as mortgages). In the case of the United States, the term "real property" has the meaning given to it by Treas. Reg. section 1.897-1(b). Consistent with section 1.897-1(b), paragraph 2 provides that the term "real property" shall include: property accessory to real property; livestock and equipment used in agriculture and forestry; rights to which the provisions of general law respecting landed property apply; usufruct of real property; and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources. Paragraph 2 also provides that ships and aircraft are not regarded as real property.

Pursuant to paragraph 3, the term “real property” also includes shares, participations and other rights in a company or legal person at least 50 percent of the assets of which consist, directly or indirectly, of real property situated in one of the Contracting States or of rights pertaining to such property. Such shares, participations and other rights are considered to be situated in the Contracting States where the real property is located. Thus, this provision encompasses real property interests other than the real property itself, so that taxation in the Contracting State in which the property is situated cannot be avoided by holding real property indirectly.

Article IV

Under Article 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Based Used for the Performance of Professional Services) of the Convention, except as provided in Article 5 (Real Property), and with the exception of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, assets forming part of the business property of a permanent establishment of an enterprise may be taxed by a Contracting State if the permanent establishment is situated in that State.

Paragraph 2 of Article 6 of the Convention defines the term “permanent establishment” as a fixed place of business through which the business of an enterprise is wholly or partly carried on. Article IV of the Protocol amends the last sentence of paragraph 2 by changing the phrase “partnership or other association that is not a corporation” to “partnership or other similar pass-through entity.” The revision takes account of 1996 changes in entity classification regulations by the United States and makes clear that an individual member of any type of pass-through entity which is engaged in industrial or commercial activity through a fixed place of business will also be deemed to have been so engaged to the extent of his interest therein.

Article V

Under paragraph 1 of Article 10 (Charitable Exemptions and Deductions) of the Convention, a transfer to a legal entity created or organized in a Contracting State is exempt from tax, or fully deductible from the gross value liable to tax, in the other Contracting State, with respect to taxes referred to in Article 2 (Taxes Covered), if the transfer would be eligible for such exemption or deduction if the legal entity had been created or organized in the other Contracting State. Under paragraph 2, the provisions of paragraph 1 apply only if the legal entity to which property is transferred (a) has tax exempt status in the State in which it is created or organized by reason of which transfers to it are exempt or fully deductible from the taxes described in Article 2; (b) is organized and operated exclusively for certain enumerated purposes; and (c) receives a substantial part of its support from contributions from the public or from government funds.

Article V of the Protocol amends paragraph 2(b) of Article 10 to add “cultural” to the list of enumerated exclusive purposes for which the legal entity must be organized and operated. Thus, a transfer to a legal entity created or organized in France is exempt from tax, or fully deductible from the gross value liable to tax, in the United States, with respect to the taxes referred to in Article 2 if the French entity is organized and operated exclusively for the same purposes as a U.S. charity generally exempt from tax under section 501(c).

Article VI

Marital Exclusion

Paragraph 1 of Article VI of the Protocol amends paragraph 2 of Article 11 (Community Property and Marital Deduction) of the Convention, which provides rules for determining the marital deduction allowed for transfers by a French domiciliary. The amendment obligates the United States to give a marital deduction for interspousal transfers of noncommunity property from domiciliaries of France to a spouse who is not a U.S. citizen. It provides that noncommunity property that may be taxed by the United States solely on the basis of situs (i.e., under Article 5 (Real Property), Article 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Based Used for the Performance of Professional Services), or Article 7 (Tangible Movable Property)) may be included in the taxable base of the United States only to the extent its value (taking into account any applicable deductions) exceeds 50 percent of the value of all the property which may be taxed by the United States. Thus, noncommunity property taxable in the United States under these Articles transferred from a French domiciliary to a spouse who is not a U.S. citizen may be taxed by the United States only to the extent it exceeds 50 percent of the net value of all property which may be taxed by the United States.

The marital deduction provided for by this amendment does not apply to a United States citizen domiciled in France or a former citizen or long-term resident of the United States whose loss of such status had as one of its principal purposes the avoidance of tax (as defined under United States law), but only for a period of 10 years following such loss. As a result, the United States is not obligated to provide the benefits of new paragraph 2 of Article 11 of the Convention to the estate of or a gift made by such a person. For example, a United States citizen who is domiciled in France under French law could, for purposes of the Convention, be determined to have his fiscal domicile in France under the tie-breaking rules of paragraph 2 of Article 4 (Fiscal Domicile). As a result of Article VI of the Protocol, the United States is not required to provide the marital exclusion of new paragraph 2 of Article 11 of the Convention with respect to interspousal transfers from that U.S. citizen to a spouse who is not a U.S. citizen. (If the spouse is a U.S. citizen, the transfer might be eligible for the unlimited marital exclusion provided under U.S. law).

Marital Deduction

Article VI of the Protocol also renumbers existing paragraph 3 of Article 11 as paragraph 4, and adds a new paragraph 3. New paragraph 3 allows a marital deduction in connection with transfers satisfying each of five conditions. First, the property transferred must be "qualifying property." Second, the decedent must have been, at the time of death, domiciled in either France or the United States, or a citizen of the United States. Third, the surviving spouse must have been, at the time of the decedent's death, domiciled in either France or the United States. Fourth, if both the decedent and the surviving spouse were domiciled in the United States at the time of the decedent's death, at least one of them must have been a citizen of France. Finally, in order to limit the benefits of new paragraph 3 to relatively small estates, the executor of the decedent's estate is required to elect the benefits of new paragraph 3 and to waive irrevocably the benefits of any estate tax marital deduction that would be allowed under U.S. domestic law, on a U.S. Federal estate tax return filed by the deadline for making a qualified domestic trust election under Internal Revenue Code section 2056A(d). In the case of the estate of a decedent for which the U.S. Federal estate tax return is filed on or before the date on which this Protocol enters into force, this election and waiver must be made on any return filed to claim a refund pursuant to the special effective date applicable to such estates (discussed below with respect to Article IX of the Protocol).

In order for property to be "qualifying property," it must pass to the surviving spouse (within the meaning of U.S. domestic law) and be property that would have qualified for the estate tax marital deduction under U.S. domestic law if the surviving spouse had been a U.S. citizen and all applicable elections specified by U.S. domestic law had been properly made. Because one of the requirements for property to qualify for the marital deduction under U.S. domestic law is that the property be included in determining the value of the gross estate, property will not qualify for the marital deduction of new paragraph 3 to the extent the property is excluded from the decedent's gross estate by reason of paragraph 2 of Article 11 of the Convention. The second example under Article VII of the Protocol (below) illustrates the interaction of the two provisions.

The amount of the marital deduction allowed under new paragraph 3 of Article 11 of the Convention equals the lesser of (i) the value of the qualifying property, or (ii) the "applicable exclusion amount" (within the meaning of the law of the United States, determined without regard to any gift previously made by the decedent). The "applicable exclusion amount" is determined under section 2010 of the Internal Revenue Code with respect to the year in which the decedent dies. For decedents dying in 2004 or 2005, the applicable exclusion amount for estate tax purposes is $1,500,000. The applicable exclusion amount under section 2010 is scheduled to increase to $2,000,000 for estates of decedents dying during 2006, 2007, or 2008, and to $3,500,000 for estates of decedents dying in 2009.) Estates of decedents dying during 2010 are not subject to the estate tax. However, under a "sunset" provision effective January 1, 2011, this one-year "repeal" of the estate tax terminates and the applicable exclusion amount reverts to $1,000,000 for estates of decedents dying after the year 2010.

In certain cases, the provisions of new paragraph 3 may affect the U.S. estate taxation of a trust that would meet the requirements for a qualified terminable interest property ("QTIP") election (for example, a trust with a life income interest for the surviving spouse and a remainder interest for other family members) or a qualified domestic trust ("QDOT") election. If, in lieu of making the QTIP election or the QDOT election, the decedent's executor makes the election described in new subparagraph 3(b), the provisions of Internal Revenue Code sections 2044 (regarding inclusion in the estate of the second spouse of certain property for which the marital deduction was previously allowed), 2056A (regarding qualified domestic trusts), and 2519 (regarding dispositions of certain life estates) will not apply. To obtain this treatment, however, the executor is required, under new paragraph 3, to irrevocably waive the benefit of any marital deduction allowable under the Internal Revenue Code with respect to the trust.

Article VII

Article VII of the Protocol replaces Article 12 (Exemptions and Credits) of the existing Convention. Under paragraph 1, each Contracting State is required, except as otherwise provided in the Convention, to impose its tax, and to allow exemptions, deductions, credits, and other allowances, in accordance with its own internal laws.

Paragraph 2 provides specific rules for relieving double taxation. Paragraph 2(a) applies when France imposes tax on the basis of the domicile (as determined under Article 4 (Fiscal Domicile)) of the decedent or donor. Under paragraph 2(a), France will tax the entire property comprising the estate or the gift, but must allow a deduction from that tax (i.e., a credit) for any U.S. tax imposed in accordance with the Convention (e.g., in accordance with Article 5 (Real Property), Article 6 Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Based Used for the Performance of Professional Services), Article 7 (Tangible Movable Property), or the saving clause of paragraph 4 of Article 1 (Estates and Gifts Covered)) upon the transfer of any property in relation to the same event. Such deduction, however, shall not exceed that part of the French tax (computed before any deduction is made) attributable to the property in respect of which the deduction is to be allowed.

Under French law, the rates of the inheritance and gift tax are determined on the basis of the proximity of relationship between the deceased or the donor and the beneficiary or the donee. In general, graduated rates are imposed where there is a close proximity of relationship and flat rates are imposed where there is not a close proximity. Where the amount of the French tax is computed by applying graduated rates, France must allow a deduction for any U.S. tax imposed in accordance with the Convention, up to the amount computed by multiplying the taxable net value of the property in respect of which the deduction is to be allowed by the ratio of the French tax actually payable on the total property taxable in accordance with French law to the net value of that total property. In other words, the upper limit on the deduction France must allow is computed by multiplying the amount of the property also subject to U.S. tax by the average rate of French tax actually payable on all the property comprising the estate or the gift. Where the amount of the French tax is computed by a applying a flat rate, however, the upper limit on the deduction France must allow is computed by multiplying the amount of the property also subject to U.S. tax by the rate actually applicable to the property in respect of which the deduction is to be allowed.

Under paragraph 2(a)(iii), the taxes for which France must allow a deduction, as described above, include the United States Federal estate and gift tax, except where such taxes are imposed solely pursuant to the saving clause of paragraph 4 of Article 1 (Estate and Gifts Covered). In addition, where the United States imposes its tax on the basis of situs, France is obligated to allow a deduction for such tax (subject to the limitations discussed earlier) only if the decedent (at the time of his death) or the donor (at the time of the gift) was a United States citizen and the tax is actually paid.

Under paragraph 2(b)(i), where both States impose a tax with respect to property which is taxable by France in accordance with Articles 5, 6, or 7, the United States must allow a credit equal to the amount of the tax imposed by France with respect to such property. Under paragraph 2(b)(ii), if a decedent or donor was a citizen of the United States at the time of his death or the making of a gift, and such person is considered under Article 4 as having been domiciled in France, the United States must allow a credit equal to the amount of the tax imposed by France, net of any deduction from tax allowed under paragraph 2(a). In addition, if the United States includes property in a decedent's estate solely because he was a former citizen or long-term resident of the United States whose loss of such status (within 10 years of the date of death) had as one of its principal purposes the avoidance of tax, the United States must allow a credit equal to the amount of the tax imposed by France in respect of all such property. Under paragraph 2(b)(iii), notwithstanding the provisions of paragraph 2(b)(i) and (ii), the total amount of all credits allowed by the United States pursuant to Article 12 or pursuant to its own laws or other conventions with respect to all property in respect of which a foreign tax credit is allowable under paragraph 2(b)(i) and (ii) is not to exceed that part of the United States tax which is attributable to such property. The part of the tax deemed to be so attributable is to be determined in accordance with the principles of section 2014(b)(2) of the Code and section 20.2014-3 of the Estate Tax Regulations.

Pro Rata Unified Credit

Paragraph 3 grants a "pro rata" unified credit to the estate of a decedent (other than a United States citizen) domiciled in France for purposes of computing the U.S. estate tax. Provisions similar to this and the marital deduction against U.S. estate tax in respect of certain transfers to a surviving spouse (discussed above as new paragraph 3 of Article 11 (Community Property and Marital Deduction) of the Convention, added by Article VI of the Protocol) were included in the Third Protocol to the U.S.-Canada Income Tax Treaty and the Protocol to the U.S.-Germany Estate, Inheritance, and Gift Tax Treaty.

Under the Internal Revenue Code, the estate of a nonresident not a citizen of the United States is subject to U.S. estate tax only on its U.S. situs assets and is entitled to a unified credit of \$13,000, while the estate of a U.S. citizen or U.S. resident is subject to U.S. estate tax on its entire worldwide assets and is entitled to a unified credit in an amount determined under Internal Revenue Code section 2010. For decedents dying in 2004 or 2005, the unified credit under section 2010 for estate tax purposes is \$555,800. The unified credit under section 2010 for estate tax purposes is scheduled to increase to \$780,800 for estates of decedents dying during 2006, 2007, or 2008, and to \$1,455,800 for estates of decedents dying in 2009. As noted earlier, estates of decedents dying during 2010 are not subject to the estate tax. Pursuant to a "sunset" provision, this one-year repeal of the estate tax terminates and the unified credit reverts to \$345,800 for estates of decedents dying after the year 2010. A lower unified credit is provided for the estate of a nonresident not a citizen because it is assumed that such estates generally will hold fewer U.S. situs assets, as a percentage of the estate's total assets, and thus will have a lower U.S. estate tax liability.

Subject to certain limitations, the pro rata unified credit provisions of paragraph 3 increase the credit allowed to the estate of a non-U.S. citizen domiciled in France to an amount between $13,000 and the unified credit available to a U.S. citizen, to take into account the extent to which the assets of the estate are situated in the United States. Paragraph 3 also provides that the amount of the unified credit allowed to the estate of a non-U.S. citizen decedent domiciled in France will in no event be less than the $13,000 allowed under the Internal Revenue Code to the estate of a nonresident not a citizen of the United States (subject to the adjustment for prior gift tax unified credits, discussed below). Paragraph 3 does not apply to the estates of U.S. citizen decedents, whether resident in France or elsewhere, because such estates receive the unified credit under section 2010 of the Internal Revenue Code.

Subject to the adjustment for any gift tax unified credit previously allowed against gift tax liability, the pro rata credit allowed under paragraph 3 is determined by multiplying the unified credit available to a U.S. citizen under section 2010 of the Internal Revenue Code for the year in which the decedent dies (e.g., $555,800 in 2004 or 2005) by a fraction, the numerator of which is the value of the part of the gross estate situated in the United States and the denominator of which is the value of the entire gross estate wherever situated. Thus, if a non-U.S. citizen domiciled in France died in 2005 and half of his entire gross estate (by value) were situated in the United States, the estate would be entitled to a pro rata unified credit of $277,900 (provided that the U.S. estate tax due is not less than that amount). The entire gross estate wherever situated (i.e., the worldwide estate, determined under U.S. domestic law) is to be taken into account in computing the denominator. For purposes of computing the numerator, an estate's assets will be treated as situated in the United States if they are so treated under U.S. domestic law. However, an estate's assets will not be treated as situated in the United States for purposes of this computation if the United States is precluded from taxing them by reason of obligations elsewhere in the treaty.

Paragraph 3 restricts the availability of the pro rata unified credit in two respects. First, the amount of the unified credit otherwise allowable under paragraph 3 is reduced by the amount of any unified credit previously allowed against U.S. gift tax imposed on any gift by the decedent. This rule reflects the fact that, under U.S. domestic law, a U.S. citizen or U.S. resident individual is allowed a unified credit against the U.S. gift tax on lifetime transfers. However, as a result of the estate tax computation, the individual is entitled only to a total unified credit against estate tax of $555,800 (for decedents dying in 2004 or 2005), and the amount of the unified credit available for use against U.S. estate tax on the individual's estate is effectively reduced by the amount of any unified credit that has been allowed in respect of gifts by the individual. (Note that the unified credit against gift tax liability is capped at $345,800 for all years after 2001.) Pursuant to this rule, the amount of the pro rata unified credit otherwise allowed to the estate of a deceased individual under paragraph 3 is reduced by the amount of any unified credit previously allowed with respect to lifetime gifts by that individual. Under U.S.

law, the only circumstance under which any unified credit would have been previously allowed is where the decedent made gifts subject to the U.S. gift tax while a U.S. citizen or U.S. resident (as defined under the Internal Revenue Code for U.S. gift tax purposes).

Paragraph 3 also conditions allowance of the pro rata unified credit upon the provision of all information necessary to verify and compute the credit. Thus, for example, the estate's representatives will be required to demonstrate satisfactorily both the value of the worldwide estate and the value of the U.S. portion of the estate. Substantiation requirements also apply, of course, with respect to other provisions of the Protocol and the Convention. However, the negotiators believed it advisable to emphasize the substantiation requirements in connection with this provision, because the computation of the pro rata unified credit involves certain information not otherwise relevant for U.S. estate tax purposes.

In addition, the amount of the pro rata unified credit is limited to the amount of U.S. estate tax imposed on the estate. See section 2102(b)(4) of the Internal Revenue Code.

The following examples illustrate the operation of the pro rata unified credit and the marital deduction of new paragraph 3 of Article 11 of the Convention and their interaction with the marital exclusion of new paragraph 2 of Article 11. Unless otherwise stated, assume for purposes of illustration that: H, the decedent, and W, his surviving spouse, are French citizens resident in France at the time of the decedent’s death; H dies in 2005, when the unified credit for estate tax purposes under section 2010 of the Internal Revenue Code is $555,800 and the applicable exclusion amount under section 2010 is $1,500,000; all conditions set forth in paragraph 3 of Article 11 and paragraph 3 of Article 12 of the Convention, as added by the Protocol, are satisfied (including the condition that the executor waive the estate tax marital deduction allowable under U.S. domestic law); no deductions are available under the Internal Revenue Code in computing the U.S. estate tax liability; there are no adjusted taxable gifts within the meaning of Internal Revenue Code section 2001(b) or 2101(c); and the applicable U.S. domestic estate and gift tax laws are those that were in effect on the date the Protocol was signed.

<u>Example 1.</u> (i) H has U.S. real property worth $4,000,000, all of which he bequeaths to W. The remainder of H’s estate consists of $6,000,000 of French situs property.

(ii) Pursuant to new paragraph 2 of Article 11, the U.S. gross estate equals $2,000,000 (the amount by which the $4,000,000 of U.S. real property bequeathed to W exceeds $2,000,000 (50% of the total value of U.S. property taxable by the United States under the Convention)). H’s worldwide gross estate equals $8,000,000 ($2,000,000 plus $6,000,000 of French situs property).

(iii) The $2,000,000 U.S. gross estate is reduced by the $1,500,000 marital deduction of new paragraph 3 of Article 11, resulting in a $500,000 U.S. taxable estate. The tentative tax on the taxable estate equals $155,800. H’s estate would also be entitled to the pro rata unified credit allowed by new paragraph 3 of Article 12 of $138,950 ($555,800 (the full unified credit) multiplied by a fraction equal to the $2,000,000 U.S. gross estate over the $8,000,000 worldwide gross estate). Thus, the total U.S. estate tax liability is $16,850 ($155,800 - $138,950).

Example 2. (i) The facts are the same as in Example 1, except that H bequeaths $1,200,000 of his U.S. real property to W and $2,800,000 of his U.S. real property to C, H's child.

(ii) The $2,800,000 of U.S. real property bequeathed to C is included in H's U.S. gross estate. Pursuant to new paragraph 2 of Article 11, none of the U.S. real property bequeathed to W is included in the gross estate, because such property would be included only to the extent its value (i.e., $1,200,000) exceeded 50% of the $4,000,000 total U.S. situs property taxable under Articles 5, 6 or 7 of the Convention. H's worldwide gross estate equals $8,800,000 ($2,800,000 plus $6,000,000 of French situs property).

(iii) Because none of the U.S. situs property bequeathed to W is included in the U.S. gross estate, the property is not "qualifying property", and therefore no marital deduction is allowed with respect to that property under new paragraph 3 of Article 11. The tentative tax on the $2,800,000 gross estate equals $1,156,800. H's estate would also be entitled to the pro rata unified credit allowed by new paragraph 3 of Article 12, which equals $176,845 ($555,800 (the full unified credit), multiplied by a fraction equal to the $2,800,000 U.S. gross estate over the $8,800,000 worldwide gross estate). Thus, the total U.S. estate tax liability is $979,955 ($1,156,800 - $176,845).

Paragraph 4 provides that in determining the French gift or inheritance tax with respect to transfers by a donee or decedent who, at the time of making the gift or at death, was a citizen of the U.S. or was domiciled in the U.S., the same deductions and credits must be allowed as if the individual were domiciled in France. In addition, in determining the French gift or inheritance tax with respect to transfers by a donee or decedent who, at the time of making the gift or at death, was domiciled in France to an individual who is a U.S. citizen or is domiciled in the U.S., the same deductions and credits must be allowed as if the individual were domiciled in France.

Under paragraph 5, the credits or deductions for tax imposed by a Contracting State allowable under Article 12 are in lieu of, and not in addition to, any credits or deductions for such taxes allowed by the internal laws of the other Contracting State and must be computed according to and subject to the limitations of the law of such other Contracting State, as amended from time to time without changing the general principle thereof.

Paragraph 6 provides that a Contracting State is not prohibited from imposing tax where property, under the rules of the Convention, is taxable only in the other Contracting State but tax, though chargeable, is not paid. A tax, however, shall be deemed paid where tax liability is reduced or eliminated by means of a specific exemption, deduction, exclusion, credit, or allowance.

Under paragraph 7, where, pursuant to the provisions of the Convention, property may not be taxed in a Contracting State, that Contracting State may nevertheless take into account such exempted property that is otherwise taxable under its internal law in calculating the amount of tax on the property that may be taxed in that Contracting State pursuant to the Convention. In other words, such exempted property may be included in the tax base for purposes of determining the applicable marginal rate of tax.

Under paragraph 8, the provisions of the Convention may not result in an increase in the amount of the tax imposed by either Contracting State under its domestic laws. A reduction in the credit allowed against a Contracting State's tax for tax paid to the other Contracting State, which reduction results from the application of the Convention, is not for these purposes to be construed as an increase in tax. This prevents the argument, for example, that an estate would have received a higher foreign tax credit without the treaty, because it would have paid more French taxes, and thus should be allowed the higher foreign tax credit even though the treaty reduced the estate's French tax.

Article VIII

Article VIII of the Protocol amends Article 15 (Filing of Returns and Exchange of Information) of the Convention by modifying the last sentence of paragraph 2. Under paragraph 2, the competent authority of each Contracting State is required to exchange two specific categories of information with the competent authority of the other Contracting State. As amended by the Protocol, the last sentence of paragraph 2 provides that any information furnished must be treated as secret by the recipient State. Such information may not be disclosed to persons other than those "involved in the" assessment, collection, enforcement, or prosecution in respect of the taxes which are the subject of the Convention. This is a change from the current language, which refers to persons "concerned with" such activities.

Article IX

Article IX contains the rules for bringing the Protocol into force and giving effect to its provisions.

Paragraph 1 provides for the ratification of the Convention by both Contracting States according to their constitutional and statutory requirements. Each State must notify the other as soon as its requirements for ratification have been complied with. Paragraph 2 provides that the Convention will enter into force on the date of the later of such notifications.

In the United States, the process leading to ratification and entry into force is as follows: Once a protocol or treaty has been signed by authorized representatives of the two Contracting States, the Department of State sends the protocol or treaty to the President who formally transmits it to the Senate for its advice and consent to ratification, which requires approval by two-thirds of the Senators present and voting. Prior to this vote, however, it generally has been the practice of the Senate Committee on Foreign Relations to hold hearings on the protocol or treaty and make a recommendation regarding its approval to the full Senate. Both Government and private sector witnesses may testify at these hearings. After receiving the Senate's advice and consent to ratification, the protocol or treaty is returned to the President for his signature on the ratification document. The President's signature on the document completes the process in the United States.

The date on which a treaty enters into force is not necessarily the date on which its provisions take effect. Paragraphs 2 and 3 contain rules that determine when the provisions of the treaty will have effect.

Pursuant to paragraph 2, the Protocol will generally have effect with respect to gifts made and deaths occurring after such date.

Paragraph 3 contains special retrospective effective date provisions for paragraph 3 of Article 11 (Community Property and Marital Deduction) of the Convention and paragraph 3 of Article 12 (Exemptions and Credits) of the Convention, in each case as amended by the Protocol. These paragraphs will take effect with respect to deaths occurring and gifts made after November 10, 1988. However, the benefits of those provisions will be available with respect to gifts made or deaths occurring after November 10, 1988, and prior to the general effective date of paragraph 2, only if a claim for refund due as a result of those paragraphs is filed before the date that is one year after the first day of the second month following the date on which the Protocol enters into force or within the otherwise applicable period for filing such a claim expires under the domestic law of the Contracting State concerned. Additionally, the saving clause of paragraph 4 of Article 1 (Estates and Gifts Covered) applies to any such claim for refund. Where an estate, prior to entry into force of the 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 in the preceding sentence. 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 Convention.