Patterson Belknap Webb & Tyler LLP

Investing in the US: Tax Considerations for French Investors

September 2016

pbwt.com

8863321v4

Authors

Henry P. Bubel

Partner

212-336-2615

hpbubel@pbwt.com

Dahlia B. Doumar

Partner

212-336-2988

dbdoumar@pbwt.com

Carl A. Merino

Counsel

212-336-2067

cmerino@pbwt.com

Patterson Belknap Webb & Tyler LLP

Patterson Belknap Webb & Tyler LLP is a New York City based law firm with more than 200 lawyers. The firm is included on *The American Lawyer's* 2015 "A-List" of the 20 leading law firms in the United States. Patterson Belknap delivers a full range of services across approximately 20 practice groups in both litigation and commercial law. For more information, please visit www.pbwt.com.

Outline of Presentation

- Recent Developments
- Overview of US Federal Income, Gift and Estate Taxation of Nonresident Alien Individuals
- US Investments by Nonresident Alien Individuals: Breakdown by Asset Class
- Use of “Blocker” Corporations to Make US Investments
- Exhibit A: Treaty Eligibility Under France-US Income Tax Treaty

Recent Developments

Recent Developments

- **New model treaty:** The US Treasury Department has released a new model income tax treaty. The updates attempt to address concerns about base erosion, profit-shifting and other tax-avoidance behavior, including potential misuse of permanent establishments. Future amendments to the France-US income tax treaty could ultimately reflect some of these changes.
- **Proposed regulations on foreign-owned disregarded entities:** The IRS has issued proposed regulations that would require "disregarded entities" organized in the US, such as wholly owned limited liability companies, to file information returns with respect to their foreign owners to the IRS. Similar reporting requirements already apply to US corporations with foreign owners.
- **New FinCEN rules:** The US Treasury Department has issued expanded "know-your-customer" rules requiring banks, brokers, securities dealers and other financial institutions to collect and verify personal information on the ultimate beneficial owners and control persons of entities opening accounts.
- **Proposed "Section 385" regulations:** Proposed regulations would recharacterize certain related party debt financings as equity (resulting in loss of interest deductions for debtors, among other things) and impose new procedural requirements for certain related party loans to corporations.
- ***Grecian Magnesite* case:** The IRS treats gains from the sale by a non-US partner of interests in a partnership engaged in a trade or business in the US as taxable business income in certain cases. A Greek mining and industrial company is currently litigating this position before the US Tax Court.

Overview of US Federal Income, Gift and Estate Taxation of Nonresident Alien Individuals

US Federal Income Taxation of Non-US Individuals: General Rules

- **US citizens and resident alien individuals:** Taxed on their worldwide income.
- **Nonresident alien individuals:** Subject to federal income taxes on the following:
  - Business profits from the conduct of a trade or business in the US – taxed at graduated rates of up to 39.6% (net of applicable deductions).
    - Under the France-US income tax treaty, a French resident who is not a US citizen generally is not subject to US federal income taxes on business profits unless the profits are attributable to a "permanent establishment" (fixed place of business) in the US.
    - State and local taxes may apply without regard to the treaty.
  - Dividends, interest, rents, royalties and other portfolio income from US sources – taxes are withheld at the source at a flat 30% rate (without offsetting deductions for related expenses), but subject to exemptions or reduced rates in certain cases:
    - Under the France-US income tax treaty, interest and royalties may be exempt from federal income tax and dividends may be taxed at reduced rates (15% for individuals).
    - Interest also may be exempt under certain provisions of the US Internal Revenue Code (the "Code") even if the individual is not eligible for treaty benefits.
  - Gains from the sale of US real estate – taxable, but potentially eligible for a federal long-term capital gain rate of only 20% (not including applicable state or local income taxes).

US Federal Income Taxation of Non-US Individuals: Residence Status and Treaty Tie-Breaker Rules

- **Residence status:** In general, an individual is considered a resident for US income and employment tax purposes – and thus is taxable in the US on his or her worldwide income – if he or she either (a) is a "lawful permanent resident" (a green card holder), or (b) satisfies the "substantial presence test" (a formula based on the number of days present in the US during the current and two immediately preceding calendar years).
  - *Code-based exceptions.* There are a number of exceptions to the normal day-counting rules, including for individuals visiting the US on certain visas (for example, students, teachers and diplomatic staff) and individuals who can establish a closer connection to another country.
  - *Treaty-based exceptions.* Many treaties, including the France-US income tax treaty, include "tie-breaker" rules for individuals who might otherwise be considered dual residents.
    - These provisions look first to where such individual maintains a permanent home, second to where he or she maintains an habitual abode, and third to citizenship. If none of these is conclusive, the matter would have to be settled by the French and US tax authorities.
    - If an otherwise dual resident individual is treated as a nonresident of the US by operation of the treaty, his or her US federal income tax liability generally will be determined as if he or she was a nonresident alien eligible for benefits under the treaty. However, he or she still would be considered a resident for most other US tax purposes.

US Federal Income Taxation of Non-US Individuals: Residence Status and Expatriation

- **Expatriation and exit Tax:** Subject to certain exceptions, the US imposes a mark-to-market exit tax on (i) US citizens who relinquish their citizenship, and (ii) "long-term residents" who give up their green cards.
  - *Long-term residence and mechanics of expatriation.* A long-term resident is an individual who has been a "lawful permanent resident" of the US for eight of the last fifteen years. A lawful permanent resident is a green card holder whose status has not been revoked or administratively or judicially determined to have been abandoned. Thus, giving up one's green card does not trigger the exit tax if one has not maintained his or her green card status for at least eight of the last fifteen years.
  - *Treaty positions and accidental expatriations.* A long-term resident also ceases to be a lawful permanent resident – potentially triggering the exit tax – if he or she (i) is considered a nonresident under a tie-breaker provision in a treaty, (ii) does not waive the benefits of such treaty, and (iii) notifies the IRS of such treaty position (e.g., by filing a Form 1040NR nonresident alien return and a Form 8833 to disclose such treaty position).
    - This can be a trap for the unwary if an individual taking such treaty position for tax purposes does not realize that he or she has already become a long-term resident.
    - Note: Years during which an individual (i) is treated as a nonresident by operation of an income tax treaty and (ii) does not waive treaty benefits do <u>not</u> count as years of lawful permanent residence for purposes of the eight-year test for long-term residence.
  - *Transfer taxes.* Additional transfer taxes may be imposed if such expatriated individuals subsequently make gifts or bequests to US persons.

US Estate Tax and Non-US Decedents

- **US citizens and domiciliaries:** A US decedent's estate is taxed on the decedent's assets worldwide.
  - 40% tax on portion of estate in excess of $5,450,000 exemption amount for US decedents who die in 2016. The exemption amount is indexed for inflation and is reduced by taxable lifetime gifts.
  - An unlimited marital deduction may apply to bequests to a surviving spouse who is a US citizen.
- **Non-citizens domiciled outside the US:** A non-US decedent's estate is taxed only on "US situs" assets.
  - The same 40% tax is imposed as for US decedents, but the exemption amount is reduced to $60,000 for the US estates of non-US decedents.
  - *Domicile.* An individual's domicile is where he or she intends to reside indefinitely and is determined based on all of the facts and circumstances. One could become a resident alien for income tax purposes based on his or her days present in the US without becoming a US domiciliary (for example, a temporary work assignment in the US).
  - *US situs assets.* US situs assets include real and tangible personal property situated in the US and certain types of intangible property, such as stock in US companies, intellectual property used in a US trade or business and certain non-portfolio debt instruments issued by US persons.
  - *State taxes.* State-level estate taxes may apply to property situated in a given state.
  - *Expatriates.* As noted in the previous slide, special transfer taxes may apply to former citizens and former long-term residents who make bequests to US persons.

US Gift Tax and Non-US Individuals

- **US Citizens and domiciliaries:** Subject to gift tax at 40% rate on taxable gifts made during their lifetimes (without regard to situs). The gift tax serves as a backstop to the estate tax.
  - *Lifetime exemption.* $5,450,000 combined exemption for gift and estate taxes (indexed for inflation).
  - *Annual exclusions.* Unlimited marital deduction for gifts to spouse who is US citizen, $148,000/year marital deduction for gifts to non-citizen spouse and $14,000/year exclusion for all other donees. Both exclusion amounts are indexed for inflation.
- **Non-citizens domiciled outside the US:** Subject to gift tax at 40% rate on gifts of real property and tangible personal property situated in the US.
  - *Domicile.* Same as for the estate tax (i.e., where an individual intends to reside indefinitely).
  - *Key difference from estate tax.* The gift tax applies only to gifts of tangible property situated in the US. For example, a non-US person could make a tax-free gift of stock in a US corporation. The same stock would have been included in his or her estate. There are other situs differences as well.
  - *$60,000 exemption and annual exemptions.* The combined gift and estate tax exemption amount for non-US individuals is only $60,000.
  - *Annual exclusions.* Same as for US citizens and residents.
  - *Expatriates.* As noted in previous slides, special transfer taxes apply to former citizens and long-term residents who make gifts to US persons.

Impact of France-US Treaty on Estate and Gift Taxes

- **Impact of treaty on French domiciliaries:** The France-US estate and gift tax treaty modifies the situs rules for assets held by French domiciliaries who are not US persons.
  - Real and tangible personal property situated in the US remain subject to estate tax.
  - Stock and other securities issued by a US corporation generally are not considered US situs assets in the hands of a French domiciliary.
    - *Exception:* If 50% or more of the assets of a corporation, partnership or other entity are US real property, interests in such entity may be subject to US estate tax under the treaty. (Note that stock of a foreign corporation generally will not be considered a US situs asset regardless of what the corporation owns.)
  - Property (tangible or intangible) of a permanent establishment in the US through which a business enterprise is carried on is considered a US situs asset. The permanent establishment of a partnership is imputed to its partners.
- **Special rules on domicile:** A French national domiciled in the US for less than five of the last seven years before death will be considered a non-US person domiciled in France (and eligible for treaty benefits) if he or she (i) had a clear intention to remain domiciled in France, or (ii) was present in the US by reason of a work assignment.

US Investments by Nonresident Alien Individuals: Breakdown by Asset Class

US Investments by Nonresident Alien Individuals: Stock in US Corporations

- **Dividends:** Dividends are taxed at a 15% rate for individuals who reside in France and are eligible for treaty benefits under the France-US income tax treaty. Similar reduced rates apply under many other US income tax treaties.
  - *No treaty.* The tax rate is 30% if no tax treaty applies.
  - *Withholding.* Taxes are withheld at the source. The investor's brokerage account may be with a French brokerage firm, but the taxes generally are withheld by an associated US financial institution.
  - *No tax return required.* The non-US accountholder generally does not have to file a US tax return to report dividends from an unrelated corporation (assuming he or she owns the stock as a passive investor) if the dividends were reported to the IRS by the financial institution on Form 1042-S and any applicable taxes were withheld.
- **Capital gains:** Gains from the sale of stock generally are not taxable unless the issuer is a US real property holding corporation. See US Real Property discussion beginning on slide 19.
- **Estate tax:** Stock in a US corporation generally is a US situs asset subject to estate tax in the US in the absence of a treaty. However, it is not subject to US estate tax if the decedent was domiciled in France and eligible for benefits under the France-US estate and gift tax treaty, provided that the company does not primarily own US real estate.
- **Gift tax:** Gifts of stock in a US or non-US company by a non-citizen domiciled abroad are not subject to US gift taxes regardless of the donor's eligibility for treaty benefits.

US Investments by Nonresident Alien Individuals: Bonds and Other Debt Instruments

- **Interest:** Interest on bonds issued by an unrelated US company generally is tax-free to a non-US holder under the "portfolio interest" exception in the Code if the interest is not earned in connection with the holder's conduct of a trade or business in the US.
  - The portfolio interest exception is not available if interest payments are contingent or tied to the earnings of the issuer or if the holder owns 10% or more of the issuer. However, the holder may own a higher percentage of the nonvoting stock of a corporate issuer.
  - Interest also may be tax-free under the France-US income tax treaty. However, interest payments still may be taxable under the treaty if the amounts are contingent or tied to the earnings of the issuer.
- **Gains:** Gains from the sale of a bond generally are not taxable to non-US holders.
- **No tax return required:** Interest from an unrelated issuer generally is not reportable by a non-US holder if it is excludable from income and properly reported to the IRS by the financial institution on Form 1042-S.
- **Estate tax:** Bonds issued by US corporations and certain other US issuers are US situs assets potentially subject to estate tax, but are <u>not</u> includable in the US estate of a French domiciliary eligible for benefits under the France-US estate and gift tax treaty.
- **Gift tax:** Gifts of debt instruments by a non-citizen who is domiciled abroad are not taxable regardless of the donor's eligibility for benefits under a tax treaty with the US.

US Investments by Nonresident Alien Individuals: Investment Partnerships

- **Flow-through of partnership income:** The earnings of a partnership (including most US limited liability companies) flow up to the owners for income tax purposes. This can trigger federal and state income tax liabilities and return filing obligations for non-US partners.
  - *Attribution of permanent establishment to partners.* If the partnership has a permanent establishment in the US, then a non-US partner will be deemed to have a permanent establishment in the US by attribution. Treaty exclusions for business profits may not apply.
  - *Federal and state tax returns.* If the partnership is an operating business or invests in other partnerships that conduct active businesses in the US, the non-US partners likely will have to file US federal (and possibly state) income tax returns to report their taxable income.
    - Most master limited partnerships in the oil and gas sector generate taxable business income. This can trigger both federal and state return filing obligations.
    - Because the France-US income tax treaty generally does not extend treaty benefits to state or local income taxes, the threshold level of business activity (whether at the partnership or partner level) that could trigger a state or local return filing obligation for a foreign partner may be much lower than what would trigger a federal return filing obligation.
  - *Withholding taxes.* The partnership must withhold taxes on behalf of the non-US partners. This does not eliminate the partners' filing obligations if the partnership earns business income.

US Investments by Nonresident Alien Individuals: Investment Partnerships (continued)

- **Blocker structures:** Investment funds that invest solely in corporations or (or that invest in partnerships only through corporate "blockers") generally should not generate business profits that would trigger return filing obligations for non-US partners, provided that the investment funds themselves satisfy applicable tax withholding and reporting obligations.
- **Dividends and capital gains:**
  - Dividends earned by the partnership are taxable to non-US partners (possibly at reduced rates under a treaty) and subject to withholding by the partnership.
  - Capital gains (other than from the sale of US real estate and resource properties) and many types of interest are not taxable to non-US partners.
- **Offshore fund structures:** Many offshore funds are set up as corporations for US tax purposes, allowing non-US investors to indirectly invest in US partnerships without triggering return filing obligations or directly entering the US tax system.
- **Sale of a partnership interest:** The IRS takes the position that a non-US partner's gain from the sale or exchange of an interest in a partnership that conducts business in the US through a fixed place of business is taxable business income to the extent of the partner's share of the appreciation in value of the partnership's business assets. This position is currently being litigated in the *Grecian Magnesite* case.
  - *US real property holdings.* The sale of an interest in a partnership that owns US real property may trigger taxable gains and return filing obligations for the seller (and in some cases, withholding tax obligations for the buyer). See US Real Property discussion beginning on slide 19.

US Investments by Nonresident Alien Individuals: Investment Partnerships (continued)

- **Estate tax:** If a non-US decedent was domiciled in France and eligible for benefits under the France-US estate and gift tax treaty, the treaty generally would prevent a partnership interest held by the decedent from being included in his or her taxable US estate unless the partnership either (a) was engaged in commercial and business activities through a fixed place of business in the US, or (b) held US real property. However, the estate tax treatment of partnership interests held by non-US decedents is not fully settled under US law.
  - *US real property holdings.* Legal entities may be treated as US situs assets under the treaty if 50% or more of their assets consist of US real property.
- **Gift tax:** A gift of an interest in a partnership (US or foreign) by a non-citizen domiciled abroad generally should not be subject to gift tax in the US because the partnership interest is intangible property. However, the law is not fully settled in this area.
  - Note: If the partnership holds US real property <u>and</u> the property is leveraged, the gift potentially could be treated as a taxable sale for income tax purposes (with the transferor's share of the underlying debt being treated as cash proceeds from a deemed sale of the partnership interest).

US Investments by Nonresident Alien Individuals: US Real Property

- **General rule for capital gains:** Nonresident aliens and foreign corporations generally are not subject to federal income taxes on gains from the sale of capital assets.
- **Taxation of gains from the sale of US real property:** Taxable to non-US sellers.
  - Under the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), foreign corporations and nonresident aliens who sell interests in real property (including natural resource properties) situated in the US are taxed on the gains from such sales. As noted in earlier slides, this can include the sale of interests in partnerships and US corporations if their assets consist primarily of US real property interests.
    - Non-US corporations are subject to federal income taxes on such gains a 35% rate, while nonresident aliens are taxed at a 20% rate if they held the asset for more than one year. Higher rates may apply to individuals who have held and depreciated the property as a business asset or who have held it as inventory (for example, real estate developers).
    - Non-US investors also may be subject to state and local taxes (including on investments in US real estate held through US and foreign partnerships).
  - *Withholding taxes.* A purchaser buying US real property from a non-US person generally must withhold 15% of the amount realized upon the sale.
    - The seller can apply for a refund of overwithheld taxes by filing a tax return. In some cases, the buyer and seller may apply for a withholding certificate from the IRS in advance of the sale to reduce the amount of taxes that must be withheld.

US Investments by Nonresident Alien Individuals: US Real Property (continued)

- **US real property holding corporations:** The sale of stock in a US corporation may be subject to the FIRPTA tax and applicable withholding if the corporation has been a US real property holding corporation at any time during the previous five years.
  - *Definition.* A US real property holding corporation is any US corporation if the fair market value of its US real property interests equals or exceeds 50% of the sum of (1) its US real property interests, (2) interests in real property located outside the US and (3) other assets held for use in a trade or business (such as inventory, depreciable property, patents and other intellectual property).
  - *Notice requirements.* Certifications and IRS notices are required in order to establish that a US corporation is not a US real property holding corporation. Stock purchase agreements involving the sale of US target companies often require these certifications as a condition of closing the sale.
  - *Exceptions.* Gains from the sale of a US company that otherwise would be treated as a US real property holding corporation are not subject to the FIRPTA tax if the company is publicly traded and the non-US seller owns no more than 5% of any class of stock. There are also exceptions for certain interests in real estate investment trusts.

US Investments by Nonresident Alien Individuals: US Real Property (continued)

- **Nonrecognition transactions:** FIRPTA generally overrides nonrecognition treatment for otherwise tax-free transactions (for example, corporate reorganizations and "like kind" exchanges) involving transfers of US real property interests.
  - There are limited exceptions to this rule, such as where the non-US transferor receives a US real property interest (including stock in a US real property holding corporation) that itself would be a taxable asset for FIRPTA purposes in exchange for the transferred property.
- **No treaty relief:** Like most other US income tax treaties, the France-US income tax treaty allows the country in which real property is located to tax gains, rent and other income from such property. Thus, French residents are fully taxable on gains from the sale of US real property without regard to their eligibility for treaty benefits.
- **Estate and gift taxes:** Non-US decedents, including French domiciliaries eligible for benefits under the estate and gift tax treaty, are subject to federal estate taxes (and possibly estate taxes at the state level as well) on US real property held at death. Gifts of US real property are similarly taxable.
  - As previously discussed, stock in a US corporation, partnership or other entity is includable in the decedent's estate under the France-US estate and gift tax treaty if at least 50% of its assets are comprised of interests in real property situated in the US.
  - In contrast, ***gifts*** of partnership interests by nonresidents who are not US citizens generally are not subject to US gift taxes (although the law is not fully settled in this area).

US Investments by Nonresident Alien Individuals: US Mutual Funds

- **Income taxes:** Mutual funds are afforded favorable tax treatment as "registered investment companies" regulated by the SEC. Instead of two levels of tax as with most corporations (where earnings are taxed first at the corporate level and then a second time at the shareholder level when the earnings are distributed), there generally is only one level of tax in the case of a mutual fund – i.e., when the fund distributes dividend and capital gain income to the shareholders.
  - Nonresidents generally are not taxed on capital gain distributions. However, dividend distributions from a mutual fund are taxed at the same rate (15% under the France-US income tax treaty and 30% in the absence of a treaty) that would apply to distributions from the underlying companies.
  - No tax return is required if the financial institution properly reports the dividend distributions on Form 1042-S and withholds the applicable taxes.
  - It is technically possible, but highly unlikely, for a mutual fund to be a US real property holding corporation for purposes of the FIRPTA tax. However, FIRPTA will not apply if the holder owns 5% or less of the mutual fund. (Note: It would be very unusual for an individual to own such a large position in a US mutual fund.)
- **Estate and gift taxes:** Stock and other securities issued by US companies generally are US situs assets in the absence of a treaty. However, a French domiciliary who is not a US person generally would not be subject to estate taxes with respect to the stock of a mutual fund. Shares of a mutual fund (US or foreign) may be gifted by a non-US person without triggering gift tax.

US Investments by Nonresident Alien Individuals: Exchange-Traded Funds (ETFs)

- The tax treatment of an ETF depends on its structure. There are several types of ETFs:
  - **Open-end funds:** Taxed in a similar manner as mutual funds.
  - **Unit investment trusts:** Taxed in a similar manner as mutual funds.
  - **Exchange-traded notes (ETNs):** Generally treated as forward contracts. The gains are not taxable to a non-US person. They potentially could be treated as US-situs assets subject to the estate tax, but not in the hands of a French domiciliary who was not a US person.
  - **Exchange-traded grantor trusts:** The holder is treated as the owner of the underlying assets for income tax purposes – this could give rise to return filing obligations, depending on the income and assets of the trust.
  - **Partnerships:** See previous discussion regarding partnerships.
  - **MLP ETFs:** MLP ETFs are "blocker" corporations that invest in master limited partnerships and other oil and gas investments. They are taxed either as regular corporations or as mutual funds. A non-US investor could own up to 5% of an MLP ETF without being subject to the FIRPTA tax on a sale of his or her interest.
    - Because MLP ETFs invest in oil and gas properties, they are potentially includable in a French domiciliary's taxable US estate, notwithstanding application of the France-US estate and gift tax treaty.

Use of “Blocker” Corporations to Make US Investments

Use of "Blocker" Corporations to Make US Investments: Introduction

- **Establishing a blocker corporation:** A French investor might consider establishing a "blocker" corporation to make US investments for a number of reasons. Depending on the type of income that will be generated, it may make sense to set up the blocker corporation in a treaty jurisdiction.
- The following discussion covers inbound investments in the US by a French parent corporation (often with a US subsidiary) and considers the potential application of treaty benefits to different types of US source income.
- A partial list of requirements to qualify a French corporation for treaty benefits under the France-US income tax treaty is included in Schedule A at the end of this presentation.

Use of "Blocker" Corporations to Make US Investments: How Non-US Corporations Are Taxed in the US

- **Business profits:** Business profits from the conduct of a trade or business in the US by a non-US corporation are taxed twice at the federal level: (i) at a 35% rate when the profits are earned by the corporation, and (ii) at a 30% rate when the earnings are repatriated or deemed to have been repatriated under the "branch profits" tax regime.
  - *Treaty exemptions for business profits.* Under the France-US income tax treaty, a French corporation eligible for treaty benefits is not subject to federal income taxes on business profits unless such profits are attributable to a "permanent establishment" (fixed place of business) in the US. This includes a permanent establishment of a partnership or wholly owned limited liability company owned by the corporation that is disregarded for US tax purposes.
    - Once US operations rise to the level of a permanent establishment, earnings attributable to the permanent establishment are taxable at the federal level.
    - ***Because there are no treaty exemptions for state and local taxes, a French corporation may be subject to state and local income taxes on its business profits even if it does not have a permanent establishment in the US.***
  - *Treaty exemptions for branch profits tax.* The second level tax on the dividend equivalent amount deemed to have been repatriated under the branch profits tax is intended to replicate the 30% tax that would be imposed on dividends if the parent operated in the US through a US corporate subsidiary. Under the France-US income tax treaty, this tax may be reduced to 5% or even eliminated, depending on the ownership structure (see next slide).

Use of "Blocker" Corporations to Make US Investments: How Non-US Corporations Are Taxed in the US (continued)

- **Portfolio income:** US source "portfolio" income (e.g., dividends, interest, rents and royalties from US companies) that is not earned in connection with a US trade or business generally is taxed at a 30% rate without any offsetting deductions for related expenses, subject to potential exemptions or reduced tax rates under the Code or an applicable treaty:
  - *Treaty exemptions for interest and royalties.* Interest and royalties generally are exempt from US federal income taxes under the France-US income tax treaty, with some exceptions (e.g., contingent interest and interest tied to the issuer's earnings). Interest also may be excluded from income under the portfolio interest exception in the Code (discussed in slide 15).
  - *Treaty-based tax reductions for dividends.* Dividends are taxed at a 15% rate under the France-US income tax treaty, but the rate is reduced to 5% if the parent corporation directly owns at least 10% of the voting stock of the US subsidiary. The rate is reduced to zero if the French parent owns at least 80% of the voting stock of the US subsidiary. The same 5% and 0% rates would apply to an unincorporated branch (including a limited liability company or other flow-through entity) with the same levels of ownership.
- **Real estate gains:** Gains from the sale of US real property, including US real property holding corporations and certain partnerships that own US real property, are taxed at a 35% rate under FIRPTA.
  - The treaty generally does not apply to income from US real property, but may prevent branch profits taxes from applying to the gains, depending on the ownership structure.
  - There are no treaty exemptions for state and local income taxes, which may apply to business profits and real estate gains, depending on where the property is situated.

Use of "Blocker" Corporations to Make US Investments: Role of Non-US Blocker Corporations

- As previously noted, a French investor might consider investing or doing business in the US through a blocker corporation for a number of reasons. Whether it makes sense to organize the blocker corporation in a treaty jurisdiction (subject to applicable limitation-on-benefits provisions) depends on a number of US (as well as non-US) tax considerations, including the type of income that will be generated:
  - ***Doing business in the US.*** A French business that wishes to enter the US market might choose to do so through a wholly owned French holding company with a lower tier US subsidiary in order to limit liability and avoid direct federal and state tax exposure in the US for its French operations while preserving potential eligibility for treaty benefits.
    - An eligible French corporation could reduce or eliminate US taxes on dividends from a US corporate subsidiary or the branch profits tax on earnings of a branch (including a partnership or wholly owned limited liability company that is disregarded for US tax purposes).
    - The parent also could capitalize a US corporate subsidiary with debt without being taxed on the interest under the treaty, depending on how the debt is structured.
  - ***Investing in partnerships.*** Many investment partnerships generate business profits that can give rise to federal and state return filing obligations.
    - Depending on the type of income generated by the partnership, treaty exemptions may or may not be relevant. Note that many offshore funds that invest in the US already are structured as blocker corporations.

Use of "Blocker" Corporations to Make US Investments: Role of Non-US Blocker Corporations (continued)

- ***Investing in US real property.*** Many non-US investors choose to invest in US real property through non-US blocker corporations (often with a lower tier limited liability company actually holding the property) both to avoid direct federal and state income tax exposure and to prevent potential estate tax inclusions at death.
  - Shares of a non-US corporation generally are not subject to US estate tax.
  - There are income tax trade-offs, as capital gains are taxed at less favorable rates for corporations than for individuals.
  - Some investors use "foreign eligible" entities that can elect to be treated as partnerships or disregarded entities for US tax purposes, with the option of converting the entity into a corporation for US tax purposes at a later time. However, this approach is not without some estate tax risk.
  - As discussed in earlier slides, most tax treaties do not provide tax reductions or exemptions for gains or other income from US real property. However, it is often possible to structure around a second level tax (whether under FIRPTA or under the branch profits tax) by using a separate holding corporation for each US real property investment.

Use of "Blocker" Corporations to Make US Investments: Role of Non-US Blocker Corporations (continued)

- ***Publicly traded securities.*** In contrast to the above scenarios, a non-US investor who buys small positions in publicly traded securities (including mutual funds and many types of ETFs) and limits partnership investments to hedge funds, offshore funds or US investment funds that employ blockers for pass-through investments and avoid US real estate may not have much need for a blocker, particularly if he or she is eligible for benefits under the France-US estate and gift tax treaty.
  - The above investments generally will not trigger federal or state income tax filing obligations for the investor. Additionally, a French resident would be eligible for a 15% rate on dividends and an outright exemption on many types of interest payments under the France-US income tax treaty.
  - US securities generally are not considered US-situs assets under the France-US estate and gift tax treaty. However, a French domiciliary buying US securities directly might still want to avoid stock positions in REITs or companies with heavy real estate or natural resource exposure.
- ***SICAVs.*** If the above individual invests in US assets through a French SICAV, he or she should be “blocked” from US tax exposure by the SICAV. Moreover, the SICAV itself may be eligible for exemptions or reduced tax rates on US source income under the France-US income tax treaty.

Exhibit A: Treaty Eligibility Under France-US Income Tax Treaty

Treaty Eligibility Under France-US Income Tax Treaty

- **Individuals:** An individual who is a tax resident of France generally will be eligible for treaty benefits (subject to tie-breaker rules if he or she also is a US citizen or resident).
- **Corporations:** A French corporation must satisfy certain limitation-on-benefits provisions in order to claim treaty exemptions. Eligible French corporations include the following:
  - Certain corporations listed on EU stock exchanges.
  - Corporations owned at least 50% by vote or value by five or fewer French resident corporations that satisfy the prior test (e.g., publicly traded companies).
  - Corporations owned at least 50% by vote or value by persons who are eligible residents without regard to their ownership (for example, a corporation owned by French resident individuals) and satisfying certain "base erosion" tests.
  - Corporations conducting an active business in France and earning income in the US in connection with the French business.
  - Corporations owned at least 95% by seven or fewer residents of EU or NAFTA countries (subject to an additional base erosion test).
  - A SICAV, SIIC or SPPICAV that is owned more than 50% by certain eligible residents (including certain pensions).
- Note: This is not a comprehensive list of treaty-eligible entities.