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The US/France treaty applying to gift and inheritance taxes Signed on November 24, 1978, amended on December 8, 2004

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1/ Introduction

For obvious historical reasons, France and the US have developed very different systems governing inheritances and gifts, both from a legal standpoint (rules of testation and devolution) and a tax standpoint.

On the one hand, France is a civil law country. The legal rules governing the persons, goods, matrimonial regimes, successions and gifts were codified in the early 19th century under Napoleon, giving birth to our first Civil Code, which still exists more than 200 years later.

The rules set out by the Civil code – and in particular the inheritance laws – apply in the same way in the whole French territory (which includes its overseas territories). Similarly, the tax legislation in matters of inheritances and gifts apply in the same way in the whole French territory.

On the other hand, in a nutshell, the legal rules progressively developed in each of the US federated States derive from the English Common law and Equity Law, although some States' legal rules may for historical reasons have more diverse influences (see in particular Louisiana).

Because the US is a Federation, the inheritance laws and tax laws in matters of estates inheritances and gifts may differ from one State to another.

These main differences between the US and French legal and tax systems (further developed below) should always be kept in mind for the purpose of analyzing the provisions of the US-France tax treaty applying to gift and inheritance taxes signed on November 24, 1978 (the "Treaty") and understanding the logic on the basis of which the right to tax is attributed to one State or the other, depending on the situation.

At the risk of stating the obvious, it is important to bear in mind that the purpose of the Treaty is not to determine who inherits what (which is a private law question), but only which State taxes what and how to avoid potential double taxation.

Having said that, prior to analyzing the rules determining the States' right to tax, it is worth understanding the main rules of devolution of one's Estate, as well as the main tax rules governing the transfer of such Estate, under the US and French domestic laws.

2/ Main differences between France and US domestic laws

- **Rules of devolution of the Estate**

Whereas in almost all US States, the inheritance laws provide for an absolute freedom of testation, in France freedom of testation is subject to some imperative restrictions designed to protect "public order". The most important of these in practice is by far the forced heirship rules, under which certain portion of the estate is reserved for certain heirs (*la réserve héréditaire*).

When forced heirship rules apply, as a general rule all gifts made during the lifetime of the decedent must be added back to his/her Estate, for the computation of the "reserved fraction" (so called *Rapport civil*).

However, the European Union (EU) Regulation n°650-2012 on successions and Wills (entered into force on 17 August 2015), considerably modified the rules on the jurisdiction and applicable law governing matters of succession in France.

Under the Regulation, as a general rule, the law applicable to the succession as a whole (i.e. movable and immovable succession) shall be the law of the country in which the deceased had his habitual residence at the time of death, irrespective of whether this country is (or not) a Member State of the EU.

In addition to the above, the EU Regulation allows a person to choose the law of the country whose nationality he possesses at the time of making the choice, or at the time of death, as the law to govern his succession.

As a consequence, since 17 August 2015, a US citizen having his habitual residence in France can opt for the law of the State in which he has the closest interests as the law governing his/her whole Estate.

- **Settling the Estate**

In France, there is no such procedure as that of probate. Under French law, on the contrary, there is a principle under which the legal ownership of the decedent's Estate is immediately vested to his/her heirs. As we say, *Le mort saisit le vif*, which could be (poorly) translated by "the dead seize the living".

In other words, there is no intermediary period following the decedent's passing during which the latter's creditors may be allowed to file a claim against his Estate in order to obtain payment of his debts.

In addition, whereas in the US States the matters of probate and administration of estates are the competence of a judge (probate courts), in France the settling of the Estate is, as a general rule, the responsibility of the heirs which are deemed immediately vested the property of the Estate.

In practice however, in most cases the settling of an Estate is dealt with by *notaires* and/or lawyers, being specified that *notaires* have an exclusive competence for the registration of real estate transfers of ownership.

When the law applicable to the succession is the law of one American State (e.g. when the French decedent opted for said law by virtue of the EU Regulation n°650/12), the *notaire* and/or lawyer must apply this law to the whole French Estate.

- **How trusts can affect the settling of a French Estate?**

The concept of trust is alien to the French Civil Code. This is because there is no distinction between legal and equitable ownership.

Although it is impossible to create a trust under French law, and France has not ratified the Hague convention on the recognition of trusts, French courts recognise the effects in France of common law trusts, provided they comply with the mandatory provisions of French law (e.g. forced heirship rules, when applicable).

As a consequence, one may set up a trust to own assets wherever located, notably in France.

- **Who pays the gift/inheritance tax?**

Whereas in the US inheritance tax is paid by the Estate, in France it is paid by the heirs directly. As already explained this is because, under French inheritance rules, the heirs are deemed immediately vested the ownership of the Estate's assets.

In France, the rules governing gift tax and inheritance are very similar, although some differences exist.

In particular, the allowances and exemptions may differ between gift tax and inheritance tax. As an example, whereas the surviving spouse benefits from a full inheritance tax exemption (unconditional and unlimited), *intervivos* gifts between spouses are subject to gift tax.

For your information, the current rates applicable to both gift and inheritance tax are as follows:

  - Between parents and children:

Brackets	Rates
Up to € 8,072	5 %
€ 8,072 to € 12,109	10 %
€ 12,109 to € 15,932	15 %
€ 15,932 to € 552,324	20 %
€ 552,324 to € 902,838	30 %
€ 902,838 to € 1.805,677	40 %
Above € 1,805,677	45 %

  - Between brothers and sisters:

Brackets	Rates
Up to € 24,430	35 %
More than € 24,430	45 %

- Between relatives up to the fourth degree:

Flat rate of 55 %.

- For more distant relatives and unrelated persons:

Flat rate of 60 %.

- **When is the gift/inheritance tax due?**

  - Based on the situation of the concerned persons:

As a general rule, under the domestic laws of the US and France, inheritance tax may first be due based on the situation of the concerned persons:

In the US, inheritance tax may only be due if the decedent has a US "connection", namely if he is a US citizen and/or a US resident.

The French rules in this respect differ from the US rules for two reasons:

- First of all, citizenship is not a connection criterion, which means that French inheritance tax may only be due if the decedent is a French resident;
- In parallel however, contrary to the US, inheritance tax may also be due if the heir/legatee is a French tax resident (irrespective of whether the decedent is a French resident).

  - Based on the situation of the concerned assets:

Under the domestic laws of the US and France, inheritance tax may also be due based on the situation of the concerned assets:

In the US, inheritance is due in respect of assets located in the US, even if the decedent is not a US tax resident.

In France, inheritance tax is due in respect of "French located assets" within the meaning of Article 750 ter of the French tax code, even if the decedent and his/her heirs are not French tax residents.

Real estate properties and all movable assets (including works of art, financial investments, etc) located in France, as well as debts where the debtor is a French resident, are considered as French assets.

In this respect, it is worth noticing that in a nutshell, a company is deemed to be a "French asset" within the meaning of Article 750 ter of the FTC in following cases:

- First, if it is registered and/or has its head office in France;

- Secondly, a foreign company qualifies as a "real estate company" (*Société à prépondérance immobilière*) under Article 750 *ter* of the FTC (§2°, *al.* 4), i.e. if the market value of the French real property that it owns (directly or indirectly) exceeds the market value of its other French located assets;

- Thirdly, if the same "family group" owns more than 50% (directly or through intermediary companies or entities) of the company's share capital, even if the foreign company owning French real property is not a "real estate company" (Art. 750 ter of the FTC, §2, *al.* 2).

    - When the assets are held in a trust:

France introduced in 2011 a Law relating to the tax treatment of foreign trusts with a French connection (Law n°2011-900 of 29th July 2011). This law, which entered into force on 31st July 2011, created a whole new body of rules, in particular with respect to transfers for no consideration (gifts and inheritance) made though a trust.

By virtue of this new Law of 2011 (codified in Article 792-0 *bis* of the FTC), the passing of the grantor, when occurred after 31st July 2011, is as a general rule a triggering event for inheritance tax.

Under said Article, when the grantor passes, the trust funds are deemed to be "provisionally" allocated to the beneficiaries (although not actually distributed), the purpose of which is to serve as a basis for the potential inheritance tax due.

In other words, inheritance tax is due upon the passing of the grantor as if no trust existed, i.e. the beneficiaries are liable for the payment of gift or inheritance tax, which is assessed on the value of the trust assets at the time.

The tax rate is determined in accordance with the relationship between the grantor and the beneficiary, assuming the value of the trust assets is included in the inheritance tax return established by the grantor's heirs.

If it is not possible to ascertain the shares of the beneficiaries in the trust fund on the death of the grantor, the trustee should pay the inheritance tax at the rate of:

- 45%, if the class of beneficiaries only contains descendants of the grantor.
- 60%, if the class of beneficiaries contains non-descendants.

In any case however, a 60% inheritance tax rate will apply if the trust either:

- is governed by the law of other non-cooperative states or territories; or
- was settled by a French resident after 11th May 2011.

3/ The US-France tax treaty applying to gift and inheritance tax

As a general rule, a tax treaty defines the notion of domicile/residence, the taxes covered, the State which is entitled to levy tax depending on the situation, the means to avoid double taxation and finally, in succession matters, how to allocate the deductible debts of the estate between the two States.

Of course, a State's entitlement to tax may vary considerably between all the treaties signed by the States, and it is therefore always essential to refer back to the specific provisions of the treaty applicable to each specific situation.

In this respect, as already evoked in the introduction, the specificity of the Double tax treaty signed in 1978 by the US and France in matters of taxes on Estates, inheritances and gifts (as lastly amended in 2004) is that its provisions are drafted in order to take into consideration the notable differences which exist between the French and US tax legislations applicable to these matters.

The main provisions of the Treaty are briefly exposed below.

- **Fiscal domicile (Article 4 of the Treaty):**

For the purpose of the Treaty, the determination of a decedent's (or donor's) domicile is key to determine the States' rights to tax.

As already exposed, one main difference between the US and French tax rules governing the personal scope of inheritance and gift taxes is that whereas the US have two "connection criteria", namely residence and citizenship, France only applies the residence criterion.

To reflect this circumstance, Article 4 of the Treaty first provides for the usual criteria allowing to determine the domicile of a person, and then adds specific rules concerning US citizens being residents of France.

More specifically, Article 4 of the Treaty first states that "For the purpose of this Convention, the question whether an individual was domiciled in one of the Contracting States shall be determined according to the law of that State". It then provides for tie-breaking rules when an individual is considered as domiciled in both States.

Additionally, said Article adds in substance, concerning persons having US citizenship while temporarily domiciled France, that if those persons express the will to keep their domicile in the US, or if the domiciliation in France was caused by his employment, and if such domiciliation remains temporary, the person in question is considered to be domiciled only in the US.

These provisions are the direct consequence of the particularities of US tax legislation.

- **Transfers (by gift or death) of intangible assets, securities and cash (Art. 8 of the treaty):**

Article 8 of the Treaty provides that except in specific cases which are expressly listed (real property, shares in real estate companies, assets used for the conduct of the business of a permanent establishment and movable goods), "*property, including shares or stock in a corporation, debt obligations (whether or not there is written evidence thereof), other intangible property, and currency may be taxed by a Contracting State only if the decedent or donor was a citizen of or was domiciled in that State at the time of death or the making of a gift, and if taxable by that State under its laws*".

In other words, for intangible assets, securities and cash, inheritance tax may only be due in the State where the decedent was domiciled, or in the State of which the decedent a citizen (for US citizens only).

In the case where the decedent is a French resident and a US citizen, tie breaking rules will apply in order to eliminate a potential double taxation (see below, "Exemptions and Credits").

- **Transfers (by gift or death) of real estate property (Art. 5 of the treaty):**

Article 5 of the Treaty provides that "*Real property may be taxed by a Contracting State if such property is situated in that State*", being specified (paragraph 2) that "*The term "real property" shall have the meaning which it has under the law of the Contracting State in which such property in question is situated […]*".

Paragraph 3 of Article 5 states that "*The term "real property" shall also include shares, participations and other rights in a company or legal person the assets of which consist, directly or through one or more other companies or legal entities, at least 50 percent of real property situated in one of the Contracting States or of rights pertaining to such property. These shares, participations and other rights shall be deemed to be situated in the Contracting State in which the real property is situated*".

Article 5 of the convention relating to immovable property has been completely rewritten by the amendment to the Treaty dated 8 December 2004, in accordance with the French practice, in order to incorporate shares of companies (French or foreign) with a predominance of real estate into the definition of immovable property.

- **Transfers (by gift or death) of movable goods (Art. 6 of the treaty):**

As a general rule, tangible movable property (other than currency) may be taxed by a Contracting State if such property is situated in that State (assuming they are not used in the conduct of the business of a permanent establishment in the other State).

- **Exemptions and Credits (Article 12):**

As in all tax treaties, the purpose of Article 12 is to provide rules of elimination of double taxation. These provisions are extremely complex. The main rules provided by Article 12 may be summarized as follows:

  - The decedent is a non-US citizen, French resident:

France may tax the whole Estate of a French resident, including the assets which are taxable in the US by virtue of the Treaty.

In this case, France grants a tax credit equal to the amount of tax paid in the US in respect of the property taxable thereon.

In this case, for the calculation of the US tax, the Treaty provides that the estates of French residents benefit in the US from a unified tax credit, equal to the greater of the following two sums:

- the amount of the US estate tax credit granted to US citizens on the day of in proportion to the assets in the estate located in the United States; or
- the credit granted by United States law to the estates of non-residents and non-citizens of the United States.

  - The decedent is a French resident and a US citizen:

On the other hand, in this case (where the US may in practice tax its citizens as if the Treaty did not exist), double taxation is as a general rule eliminated on the US side by imputing French tax.

In addition, US citizens residing in France may notably benefit from the following measures:

- First,the exemption on US assets is maintained for the estates of French residents who are US citizens. To this end, in substance, Article 12 provides that on the French side, the tax credit in respect of the US assets is granted up to the amount of French tax on these assets, which leads to an exemption.

- Secondly, for intangible assets, securities, cash (Art. 8 of the Treaty), both States may levy taxes (France on the basis of residence, the US on the basis of citizenship). In this situation, double taxation is eliminated on the American side, by granting a tax credit equal to French tax.

    - The decedent is a US resident:

The US may tax the whole Estate of a US resident.

In this case, the US grants a tax credit equal to the amount of tax paid in the France in respect of the property taxable thereon by virtue of the Treaty.

    - "Equality of treatment"

Article 12 § 4 provides that for the computation of French inheritance tax in respect of an estate or gift made by a US citizen or a US resident (to a French resident), the same allowances and credits will apply than those granted by French domestic law in favor of the successions or donations of French domiciled persons.

The same applies to successions and donations from a French resident to the benefit of a US citizen or a US resident.

    - Measure to avoid double exemptions:

The purpose of Article 12, 6 is to avoid double exemptions that could result from misuse of the Treaty.

Under said Article, where an asset is taxable only in one State as a result of the Treaty and that such tax is not paid for a reason other than a specific exemption, a particular abatement or exclusion, the other State may tax that asset, irrespective of any contrary provision contained in the Treaty.

4/ Conclusion

The reading and application of the US-France tax treaty is far from being clear.

As a general rule, the tax credit mechanisms provided by the Treaty allow to avoid double taxation.

However this is not always the case, in particular when the triggering event (and therefore the timing) for payment of gift/inheritance tax is not the same in the US and France. This may notably be the case when the assets of the decedent/donor are placed in a trust.

In such cases, the heirs/donees may have to pay gift tax or inheritance tax in both States, at different times, without being able to benefit from the tax credit mechanism offered by the treaty.

In addition to this, one must bear in mind that in any case, the concerned taxpayer will always be subject to the highest possible taxation (either French or US), because the tax credit corresponding to a IHT paid in one State, granted by the other State, is always limited to the tax due in the latter State.

To conclude, anticipating and organizing estate planning is absolutely essential as soon as a US-French cross border situation may arise, not only for the purpose of preparing the transfer by death of one's estate, but also before one makes an investment in France or becomes a French resident.