An Overview of French and U.S. Tax Developments Concerning Tax-Haven Jurisdictions

FRANCE

In line with the OECD initiative to counter tax evasion, and commitments undertaken during the G20 meetings, France is accelerating its efforts against uncooperative countries that refuse to comply with international standards for the exchange of information.

The amended finance bill for 2009 introduced a new provision in the French Tax Code that defines the French concept of a non-cooperative country or territory as one that (i) is not an EU Member State, (ii) has not concluded at least 12 bilateral tax treaties containing a clause providing for administrative assistance allowing the exchange of information (in accordance with OECD standards) and (iii) has not entered into a treaty with France on mutual assistance regarding tax matters. On the basis of these three cumulative criteria, the French government will publish a list, which will be updated each year, with the names of the non-cooperative countries. France reserves the right to include any country that has signed tax treaties but demonstrated insufficient cooperation in tax matters, or that was unsuccessfully offered entrance into such a treaty with France.

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This first list, issued recently by the French government, includes the following countries: Anguilla, Guatemala, Niue, Belize, Cook Island, Panama, Brunei, Marshall Islands, Philippines, Costa Rica, Liberia, Saint-Kitts-and-Nevis, Dominica, Montserrat, Saint-Lucia, Grenada, Nauru, Saint-Vincent and the Grenadines.

New provisions

Pursuant to new provisions introduced by the amended finance law for 2009, any proceeds received from or paid to non-cooperative countries would either be excluded from favorable tax rules or subject to higher tax rates. The main tax consequences in France would be as follows:

› Dividends paid by a subsidiary located in a non-cooperative country do not benefit from the 95% parent-subsidiary exemption under the French participation-exemption regime.

› French withholding taxes levied on dividends and royalties paid to an entity located in a non-cooperative country increase to 50%. French-source interests cashed-in in a non-cooperative country (e.g. wired to a bank account in such country) are also subject to withholding at 50%, irrespective of the country of residence of the beneficiary, whereas any other French-source interests are no longer subject to withholding.

› French companies are not allowed to deduct from their tax result payments made to an individual or an entity located in a non-cooperative country unless they demonstrate that the main purpose of the payment is not to locate profits in a non-cooperative country.

› The new French CFC rules are more stringent when a subsidiary is located in a non-cooperative country. The French companies benefit from a safeguard clause for subsidiaries located in a tax haven when a commercial or an industrial activity is locally performed. The burden of proof is reversed when the subsidiary is located in a tax haven (the French company bears the burden of proof in such a case). Moreover, it is no longer possible to credit the withholding tax on passive income received by the CFC from a non-cooperative entity.

› The transfer-pricing documentation requirement is more restrictive for transactions with companies located in non-cooperative countries. Standard information on the activity, organization charts and information about relationships with foreign entities are required, as well as the balance sheets and income statements of the companies involved.

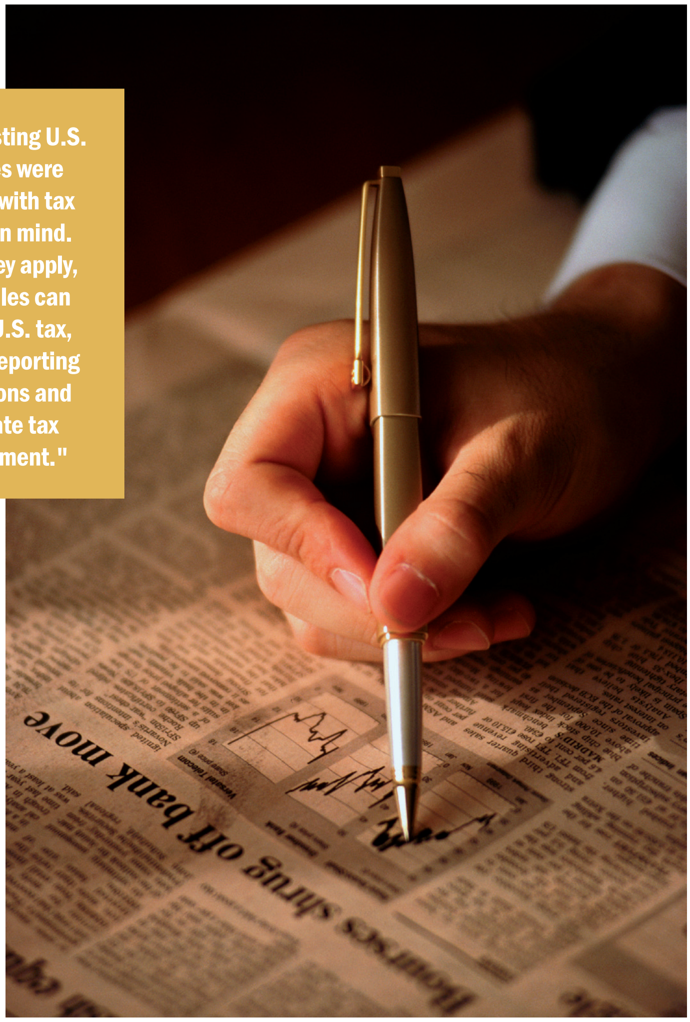
UNITED STATES

Recent U.S. federal and state legislative tax proposals echo, and in some cases exceed, the OECD commitment to combating tax-haven abuse through improved transparency and information exchange.

› The **Obama Administration** would strengthen the information-reporting and income tax-withholding systems by forcing foreign financial institutions to report the identities and account balances of U.S.-resident customers. To enforce these requirements, the U.S. would impose a 30% withholding tax on certain U.S. payments to foreign financial institutions that do not satisfy the reporting obligations. An important additional feature is a provision that would subject 10% U.S. shareholders to tax on certain income from intangibles transferred out of the U.S. to related low-taxed CFCs.

› The ***Stop Tax Haven Abuse Act*** would treat foreign corporations managed and controlled from the U.S. as domestic corporations. For purposes of civil judicial and administrative proceedings, the legislation would presume that a U.S. person (other than a public corporation) who formed, transferred assets to or received assets from a private entity located in a bank-secrecy jurisdiction has control over the entity. Parallel rules would also presume that amounts received by a U.S. person from a similar offshore entity represent unreported taxable income.

› *AB1178*, a California state proposal, would require multinational corporations filing a water's-edge election to include in their California combined report the income and apportionment factors of any affiliated corporation that does business in, or derives income from or attributable to, a tax haven. This rule would modify the existing practice of permitting eligible electing taxpayers to determine their California income by generally excluding their foreign affiliates.



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Targeted rules

Separate and apart from these initiatives, many existing U.S. tax rules were created with tax havens in mind. When they apply, these rules can trigger U.S. tax, impose reporting obligations and facilitate tax enforcement:

› CFC Income

The earnings of a foreign corporation without a U.S. taxable presence or U.S. source income generally are not subject to U.S. tax until repatriated to the U.S. The benefit of this deferral from U.S. tax is denied to 10% U.S. shareholders in circumstances where Congress felt the use of foreign corporations was abusive, as with the income of certain CFCs from tax-haven activities and investments.

› Individual Expatriates

U.S. individuals and companies are subject to U.S. tax on their worldwide income, whether or not they are U.S. nonresidents or earn income from non-U.S. sources. Some U.S. persons seeking to escape the U.S. tax net have surrendered their citizenship or residency. Since 2008, the tax cost associated with expatriation has increased substantially, as new rules impose an exit tax on most assets of covered expatriates.

› Corporate Inversions

Company expatriation typically involves the creation of a new foreign corporation, in a tax haven, that becomes the parent of a group's U.S. and foreign companies. Legislation enacted in 2004 discourages these "inversion" transactions by either limiting or eliminating any associated U.S. tax benefits.

› Transfer Pricing and Tax Reporting

U.S. transfer-pricing rules authorize the IRS to reallocate items of income or expense among related parties as necessary to ensure arm's-length dealing. The IRS's ability to monitor potential transfer-pricing abuses is facilitated by extensive reporting requirements imposed with respect to U.S.-owned foreign companies and U.S. persons engaged in cross-border transactions.

› Tax-Information Exchange

The U.S. has concluded tax-information-exchange agreements with several tax-haven jurisdictions that allow the contracting parties to exchange information, upon request, about civil and criminal tax matters.

› Offshore Deferred-Compensation Arrangements

Legislation enacted in 2008 discourages the use of tax-haven companies to pay certain deferred compensation that is not subject to a substantial risk of forfeiture to U.S. employees by eliminating any tax-deferral opportunity.

› Foreign Financial Accounts

U.S. persons must annually report whether they have a financial interest in, or signature or other authority over, a foreign financial account (including interests in foreign investment funds) with an aggregate value of more than $10,000 at any time.

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