FRENCH TAX RESIDENCE, INCOME TAX TREATIES AND NEWCOMERS REGIMES: WHERE DOES FRANCE STAND?

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INTRODUCTION

The determination of an individual's tax residence is a delicate exercise, combining a review of factual elements in light of different sets of criteria and rules. Most jurisdictions other than the U.S. impose tax sole on the basis of residence. Hence, a definition of tax residence is required. The criteria upon which tax residence is determined by a country may differ depending on the type of tax imposed, such as personal income tax or inheritance tax. Some jurisdictions may have in place a set of objective factors. Others may rely on general principles, leaving room for interpretation and uncertainty.

French domestic tax law adopts a single definition of tax residence for personal income and inheritance taxes, relying on several alternative criteria. The test can provide different results if a person's factual circumstances change during the year. If an income tax treaty applies, the analysis is first performed under French domestic tax law. If the analysis under French law is that the individual is a resident, the matter can be looked at again under a relevant income tax treaty. The tiebreaker rule that appears in most income tax treaties is based on a commonly accepted standard.

France has in effect a network of more than 120 income tax treaties. Most of them are based on the O.E.C.D. Model Income Tax Treaty. Some cover wealth tax or inheritance tax. France has also a small number of tax treaties covering gift and inheritance taxes.

Over the past 10 years, entitlement to substantive tax treaty benefits have been challenged when the individuals claimed tax residence in a treaty partner jurisdiction while benefitting from low-tax or no-tax regimes in their new country of residence. Examples of such regimes include the Beckham regime in Spain, the Aliyah exemption in Israel, the NHR regime in Portugal, the Nondom regime in the U.K., and the Italian newcomers regime.

The challenges cover entitlement to reduced withholding taxes on investment income derived from French sources and access to the tiebreaker provision under a relevant income tax treaty. The basis of the challenge is straightforward. If those taxpayers do not pay taxes locally on their foreign income they are not subject to tax on worldwide income in the country of residence. Consequently, they should not be considered to be residents of a treaty partner jurisdiction under the residence definition of a relevant income tax treaty. They risk full taxation in France.

At first, French Courts seemed to adopt a strict position on treating individuals who benefit from a newcomer regimes in a treaty partner country. In part, the courts applied the same test to individuals that were applied to corporations. Ultimately, a more lenient test was applied to individuals. The current approach is to recognize the application of income tax treaties for taxpayers benefiting from a newcomer regime in a treaty partner jurisdiction, provided that they maintain substantial personal contacts in the treaty partner jurisdiction.

This article (i) provides an overview of the criteria available under French domestic tax law and the O.E.C.D. Model Income Tax Treaty regarding the criteria for being a resident and (ii) reviews relevant French case law of the past 10 years clarifying the conditions under which taxpayers benefiting locally from a favorable newcomer regime may claim the application of an available income tax treaty to determine tax residence status.

TAX RESIDENCE STATUS UNDER FRENCH DOMESTIC TAX LAW

Under French Article 4 B of the French tax code, an individual may qualify as a French tax resident under any of the tests described below.

The individual's home or a principal place of abode is in France

French case law has linked the concepts of home and principal place of abode to residence. The primary test looks to the location of an individual's home. If that is not conclusive, the secondary test looks to the principal place of abode.[1]

The term "home" relates to the place where the individual generally lives. This criterion focuses on determining the center of the taxpayer's family interests, *i.e.*, the place where the taxpayer lives with spouse and children. The French administrative Supreme Court[2] generally considers that an individual who exercises professional activity abroad and who regularly stays in France because of the presence of a spouse and minor children results in France being the center of family interests.

The individual's main professional activity is centered in France

An individual's main professional activity is centered in France if the majority of working time related to the activity is carried out in France.[3] The rule applies if even if the French activity does not produce the main part of the individual's income. Time spent in France and elsewhere is of primary importance. If the time-spent factor comparison is not conclusory, compensation for each professional activity is examined may be examined.

The center of economic interests is located in France

The term of "center of economic interests" looks to the place where (i) an individual's main investments are located, (ii) an individual manages private affairs, (iii) the center of an individual's professional life is located, or (iv) an individual derives the most income.[4] In the situation where the taxpayer has various activities or investments,

1. French administrative Supreme Court, 3 November 1995, n°126513, Larcher.
2. French administrative Supreme Court, 12 March 2010, n° 311121, Gerschel – French administrative Supreme Court, 27 January 2010, n° 319897.
3. BOI-IR-CHAMP-10 n°220.
4. BOI-IR-CHAMP-10, n°230.

residence is determined by identifying the center of a person's economic interest, typically the country where most of an individual's income is generated.[5]

TAX RESIDENCE STATUS UNDER INCOME TAX TREATIES

If an income tax treaty is applicable, dual residence conflicts are resolved under dual resident provision of the treaty. Typically, the dual resident provision appears in Article 4 (Residence) of an income tax treaty based on the O.E.C.D. Model Income Tax Treaty. It provides a series of tests that are applied in specific order.[6] If the first test is inconclusive, the second is applied. If the second test is inconclusive, the third test is applied, and so forth until a determination is made.

Here are the typical tests and the order of application.

Permanent Home

The term "permanent home" refers to any type of home that an individual may own, rent, or occupy. It may be a house, an apartment, or a hotel room, as long as it is reserved for the individual's personal use and is available at any time. The permanence[7] of the home is essential. Where a person has a permanent home in both jurisdictions or in neither jurisdiction, the test is inconclusive.

Note that the test under an income tax treaty differs from the test under French domestic law. The former looks to the use of the physical premises and its permanence over a period of time. The latter looks also to family and personal interests at each location.

Personal and Economic Relations / Center of Vital Interests

The "center of vital interests" is determined by a body of evidence corroborating the place where the taxpayer has the greatest number of personal, professional, and patrimonial links and the relative importance of each link at each location. Examples are (i) family ties, (ii) social relations, (iii) occupations, (iv) political, cultural and other activities, (v) source of income and (vi) and wealth.

Where the economic links with one jurisdiction are stronger but the personal links are stronger in the other, the latter jurisdiction has been viewed at times as the jurisdiction of residence, provided that some amount of income is derived in that jurisdiction. However, in a recent case,[8] a court recognized that the two factors had equal weight and one negated the other. The test was found to be inconclusive.

Habitual Abode

The essential element here is the "habitual" physical presence in each of two countries. It is not absolutely necessary to count the days although a meaningful difference between the number of days spent in each country may lead to a conclusion.

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5 French administrative Supreme Court, 27 January 2010, n°294784, Caporal.

6 French administrative Supreme Court, 29 October 2012, n°346641, Kessler.

7 Durable possession of the home: French administrative Supreme Court, 17 December 2010, n° 316144, Venekas et Ms Giannarelli spouse Venekas.

8 Administrative Court of Nice, 11 March 2021, n°1402822.

Income tax treaties do not specify the period to be compared. The O.E.C.D. commentary states the following:

> * * * [T]he determination must cover a sufficient length of time for it to be possible to ascertain the frequency, duration and regularity of stays that are part of the settled routine of the individual's life.[9]

The habitual abode test under an income tax treaty must be distinguished from the most habitual abode in that counting the days is always necessary under French domestic tax law.

Nationality

The nationality test allocates the residence of an individual to the country of nationality. However, individuals may have two nationalities, if permitted by laws of each country. Where that occurs, or where the individual is stateless, the test based on nationality is inconclusive.

"If all prior tests are inconclusive, the determination of residence under an income tax treaty is determined on the basis of mutual agreement by the two countries."

Mutual Agreement

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APPLICATION OF INCOME TAX TREATIES FOR NEWCOMERS

Where an individual qualifies as a French tax resident under French domestic law and a tax resident of another country under its domestic law, a conflict exists as to the sole place of residence of that individual. This conflict may be resolved by an income tax treaty only if the treaty is applicable to the individual. To determine whether a specific income tax treaty is relevant, both treaty partner countries must conclude that the individual is a dual resident under the relevant income tax treaty.

O.E.C.D. Model Income Tax Treaty and O.E.C.D. Commentary

Paragraph 1 of Article 4 (Resident) provides the definition of the term "resident" for purposes of an income tax treaty.

> For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof as well as a recognised pension fund of that State. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

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9 O.E.C.D. (2017), Model Tax Convention on Income and on Capital: Condensed Version 2017, O.E.C.D. Publishing, C (4) n°19.1.

In several paragraphs, the O.E.C.D. commentary to Paragraph 1[10] addresses what it means to be liable to tax.

> 8. Paragraph 1 provides a definition of the expression "resident of a Contracting State" for the purposes of the Convention. The definition refers to the concept of residence adopted in the domestic laws (see Preliminary remarks). As criteria for the taxation as a resident the definition mentions: domicile, residence, place of management or any other criterion of a similar nature. As far as individuals are concerned, the definition aims at covering the various forms of personal attachment to a State which, in the domestic taxation laws, form the basis of a comprehensive taxation (full liability to tax). It also covers cases where a person is deemed, according to the taxation laws of a State, to be a resident of that State and on account thereof is fully liable to tax therein (*e.g.* diplomats or other persons in government service).
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> 8.1 In accordance with the provisions of the second sentence of paragraph 1, however, a person is not to be considered a "resident of a Contracting State" in the sense of the Convention if, although not domiciled in that State, he is considered to be a resident according to the domestic laws but is subject only to a taxation limited to the income from sources in that State or to capital situated in that State. That situation exists in some States in relation to individuals, *e.g.* in the case of foreign diplomatic and consular staff serving in their territory.
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> 8.3 The application of the second sentence, however, has inherent difficulties and limitations. It has to be interpreted in the light of its object and purpose, which is to exclude persons who are not subjected to comprehensive taxation (full liability to tax) in a State, because it might otherwise exclude from the scope of the Convention all residents of countries adopting a territorial principle in their taxation, a result which is clearly not intended.

Although comment 8.3 above seems to avoid the systematic exclusion of territorial tax systems, it could be viewed as also covering those tax systems where only newly arrived residents are subject to territorial taxation. Consequently, the O.E.C.D. commentary to Paragraph 1 could be viewed as applying to taxpayers benefiting from a newcomer regime that imposes tax only on domestic source income for a specified period of time.

Relevant French Case Law

First Stone

In the France-U.K. context, the French administrative Supreme Court ruled in 2012 in the *Regazzacci* case[11] that an individual resident in the U.K., whose foreign source

[10] The commentary is first effective as of July 17, 2008.

[11] French administrative Supreme Court, 27 July 2012, n°337656 and 337810, Regazzacci.

income was taxable in the U.K. only at the time of remittance under a tax regime for nondomiciled individuals was indeed resident in the U.K. for the purposes of the France-U.K. Income Tax Treaty applicable at the time.

Backward Step or Double Reading

In two cases decided by the French administrative Supreme Court on November 9, 2015,[12] the court held that the France-Spain Income Tax Treaty and the France-Germany Income Tax Treaty were not applicable to two pension funds. According to the court, the purpose of an income tax treaty is the elimination of double taxation and not the allocation of taxing rights between States. Each pension fund was entirely exempt from tax in its home country. A juridical person that is exempt from tax on all income by virtue of its status or activity is not likely to be exposed to the risk of double taxation. Presumably, the fact that the individuals covered by the pension plans would be taxable on future pension payments was not considered. A third case reached the same conclusion in 2016.[13]

These decisions were interpreted as weakening the position of taxpayers benefiting from newcomer regimes. As it turned out, however, the court adopted one set of rules for individuals and another for juridical persons.

Milestone

In 2020,[14] the French administrative Supreme Court reviewed the France-China income tax Treaty and concluded that an individual was not precluded from claiming benefits under the treaty merely because he benefitted from a territorial tax system in China. The important fact was that the individual was subject to tax in China by reason of his domicile, residence, or similar personal connection. The territorial aspect of the tax regime did not mean he was not subject to tax. While the France-China income tax treaty does not generally follow the O.E.C.D. Model Income Tax Treaty, and for that reason the decision may have its limitation, the conclusion is consistent with paragraph 8.3 of the O.E.C.D. commentary discussed above. At the very least, it confirmed the view that the rule for an individual is more favorable than the rule for a juridical person.

Towards Legal Certainty

More recently, the administrative Court of Appeal of Toulouse[15] rendered a decision regarding the application of the France-Israel Income Tax Treaty that follows paragraph 8.3 of the commentary to Article 4 of the O.E.C.D. Model Income Tax Treaty.

In the case, two Israeli residents benefitted from an exemption for foreign source income under the newcomer law, commonly known as the Aliyah exemption. The individuals were entitled to French pensions, ordinarily taxed in France under French domestic law. However, Article 18 of the France-Israel Income Tax Treaty provided that these pensions were only taxable in Israel. French tax authorities denied the

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12 French administrative Supreme Court, 9 November 2015 n°371132, Sté Santader Pensionnes; and French administrative Supreme Court, 9 November 2015 n°370054, min. c/ LHV.

13 French administrative Supreme Court, 20 May 2016, n°389994 Sté Easyvista.

14 French administrative Supreme Court, 9 June 2020, n°434972.

15 Administrative Court of Appeal of Toulouse, 13 October 2022, n°20TL22832.

exemption provided by Article 18, contending that the individuals were not residents of Israel as defined in the treaty. Article 4 of the treaty is similar to the O.E.C.D. provision. The term "resident" of a treaty partner country excludes persons who are subject to tax in the country only on income from sources in that country. The Court ruled in favor of the Israeli pensioners, reasoning as follows:

> [The exclusion for persons taxable only on income from sources in a State] is only intended to exclude from the status of resident of a State, persons who are locally subject to tax only on income from sources situated in that State for reasons other than the existence of a personal link with that State.[16]

The pensioners were Israeli residents within the meaning of the treaty and the treaty benefit for pensions stood.

CONCLUSION

It is not every day that a technical question involving interpretation of income tax treaties can be considered as clarified. The final conclusion of this debate might soon be reached in a confirmation by the French administrative Supreme Court. As explained in paragraph 8.3 of the O.E.C.D. commentary to paragraph 1 of Article 4 (Resident), an individual is considered to be a resident of a treaty partner country based on actual personal presence and ties with that country. If the ties exist and the individual is generally subject to tax in the country for income other than foreign source income, that individual is a resident of the treaty partner country, except to the extent the treaty provides otherwise. In comparison, the residence rule for juridical persons requires that income sourced in France must be subject to tax in the country of residence of that juridical person in order for a treaty benefit to be available.

As previously indicated, not all income tax treaties entered into by France are silent as to the effect of favorable tax regimes on the beneficiary's status as resident of a treaty partner jurisdiction. Paragraph 6-b of Article 4 of the France-Switzerland Income Tax Treaty essentially provides that an individual who benefits from a *forfait* ruling[17] is not considered to be a Swiss resident for purposes of the treaty.

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16 Translation for information purposes.

17 See Aliasghar Kanani, "Swiss Lump Sum Tax Regime – Based on Annual Expenditures," *Insights* Volume 10, Number 1 (January 2023); and Michael Fischer, "The Forfait Tax Regime in Switzerland – a Venerable Alternative," *Insights* Volume 2, No. 10 (December 2015).