EXHIBIT A - Memorandum

QUESTION PRESENTED & CONCLUSION

1. I have been asked by Stuart Horwich to provide an expert report for the United States Tax Court discussing whether under French law the French *contribution sociale généralisée* (CSG) and *contribution pour le remboursement de la dette sociale* (CRDS) are covered by the Agreement on Social Security between the United States of America and the French Republic (the US-France Totalization Agreement), signed on March 2, 1987 and entered into force on July 1, 1988.

   Based on my review of **French and European Union laws, French and European Union court precedents and French administrative pronouncements**, it is my conclusion that under French law CSG and CRDS are French income taxes that are covered by the US-France double taxation treaty signed on August 31, 1994, as amended (the US-France DTT) and are not covered by the US-France Totalization Agreement.

DISCUSSION

2. I have read the memorandum on the same question prepared by Professor Daniel Gutmann on March 13, 2013, at the request of the Commissioner of Internal Revenue.

   I have also read the two letters from the French social security authorities attached by the Commissioner as exhibits A and B to his brief, namely a letter from the collecting agency for the Paris area (*URSSAF de Paris-Région Parisienne*) undated but probably from early 2001 (the Paris URSSAF 2001 Letter) and a letter from the central agency for social security organizations (ACOSS) of July 24, 2012 (the ACOSS 2012 Letter).

3. I concur with Professor Gutmann's statement that there is no judicial or administrative precedent in France expressly addressing the question whether CSG and CRDS are covered by the US-France Totalization Agreement. And, as I shall demonstrate below, neither of the two letters provided by the Commissioner says or implies anything on the specific question before the Court.

4. I also concur with part 1 of Professor Gutmann's memorandum which states that as they do not give an entitlement to any benefits "*CSG and CRDS are taxes*", and – as we shall see – more specifically, they are income taxes, both for French domestic law purposes and for double taxation treaties and especially the provisions of the US-France DTT. I expand on this below by illustrating how such characterization operates in various situations which have given rise to court precedents or administrative pronouncements in France, some of which have not been identified or addressed by Professor Gutmann.

5. In substance, I also concur with the first section of part 2 of Professor Gutmann's memorandum according to which the free circulation of workers and the freedom of establishment under European Union law, and the related European Union regulations on social security, prevent France from levying CSG and CRDS on persons who are

subject to the social security system of another EU Member State and certain other European jurisdictions.

I do not believe, however, that the concepts of free circulation of workers and freedom of establishment under European Union law are relevant to the issue of whether CSG and CRDS are covered by the US-France Totalization Agreement. A further analysis of the relevant precedents of the Court of Justice of the European Union (CJEU) (previously known as the European Court of Justice or ECJ) and French courts, especially the *Cour de Cassation*, based upon these EU law provisions and principles demonstrate that European Union law concepts are not useful in analyzing totalization issues with third countries like the United States.

6. Moreover, Professor Gutmann does not appear to have considered paragraph (4) of Article 2 of the US-France Totalization Agreement, which states:

   "*Unless otherwise provided in this Agreement, laws within the meaning of paragraph 1 shall not include Regulations on Social Security implementing the Treaties establishing the European Communities or treaties or other international agreements which may be in force between either Contracting State and a third State, or the laws or regulations promulgated for their specific implementation*."

   This provision bolsters my view that European Union law is not relevant in this area. Accordingly, I respectfully disagree with Professor Gutmann's proposition in section 2.2 of his memorandum that EU law and its interpretation by the ECJ and the *Cour de Cassation* might also apply to interpret the US-France Totalization Agreement (pages 17 and 18).

I. <u>A bilateral international agreement excluding reference to EU law</u>

7. The US-France Totalization Agreement is a bilateral agreement aimed at "*regulating the relationship between their two countries in the field of Social Security*."

   Article 1 states that:

   "*For purposes of the Agreement: …*

   3. "Laws" means the laws and regulations specified in Article 2."

   Paragraph 1 of Article 2 defines the applicable laws for the purposes of the Agreement, respectively in the United States and in France.

   <u>A specific exclusion</u>

8. Certain Social Security Agreements (including the European convention on Social Security drawn within the Council of Europe) provide in substance that "*laws*" shall not include treaties or other international agreements concluded by one Contracting State and a third State or laws or regulations promulgated for their specific intention (or implementation).

   As mentioned above, the US-France Totalization Agreement contains a provision that also excludes the Treaties establishing the European Communities and the regulations on social security implementing them (*Article 2(4) cited above in paragraph 6*).

Similarly, although the EU Regulation n° 1408/71 on the application of social security schemes to persons moving within the Community (now the European Union) contained no specific provision relating to social security agreements between a Member State and a third country, the European Court of Justice ruled that "*the concept of "legislation*" … *does not cover the provision of international social security agreements concluded between a single Member State and a non-member State. That interpretation is not invalidated by the fact that such agreements have been incorporated as statutory law into the domestic legal order of the Member State concerned*" (*ECJ 2 August 1993 C-23/92 Grana-Novoa, point 29, ECR I-4533; opinion van Gerven ECR I-4521; distinguished on other grounds by ECJ 15 January 2002 C-55/00 Gottardo, ECR I-433; opinion Ruiz-Jarabo Colomer, ECR I-415*).

The US-France Totalization Agreement thus exclusively considers the laws of the United States and France and excludes any reference to EU law and especially any "*regulation on social security implementing the treaties establishing the European communities*" (now the European Union).

9. For the enforcement of the rights to free movement and freedom of establishment laid down in Articles 48 and 52 of the EC Treaty (now Articles 45 and 49 TFEU) to benefit border workers who reside in France and work in a neighboring country in relation to CSG and CRDS, the ECJ held that:

   "*For the purposes of the application of Article 13 of Regulation n° 1408/71, the decisive criterion is that of the specific allocation of a contribution to the funding of the social security scheme of a Member State. Whether benefits are obtained in return or not is therefore irrelevant in this connection*" (*point 40 of ECJ 15 February 2000 C-34/98 Commission vs. French Republic, ECR I-1028; point 38 of ECJ 15 February 2000 C-169/98 Commission vs. French Republic, ECR I-1052; opinion La Pergola, ECR I-997*).

   The scope and the decisive criterion of Article 13 of EU Regulation n° 1408/71 are irrelevant to decide whether CSG and CRDS are taxes covered by the US-France Totalization Agreement as:

   – both this EU regulation and the rights to free movement of workers and freedom of establishment derive from the European Union (previously Communities) Treaties which are expressly excluded from the "*laws*" of France by Article 2(4) of the US-France Totalization agreement; and

   – the purposes of EU Regulation n° 1408/71 and the US-France Totalization Agreement are entirely different.

   Different scopes and purposes

10. The issue at stake before the ECJ was whether French legislation on CSG and CRDS, as it then stood, which made persons residing in France subject to both taxes, even where, as border workers, they worked in another Member State, hindered the free movement and freedom of establishment of persons- two "*fundamental community provisions,* (in respect of which) *any restriction even minor is prohibited*" (*ECJ C-34/98, point 49 and C-169/98, point 46*).

The ECJ found that such was the case, although CSG and CRDS applied equally to all French residents, because those who work in another Member State and accordingly contribute to the funding of the social security scheme of that other State also partially financed the French scheme through payment of CSG and CRDS. Such double taxation infringed on the free movement of worker principle (*ECJ C-34/98, point 45 and C-169/98, point 42*).

This hindrance was eliminated shortly after the ECJ ruling when the French legislation was amended by Ordinance n° 2001-377 of May 2, 2001 to relieve French residents from paying CSG and CRDS where they do not participate in the French social security system. Although the ECJ rulings had authority under EU law only, the French legislature extended the solution – as it often does – based on the French conception of equality of rights, to other French residents who are in a similar situation *i.e.,* outside the ambit of the French social security system (*Article L. 136-1 of the French social security code*).

Before this amendment came into effect, the collecting agency for the Paris area (*URSSAF de Paris–Région Parisienne*) conceded in the Paris URSSAF 2001 Letter that the exemption would be extended to "non-Community" – *i.e.*, non EEA – workers who are subject to a foreign social security system under a totalization agreement with France.

11. It is not infrequent that, in order to facilitate the free movement of persons, capital and services within the EU, EU law requires obstacles to be removed in a cross-border context while the same obstacles may remain in a domestic context or in relation with third countries, thus resulting in so called "reverse discrimination". In the CSG/CRDS case, in order to comply with the ECJ ruling pursuant to Article 228 of the EC Treaty (now Article 260§1 TFEU), France only had to exempt from CSG and CRDS border workers who were subject to the social security system of another member State. None of the ECJ rulings, any EU rule or principle or any international agreement applicable to France required the exemption to be extended to benefit other residents who might not to be subject to the French social security system. Indeed, the French Constitution permits CSG and CRDS to be assessed upon such persons (*see Constitutional Court 90-285 DC 28 December 1990 – Finance Act 1991, points 23 and 24*).

    However, "reverse discrimination" may run against the French national principle of equality of rights (*CE 6 October 2008 n° 310146 Compagnie des architectes en chef des monuments historiques, RJDA 2009.132*). In order to reconcile this principle with the requirements of EU law, the French legislature often treats purely internal situations – and/or situations involving third countries – in the same way as situations governed by EU law, so as to align French legislation to EU law.

    This alignment is not uncommon in tax matters and, as a result, French tax courts apply national legislation to purely internal situations – and also situations involving third countries – in light of EU law applicable to similar cross-border situations in the EU (*CE 17 June 2011 n° 324392 SARL Méditerranée Automobiles and n° 314667 Finiparco, Dr. Fisc. 2011 n° 37 comm. 502 opinion Collin on the taxation of corporate mergers; 20 February 2012 n° 321224 Sté Civile Participasanh, Dr. Fisc. 2012 n° 17 comm. 276 on the participation exemption*). This is exactly what the

French legislature, the URSSAF de Paris and the *Cour de Cassation* decided in 2001 when implementing the ECJ rulings.

As mentioned above, Ordinance n° 2001-377 of May 2,2001, added a sentence to Article L. 136-1 of the social security code with the effect of exempting from CSG – and, as a consequence, from CRDS – French residents who do not qualify for the French social security system.

The Paris URSSAF 2001 Letter similarly indicates that, although the ECJ rulings directly applied to EU migrant workers only, the same solution would be extended to border workers with non-EU Switzerland and Monaco and, more generally to any seconded employees belonging to a foreign social security system under a totalization agreement in force with France. Both solutions are based on the French concept of equal rights. Neither the law nor the Paris URSSAF 2001 Letter indicates or implies that CSG and CRDS are covered by any totalization agreement.

Similarly, French courts have held that French residents were relieved of paying CSG and/or CRDS where they demonstrated that they were subject to a foreign social security system (*Cassation 18 October 2001 n° 00-12463 André vs. URSSAF du Territoire de Belfort, Bull. 2001 V n° 327*) ("*Swiss case*"). Where no such demonstration was made, the relief was denied *(Cassation 8 March 2005 n° 03-30700 Sté Dalle vs. URSSAF de Lille, Bull. 2005 II n° 54* ("*Belgian case*"); *see also CE 4 May 2011 n° 330551 Cousin, RJF 2011/7 n° 907, opinion Geffray, BDCF 7/11 n° 92*).

12. As Professor Gutmann rightly points out on page 14 of his memorandum, the "Swiss case" was decided in relation to a period (1993 and 1994) when EU Regulation n° 1408/71 was not applicable to Switzerland, yet the *Cour de Cassation* judgment is formally based upon article 227 of the EC Treaty (now article 259 of the TFEU) and the authority of the infringement decision(s) made by the ECJ. However, contrary to Professor Gutmann, I believe that this specific reasoning (a) does not imply that CSG was covered by the totalization agreement between France and Switzerland and (b) has no impact on the US-France Totalization Agreement for the following two reasons.

    a) Extending unilaterally a solution deriving from EU law to situations not governed by EU law – but defined by a bilateral agreement with a third country – on the basis of the French concept of equal rights creates no rights or obligations upon the third country and accordingly does not imply that the solution is covered by the bilateral agreement with the third country.

    b) Unlike the US-France Totalization Agreement, the Swiss-French Totalization Agreement does not contain a clause similar to Article 2(4), which excludes EU law and the EU regulation on social security from the concept of "laws". In my opinion, the Court felt free to "import" a reference to the interpretation by the ECJ into its decision: the letter of the Swiss-French Totalization Agreement did not formally prevent it from doing so and it was a mere anticipation of what had become a permanent solution.

In the final analysis, I believe that had the French legislature amended Article L. 136-1 of the social security code to apply solely in the European context, a US citizen temporarily working in France would have continued to fall within the statutory

charging requirements for CSG and CRDS. The US-France Totalization Agreement would not have provided an exemption from these taxes.

13. A 2007 ruling of the ECJ confirms that CSG provides no entitlement to benefits that might be exported to another EU Member State – in other words, GCS provides no "period of coverage". The EU regulations have a wider scope than the US-France Totalization Agreement in the sense that they extend *inter alia* to special non-contributory cash benefits which, contrary to the general rule, are not "exportable" *i.e.,* not payable to a beneficiary who has ceased to be a resident of the Member State where the institution providing the benefit is situated (*Article 3(2) and (3) of Regulation n° 883/2004 replacing Article 4(2a) and 10 a of Regulation 1408/71*).

    Non-contributory benefits tend to provide either a minimum subsistence income or a specific protection to the disabled, all in line with the social situation or environment of the Member State where the beneficiary is a resident (*Article 70(1) and (2) of Regulation n° 883/2004 replacing Articles 4(2a) and 10 a of Regulation 1408/71*). Such benefits are financed "*exclusively from compulsory taxation intended to cover public expenditure*" and the attribution or amount of such "*benefits are not dependent on any contributions by the beneficiary*" (*subparagraph (b) of Article 70(2) of Regulation n° 883/2004 replacing subparagraph b of Article 4(2a) of Regulation 1408/71*).

    As the French CSG funds some of those programs – including allowances for elderly persons granted by the National Solidarity Fund (later named Old-Age Solidarity Fund (FSV)) and, more recently, the dependency allowance – the question arose whether this resulted in such programs being "contributory" and accordingly "exportable", which is equivalent to a "period of coverage" being acquired in France. Although the ECJ did not decide whether the CSG was a tax or a social charge, it did decide that the allowance for elderly persons was not contributory and accordingly could be restricted to beneficiaries residing in France, *i.e.*, it is not "exportable" (*ECJ 16 January 2007 C-265/05 Perez Naranjo, ECR I-363; and Cassation 12 June 2007 n° 04-30.050, Bull. II n° 151; see also Cassation 28 April 2011 n°10-30.502 Mme Benkaddour veuve Gouri*).

    In other words, the EU regulations are so specific and so different from a social security totalization agreement such as the US-France Totalization Agreement that the specific direct and principal allocation of income taxes like CSG and CRDS to the funding of national social security schemes (1) is sufficient to bring these taxes under the prohibition of double taxation as far as the taxation of migrant workers is concerned but (2) is not sufficient to prevent special schemes thus partly funded from being deemed financed "*exclusively from compulsory taxation intended to cover general public expenditure*."

II. <u>CSG and CRDS are income taxes</u>

14. As mentioned in Professor Gutmann's memorandum, the case law of both the Constitutional Court and the *Conseil d'État* is clear-cut: both CSG and CRDS are taxes, as opposed to social security charges, as none of these compulsory payments gives rise to an entitlement to services or benefits under French social security or social assistance schemes or other programs to which they are allocated.

As a result, the Constitutional Court held that:

– CSG may apply to persons who do not qualify for social security benefits (*90-285 DC 28 December 1990 - Finance Act 1991, points 23 and 24*).

– CSG may be used for purposes other than funding social security schemes: "*No principle or rule of constitutional standing precludes a portion of the proceeds of the general social contribution [CSG], which is among "taxes of all kinds" within the meaning of Article 34 of the Constitution, from being used for other purposes than funding the social security schemes*" (*2001-447 DC 18 July 2001 - Law relating to the loss of autonomy by elderly persons and the personal allocation for autonomy; point 17*).

Similarly, the *Conseil d'État* held that:

– CSG and CRDS, being taxes and not social security charges, may not be deducted from the taxable basis for assessing income tax under the general provisions of the tax code that allow the deduction of such charges (*CE 7 January 2004 n° 237395 Martin, RJF 4/04 n° 375, opinion E. Glaser, BDCF 4/04 n° 50; and 15 June 2005 n° 258039 Gréard, RJF 10/05 n° 1001*). Only a limited portion of CSG, since it was increased, is now deductible under a specific provision of the code (*Article 154 quinquies of the French general tax code*).

– CSG on dividend income is payable by a recipient shareholder even where he was not affiliated with any social security scheme (*CE 4 May 2011 n° 330551 Cousin, RJF 7/11 n° 907, opinion E. Geffray, BDCF 7/11 n° 92*).

15. CSG and CRDS are specially allocated to certain purposes. Some of these purposes are covered by the "*laws*" in the US-French Totalization Agreement (*e.g.*, family benefits and compulsory health schemes) and some of these are not (*e.g.*, Old-Age Solidarity Fund).

Under section IV of article L. 136-8 of the Social Security code, CSG is allocated to five programs of which three are social security schemes:

– family benefits;

– compulsory health schemes; and

– the Old-Age Solidarity Fund (which provides non-contributory benefits).

Portions of the proceeds of CSG are also allocated to purposes such as:

– the National Solidarity Fund for Autonomy; and

– the Social Debt Redemption Fund.

Under Article 4 of Ordinance n° 96-50 of January 24, 1996, the Social Debt Redemption Fund was established to repay debts incurred by certain social security schemes, and to finance certain payments made to France's general budget.

Although these allocations are mandated by statute, nothing in French constitutional law or treaty obligations would preclude the legislature from changing these allocations.

16. One of the most important consequences of the determination that CSG and CRDS are taxes, rather than social security charges, is that they are governed by two constitutional principles set out in articles 12 and 13 of the Declaration of the Rights of Man and the Citizen of July 17, 1789.

Article 12 sets out the principle of equality in public burden sharing.

Article 13 provides:

"*A common contribution is indispensable for the maintenance of the public force: it should be equally distributed among all citizens, in proportion to their ability to pay*".

Under this provision, the Constitutional Court has stated that:

"*Under Article 34 of the Constitution, it is the task of Parliament, to determine, in due compliance with constitutional principles and taking into account the specificities of each tax, the rules applicable to the assessment of such ability to pay, without such assessment entailing any patent infringement of the principle of equality in public burden sharing*;"

The Constitutional Court has applied these principles on several occasions to ascertain the compatibility of new legislative measures relating to CSG or CRDS or both (*90-285 DC, point 40; 2000-437 DC, points 7 to 12; 2000-442 DC, point 28; 2007-455 DC, points 15 and 16; 2012-659 DC, point 15; 2012-622 DC, points 17 to 21, 51, 80, 81 and 101*).

When taking into account the specificities of each tax, the Constitutional Court has constantly viewed CSG and CRDS as income taxes and considered the specific character of income tax in France which (a) is a progressive tax that applies at escalating rates to (b) the overall income of a family household. The reference to the taxable household for income tax purposes was recently emphasized by the Constitutional Court in its decision 2012-662 DC (points 71 to 73), which invalidated the newly introduced 75% marginal tax rate.

These principles and methods are reflected in decisions of the Constitutional Court relating either to reduced rates and exemptions of CSG and CRDS or to the maximum overall tax burden.

<u>Reduced rates and exemptions for CSG and CRDS</u>

17. By its decision 2000-437 DC, the Constitutional Court invalidated a provision of the Social Security Financing Act of 2001 which reduced CSG on earned income where such income was lower than a certain amount, a provision that arguably could have been valid if the CSG were a social security charge. The Constitutional Court restated that the legislature must comply with constitutional principles and rules and accordingly take into account the capacity to contribute (*i.e.*, ability to pay) of the taxpayer considering the specificities of each tax (point 7). The court further stated that "*if the legislator may modify the taxable basis of the CSG in order to alleviate the*

burden falling upon the most modest taxpayers, it is on the condition not to create a patent infringement of equality between those taxpayers." The court then added that "*the challenged provision does not take into account either the income derived by the taxpayer from sources other than its activity or the income of the other members of the household or of the dependent persons of the household*." The court concluded that "*the choice thus made by the legislator not to take into consideration the overall ability to pay thus creates among the taxpayers concerned a manifest disparity which is contrary to Article 13 of the 1789 Declaration*" (*2000-437 DC 19 December 2000 - Social Security Financing Act for 200,1 point 9*).

18. Conversely, where exemptions from CSG and CRDS are based upon the same criteria as exemptions from income tax, the Constitutional Court found them valid. In reviewing the Finance Act of 2001, the court held that "*in exempting from CRDS unemployment income and incapacity payments, together with retirement pensions, of persons who are not subject to income tax, the legislator did not overlook the requirements of article 13 of the Declaration of the Rights of Man and the Citizen of 1789*" (*2000-442 DC 28 December 2000, point 28*).

    Similarly, the Constitutional Court held that the 2007 Act pertaining to work, employment and purchasing power could validly exempt overtime from income tax and social security charges and, although not exempting overtime from CSG and CRDS, further reduce social security charges for amounts covering the CSG and CRDS due by an employee working overtime, without infringing the principle of equality as derived from Article 13 of the Declaration of 1789 (*2007-555 DC 16 August 200,7 point 16*).

    These decisions show that, in assessing the specifics of each tax, the Constitutional Court applies the same standards to CSG and CRDS as it does to income tax and does not treat CSG and CRDS as social security charges. The same applies to the appreciation of the maximum tax burden that may be imposed upon a taxpayer, *i.e.*, a tax household.

    <u>Maximum tax burden</u>

19. The same 2007 Act introduced a controversial "tax shield" by inserting a new article 1 to the general tax code establishing 50% as the maximum percentage of income that a tax household may be required to pay in direct taxes. This 50% ceiling included CSG and CRDS (but not social security charges) in the amount of such maximum total direct taxes.

    In reviewing this provision, the Constitutional Court held:

    "*24° The requirement deriving from Article 13 of the Declaration of 1789 would not be complied with if taxation were to be of a confiscatory nature or subjected a certain category of taxpayers to an excessive burden in comparison with their ability to pay taxes. The principle of capping the proportion of a tax household's income allocated to paying direct taxes, far from infringing the principle of equality in public burden sharing, is intended to avoid a patent infringement of this same principle*;

    25° Firstly, the ***general social contribution [CSG]****, the* ***contribution to the repayment of the social debt [CRDS]****, the social levy on income from property and*

financial investments together with the further contribution to the National Autonomy Fund ***are all taxe****s of all kinds within the meaning of Article 34 of the Constitution.* ***Including such taxes in the total of direct taxes taken into account is not inappropriate*** *for the purpose which Parliament seeks to achieve;*

26° Secondly, fixing at 50% the percentage of income beyond which payment entitles the taxpayer to a refund is not flawed by any patent error of appreciation;

27° Lastly, the capping mechanism which consists of refunding the taxpayer the amounts paid in direct taxes over and above the ceiling fixed by the statute is based on an overall calculation of tax paid and not on any calculation of each type of tax. The argument that this mechanism inures to the benefit of those who pay certain taxes is thus to be dismissed;

28° In view of the foregoing, section 11 of the statute referred for review does not run counter to Article 13 of the Declaration of 1789" (*2007-555 DC 16 August 2007, points 24 to 28*).

20. When assessing whether the tax increases introduced late in 2012 by the Finance Act of 2013, resulted in an excessive burden in comparison with certain taxpayers' ability to pay, the Constitutional Court made a similar analysis and examined the total income tax burden resulting from the accumulation of the multiple layers of income tax, including CSG and CRDS with income tax itself, but not including social security charges (*2012-662 DC 29 December 2012*).

    The relevant parts of this decision are quoted in Appendix A to this report.

    It follows from such decision that CSG and CRDS – and certain other contributions some of which are embodied in the social security code – are two of the multiple layers of France's "*overall body of taxes applicable to the same income which are paid by the same taxpayer*" often described as a "*mille feuilles*" or Napoleon pastry. As such, they are relevant to determine the ability to pay tax under Article 13 of the Declaration of Rights of 1789. Both CSG and CRDS are constantly distinguished from social security charges, which are not considered in determining either the overall tax burden or the capacity to pay tax under the French Constitution.

21. A confirmation of this analysis can be found in another decision of the Constitutional Court which further distinguished CSG and CRDS, regarded as direct income taxes, from social security charges and especially the contribution for health care benefits.

    Professor Gutmann briefly presented this so called "*Derouin Case*", in which I was personally the plaintiff, and the court decisions as a result of which occupational income from foreign sources accruing to French residents are exempt from CSG and CRDS pursuant to the relevant double taxation treaties. I shall address this further under paragraph 25 of this report.

    In order to compensate for the loss of revenue to the health care branch of social security resulting from this exemption of foreign source income from CSG and CRDS, the French legislature introduced a provision in article L. 131-9 of the social security code with the effect of increasing the rate of health insurance charge on "*income exempted from direct taxes as a result of an international agreement*." This provision

was declared unconstitutional by the Constitutional Court decision of December 13, 2012 on the ground that "*in submitting to a derogatory rate regime certain beneficiaries of a French health insurance scheme such provision creates a breach of equality between the beneficiaries of the same scheme which is not based upon a difference of situation linked to the purpose of the social charge*" (*n° 2012-659 DC, point 15*). In other words, CSG and health care insurance charges are so unlinked that an exemption from the former is not a valid justification for an increased rate of the latter.

22. As a result of all the characteristics of CSG and CRDS - being direct income taxes (as opposed to social security charges), being governed by French constitutional rules on income taxes, and further being unlinked to social security charges – I believe the laws governing CSG and CRDS do not fall within the definition of the "laws of France" for the purposes of the US-France Totalization Agreement.

    This is all the more the case as both CSG and CRDS are covered by double taxation treaties entered into by France, including in particular the US-France DTT.

III. <u>CSG and CRDS are covered by double taxation treaties, including US-France DTT</u>

23. As Professor Gutmann states in section 1.2 of his memorandum, the French tax authorities have consistently taken the view that CSG and CRDS are covered by the double taxation treaties entered into by France.

    This rule applies also where CSG and CRDS are not expressly mentioned among the covered taxes, as they are deemed "*identical or substantially similar*" to income tax within the meaning of Article 2 of the model tax treaties established by the OECD and the U.N. and also Article 2(4) of the US model income tax treaty and Articles 2(4) and 24(1)(e) of the US-France DTT.

    This analysis was publicly expressed on several occasions and is currently set out on the official website of the French tax authorities (Bofip.impôts.gouv) as follows:

    – Exchange of letters of July 7 and 28, 1998 between the governments of France and Italy regarding the Italy-France DTT (*BOI-INT-CVB-ITA-10-10-20120912, point 130*);

    – Commentary on the Algeria-France DTT (*BOI-INT-CVB-DZA-10-20120912, point 200*). In the original commentary published in BOI 14 B-3-03, the French administration indicated that "*These commentaries may serve as a reference for the interpretation of the double taxation agreements containing identical stipulations.*" This indication now can be found in Bofip.impôts.gouv at *BOI-INT-CVB-BWA-20120912, point 10*;

    – Commentary on the Botswana-France DTT (*BOI-INT-CBV-BWA-10-20120912, point 60*); and

    – Commentary on the Uzbekistan-France DTT (*BOI-INT-CVB-UZB-10-20120912, point 40*).

As a matter of French law, where the French tax administration has formally expressed its position on this website, taxpayers are protected from any different interpretations by the administration or by the courts.

24. The application of the US-France DTT to CSG and CRDS is expressly confirmed:

– by three administrative documents, namely:

    (i) a private letter ruling of December 12, 1997 from the French tax legislation department to the Association of American Residents Overseas,

    (ii) the French official guidelines on compensation for government service (*Doc. Adm. 5 F 1321, point 60*), and

    (iii) currently, a position now embodied in Bofip.impôts.gouv at BOI-INT-CVB-USA-10-20-40-20120912, point 120; and

– by a judgment of the Cour de Cassation (*Cassation 2e civile 23 May 2007 n° 06-19.723, X. vs. Fortis assurances*).

This judgment relates to the withholding of CSG and CRDS by a French insurance company on investment income paid to a person who was residing in the United States. The court held that the insurance company was entitled to withhold such sums since the beneficiary did not provide the form stipulated in Article 32 of the US-France DTT to demonstrate his residence in the United States, thereby confirming that CSG and CRDS are covered by the US-France DTT.

25. As far as CSG and CRDS on professional income are concerned, the Paris Court of Appeals has rendered two dispositive decisions in a series of similar cases (*Paris 6 November 2008 n° 03/43012 Derouin vs. URSSAF de Paris, Dr. Fisc. 2008 n° 48 act. 347, JCP E. 2008 n° 49 com. 2489; and 26 March 2009 n° 03/43012 not reported*).

The first decision addresses CSG and the second CRDS, in each case on foreign source income realized by a French partner in a major multinational partnership providing legal services. Both decisions were rendered after a preliminary ruling was sought from the ECJ as to whether EU Regulation n° 1408/71 precludes a treaty, such as the double taxation treaty between France and the United Kingdom, from providing that income received in the United Kingdom by workers resident in France and covered by French social insurance, is excluded from the base on which CSG and CRDS levied in France are assessed. The ECJ ruled that the relevant regulation "*does not preclude a Member State whose social legislation is alone applicable to a resident self-employed worker, from excluding from the tax base for contributions such as the General Social Contribution [CSG] and the Social Debt Repayment Contribution [CRDS] income earned by the worker in another Member State, by application, in particular, of a treaty for the avoidance of double taxation with respect to taxes on income*" (*ECJ 3 April 2008 C-103/06 Derouin, ECR I-1853*).

After this ruling, the Court of Appeals referred to the above mentioned decisions of the Constitutional Court (see paragraph 15 above) stating that CSG is a tax even if it is specially allocated to the funding of social security schemes and is within the scope of EU Regulation n° 1408/71. The court added that "*CSG constitutes* (one of) *the*

measures taken in the context of an increased financing of social security by taxes." The court went on to state that as a result of the characterization by the Constitutional Court, CSG is a tax covered by the UK-France income tax treaty pursuant to which professional income attributable to a fixed base in the United Kingdom is exclusively taxable in the United Kingdom. The court added a reference to the above mentioned exchange of letters between France and Italy as a confirmation of the intention of the French government to exclude (professional) income from foreign sources from the taxable basis of CSG.

A further appeal by the collecting agency (*URSSAF de Paris*) was lodged and later withdrawn. Accordingly, these judgments are final and the rulings have been applied ever since by the *URSSAF de Paris* not only on professional income from UK and Italian sources but also from sources in other countries which have income tax treaties with France, such as the United States. I am informed that the collecting agency repaid, where applicable, the excess CSG and CRDS collected on professional income from sources in countries that have entered into double taxation treaties with France. One such repayment is reported in a recent judgment of the Paris Court of Appeals (*11 April 2013 n° 10/10393 X. vs. URSSAF de l'Ile de France unreported, further analyzed below*).

These rulings, and the conforming conduct of URSSAF de Paris, demonstrate that CSG and CRDS are covered by the US-France DTT.

26. By contrast, where social security charges (that bring benefits) are involved, French courts exclude any reference to double taxation treaties and apply the "laws of France" as designated under a totalization agreement. For example, French resident partners in other multinational partnerships asserted that the exemptions of CSG and CRDS on foreign source income could also apply to social security charges, especially the health care insurance charge. Their case was dismissed by the *Cour de Cassation* on the essential ground that "*social security charges are not among the taxes covered by the* (UK) *double taxation treaty*." (*Cassation 2e civile 15 March 2012 n° 10-19.605 RSI des professions libérales d'Ile de France vs. Crosthwaite, unreported*).

    Similarly, the Paris Court of Appeals recently held that the family benefit charge was payable on the global professional income of a French partner in another multinational partnership, including income derived from the United States, despite the provisions in the US-France DTT (*Paris Court of Appeals 11 April 2013 n° 10/10393 mentioned above*). Although the court did not refer to the US-France Totalization Agreement to reach this conclusion, which is based only on French law, the judgment states that the collecting agency availed itself of Article 7§3 of the US-France Totalization Agreement.

    These decisions show that French courts also clearly distinguish between CSG and CRDS, as taxes covered by income tax treaties (*Cassation 2^e Ch. Civile 23 May 2007 n° 06-19723 X. vs. Fortis assurances, Paris 6 November 2008 and 26 March 2009 Derouin vs. URSSAF de Paris*) and social security charges which are not covered by double taxation treaties. (*Cassation 15 March 2012 RSI vs. Crosthwaite and Paris 11 April 2013 X vs. URSSAF d'Ile de France*).

Tax credits to relieve double taxation under the US-France DTT

a) In France, under paragraph (2) of Article 24

27. Under French domestic law, there is no unilateral relief for income taxes paid abroad and such relief results only from the provisions of applicable income tax treaties. Under the US-France DTT, as under many of the other DTTs entered into by France, a tax credit is granted to French residents who receive income from the other contracting State. Depending upon the nature of the income, such tax credit is equal to:

– either the tax paid on such income in the source country (*e.g.*, the United States) within the limit of the amount of French tax attributable to such income; or

– the amount of French tax attributable to such income (irrespective of the tax paid in the source country, a solution which is substantially equivalent to an exemption) (*see Article 24(2)(a) of the US-France DTT and CE 29 June 2011 n° 320263 Chauvin opinion E. Cortot-Boucher; Droit fiscal 2011 n° 39 comm. 532*).

For the purposes of implementing such provisions, the French tax authorities have published guidelines according to which "*the amount of French tax includes income tax, general social contribution [CSG], social debt contribution [CRDS] and* (certain other contributions)" (*BOI-INT-CVB-USA-10-20-40-20120912 point 120; BOI-INT-CVB-DZA-60-20120912 point 20 etc.*). As such, it is clear that under French law, CSG and CRDS are taxes "*identical or substantially similar*" to income tax for the purposes of the US-France DTT and more specifically are included within the amount of French tax attributable to any income under such treaty for the purpose of relieving double taxation in France.

b) In the United States, under paragraph (1) of Article 24

28. With respect to the taxation – and relief from double taxation in the United States – of government employees who are citizens of France and at the same time either citizens or green card holders in the United States, the French administration considered that under Article 24(1)(e) of the US-France DTT, CSG and CRDS are among the "*identical or substantially similar taxes*" and affirmed that they give rise to a tax credit in the United States (*Doc. Adm. 5 F 1321, point 60*).

The US-France DTT makes no distinction with respect to other income and so in my opinion, the US foreign tax credit should extend to CSG and CRDS on other earned income as well.

This position is not contradicted by the recent ministerial response to a question from a member of the French Parliament on the taxation of certain capital gains where the French Finance Secretary stated that "*in this particular case, the wording of Article 24 of the Treaty, which spells out the conditions under which the United States agree to offset a tax credit against the US income tax, drives the United States to consider that this provision does not apply to CSG and CRDS*."

I concur with Professor Gutmann's view that this answer is not an endorsement of a position reportedly attributed to the United States. In his own words: "*the content of the Ministerial answer regarding the France-United States Tax Treaty should*

therefore not be understood as a different approach to the question whether CSG and CRDS are covered by tax treaties. On the contrary, this statement by the French tax authorities takes the view that CSG and CRDS are indeed covered by tax treaties" (*Professor Gutmann's memorandum page 6*).

To be more specific, the French authorities' view that CSG and CRDS are included in the French taxes giving rise to a tax credit under either section (1) or section (2) of Article 24 of the US-France DTT remains unaffected.

As no provision of the US-France DTT excludes the foreign tax credit relating to CSG and CRDS, could such an exclusion result from the US-France Totalization Agreement? Such a conclusion requires that CSG and CRDS be covered by both treaties and we shall demonstrate that, under French law, they cannot be.

Reconciliation of US-France DTT and US-France Totalization Agreement with respect to CSG and CRDS

29. Under French construction of international law, international agreements or treaties (other than EU treaties and other instruments of EU law) have equal status or ranking and must be reconciled according to the principles of international law embodied in the Vienna Convention on the Law of Treaties done on May 23, 1969 even though France is not a party to this convention (*CE 23 December 2011 n° 303678 Kandyrine de Brito Paiva, opinion Boucher, reported in Droit Fiscal 2012 n° 4 act. 48*).

Among these principles, Article 30(3) of the Vienna Convention states:

"*When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59,* ***the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty***."

In order to reconcile the provisions of the two treaties, it is accepted that the courts must interpret them according to the rules of interpretation also embodied in Articles 31 to 33 of the Vienna Convention.

In determining the applicable legislation in an international context, social security totalization agreements tend to determine the single legislation that shall apply both to the benefits and to the charges of a given person at a given moment. Such is the object of Articles 5 to 7 of the US-France Totalization Agreement as a result of which a person may be subject only to the laws of one of the contracting States. Income taxation agreements operate differently and allocate taxing rights among the contracting States according to the nature of the income a resident of a contracting State may derive from sources in another contracting State. Such is the purpose of Articles 6 to 21 of the OECD model and the corresponding provisions in the US model and the US-France DTT. As far as "active" income is concerned (*e.g.*, business profits, employment income and self-employed professional income), priority is given to the State where the income is sourced.

As a result, a self-employed person residing in France and receiving part of his/her professional income from the United States:

– is covered only by the laws of France for social security purposes under Article 7 of the Totalization Agreement and accordingly is liable to social security charges in France only, including on his/her professional income from US sources (*Paris 11 April 11, 2013 mentioned in paragraphs 26 and 27 above*); and

– is liable for income taxes both in France and, as far as his/her professional income from US sources is concerned, also in the United States. Double taxation is avoided in France where he/she is granted a tax credit equal to the French tax substantially equivalent to an exemption on such income from US sources under Articles 14 and 24 of the US-France DTT.

Clearly, the same contribution may not fall within the scope of both the US-France DTT and the US-France Totalization Agreement, as Article 7 of the US-France Totalization Agreement would reserve full taxing rights to France while articles 14 and 24 of the US-France DTT would allocate priority taxing rights to the United States and create a *quasi*-exemption in France. The same conclusion applies to other types of income.

In order to reconcile the provisions of the two treaties:

– either the US-France Totalization Agreement must be interpreted in the sense that the "Laws" referred to under its Article 2 do not extend to the laws and regulations governing a contribution that is regarded as an income tax under the US-France DTT; or

– pursuant to the principles laid out by the Vienna Convention, and since the US-France DTT is the later treaty, the provisions of the US-France Totalization Agreement should be set aside insofar as they address such laws and regulations.

Although there is no court precedent on the point, the practice of the French administration and collecting agencies such as *URSSAF d'Ile de France* since the "*Derouin Case*" reflects a similar analysis with respect to CSG and CRDS. As reported by the same Court of Appeals judgment of April 11, 2013, *URSSAF d'Ile de France* discharged and repaid CSG and CRDS which was levied on professional income from foreign sources, thus applying the US-France DTT and foregoing any taxing rights it might have derived from Article 7 of the US-France Totalization Agreement.

30. This analysis is consistent with the position taken by the French social security supervising agency (ACOSS) in its letter of July 24, 2012 according to which CSG and CRDS "*are not due on remuneration received by an employee on secondment from the US to France, with the applicable social legislation being the American legislation*."

Under French law, taxes may be assessed according to French laws only and a double taxation treaty may not be the legal basis for a tax assessment. Accordingly, the allocation of taxing rights to France under a double taxation treaty does not create any obligation on the French government to effectively levy, or upon the taxpayer to pay, income taxes on any income thus allocated to France, especially where such income either is not taxable or is exempt under French domestic law.

Such is the case for residents of France receiving employment – or self-employed – income for activities performed in France: France has primary taxing rights on such income as a result of the US-France DTT but France does not exercise such rights with respect to CSG and CRDS where the resident is not subject to French social security legislation.

As mentioned in the ACOSS 2012 Letter:

"*The position taken on the matter by the organizations of French social security results from* ***an internal legal document****, Ordinance n° 2001-377 of May 2, 2001, which modified the criteria for liability of earned income and replacement income to the CSG and the CRDS* (…).

The result of article L. 136-1 of the social security code as it is modified by the above-cited Ordinance, is that the CSG and the CRDS are due on income derived by people who are both considered tax domiciled in France for purposes of the income tax and subject to a French health insurance regime."

The letter then recalls that seconded employees remain subject to the legislation of their country of origin for a certain period under the relevant provision of the US-France Totalization Agreement and that accordingly employees temporarily seconded from the United States to France are outside the scope of the French social security system. As a result of the above provision of French domestic law, they are not subject to CSG and CRDS on their employment income.

The ACOSS 2012 Letter does not indicate – and the exemption of seconded employees from CSG and CRDS does not imply – that CSG or CRDS are covered by the US-France Totalization Agreement or that the French legislation on those taxes is within the laws of France for the purposes of the US-France Totalization Agreement. The letter clearly says that this exemption results from the provisions of French domestic law under Article L. 136-1 of the social security code currently in force.

Neither the ACOSS 2012 Letter nor the reasoning it contains contradicts the above finding that CSG and CRDS are covered by the US-France DTT and excluded from the "laws" of France under the US-France Totalization Agreement.

31. In conclusion, I am of the opinion that under French law, CSG and CRDS (1) being income taxes – subject as such to the specific constitutional and legislative rules and principles governing income taxes – and (2) being covered by the US-France DTT, are not, and may not be considered to be, covered by the US-France Totalization Agreement.

Appendix A

Excerpts from Decision 2012-662 DC of the French Constitutional Court of 29 December 2012 on the Finance Act 2013

The Constitutional Court restated:

"*15. Considering that Article 13 of the 1789 Declaration provides: "A common contribution is essential for the maintenance of the public forces and for the cost of administration. This should be equitably distributed among all the citizens in proportion to their means"; that this requirement will not be respected if the tax is confiscatory in nature or imposes an excessive burden on a category of taxpayers, taking account of their capacity to pay tax; that pursuant to Article 34 of the Constitution, it is for Parliament to determine, in accordance with constitutional principles and taking account of the characteristics of each tax, the rules according to which the capacity to pay tax must be assessed; that in particular, in order to ensure that the principle of equality is respected, it must base its assessment on objective and rational criteria intended to further the goals it proposes; that this assessment may not however result in any inequality in relation to public charges*;"

The Court then held:

"*16. Considering in the first place that the establishment by Article 3 of a new marginal rate of taxation of 45% for the portion of income subject to income tax exceeding 150,000 Euros per share increases tax revenue and enhances the progressive nature of the system of income tax; that in itself, it does not impose an excessive burden on taxpayers having regard to their capacity to pay tax and does not result in any inequality in relation to public charges*;"

The Court went on to consider the overall income taxation which would have applied to certain categories of income; namely certain pensions, income of unidentified holders of certain financial instruments, gains on stock options and restricted free shares and capital gains on immovable property.

With respect to certain pensions the Court held:

"*17. Considering secondly that **the revenue comprising pensions** paid in relation to defined−benefit retirement plans, which **are subject to income tax** at the rate provided for under subparagraph 1 of paragraph I of Article 197 of the General Tax Code, as amended by Article 3 of the law referred, **are also subject to** the exceptional contribution on high incomes provided for under Article 223−sexies of the General Tax Code, to the **general social contribution [CSG]** provided for under Article L. 136−1 of the Social Security Code, to the **contribution for the repayment of the social debt [CRDS]** provided for under Article 14 of the aforementioned Ordinance no. 96−50 of 24 January 1996 along with the contribution provided for under Article L. 137−11−1 of the Social Security Code; that pensions paid starting from 2013 will also be subject to the contribution provided for under Article L. 14−10−4 of the Code of Social Action and Families;*

*18. Considering that, on the one hand, whilst **when assessing compliance with the principle of equality in relation to public charges*** (…) ***it is necessary to take account***

***of the overall body of taxes applicable to the same income which are paid by the same taxpayer**, nevertheless the contribution provided for under Article L. 137−11 of the Social Security Code is a levy on the employer which does not apply to the amount of pension paid; that accordingly, it need not be taken into account in this assessment;*

*19. Considering on the other hand that, as a result of the amendment provided for under Article 3 and after taking into account the deductibility of a portion of the general social contribution and of a portion of the contribution provided for under Article L. 137−11−1 of the General Social Security Code from the amount liable to income tax, **the maximum marginal rate of taxation applicable to pensions** paid in relation to defined−benefit retirement plans **has been increased to 75.04% for pensions received in 2012 and to 75.34% for pensions received starting from 2013**; that **this new level of taxation imposes an excessive burden on taxpayers having regard to their capacity to pay tax**; that **it breaches the principle of equality in relation to public charges***;"

With respect to stock options and restricted free shares, the Court reported:

"*75. Considering that Article 11 alters the tax on capital gains and economic benefits resulting from the exercise of an option to subscribe to or to purchase shares or from the acquisition of shares for no consideration allocated after 28 September 2012, stipulating that they are to be subject to income tax;* (…)

77. Considering in the first place that according to the preparatory work, in subjecting capital gains and economic benefits resulting from the exercise of an option to subscribe to or to purchase shares or the acquisition of shares for no consideration allocated after 28 September 2012 to income tax, Parliament intended to bring the tax arrangements applicable to income from these capital gains and economic benefits into line with those applicable to income from employment;"

Then the Court held:

"*80. Considering* (…) *that subparagraph 2 of letter D of paragraph II of Article 11 has the objective of raising the salary contribution rate provided for under Article L. 137−14 of the Social Security Code to 17.5% and, if the shares purchased are not restricted for a certain period of time, to 22.5%; that **the capital gains and economic benefits resulting from the exercise of an option to subscribe to or to purchase shares or from the allocation of shares for no consideration are** moreover **taxed as remuneration and salary** pursuant to Articles 80−bis and 80−quaterdecies of the General Tax Code, as amended respectively by subparagraph 1 of letter A of paragraph I and letter B of paragraph I of Article 11; that **these economic benefits are moreover subject to the general social contribution [CSG]** pursuant to Articles L. 136−2, L. 136−5 and L. 136−6 of the Social Security Code as amended by letters A, B and C of paragraph II of Article 11 **and**, consequently, **to the contribution for the repayment of the social debt [CRDS]** provided for under Article 14 of Ordinance no. 96−50 of 24 January 1996;*

*81. Considering that **the rates** of 17.5% and 22.5% provided for respectively under second and third indents of subparagraph 2 of letter D of paragraph II of Article 11, **in conjunction with the other overall rates of taxation** of capital gains and economic benefits applicable to the exercise of an option to subscribe to or to*

purchase shares or to the allocation of shares for no consideration ***have the effect****, after taking into account the eligibility for relief of a portion of the general social contribution for the purposes of income tax,* ***of increasing the maximum marginal rate of taxation on these capital gains and economic benefits respectively to 72% and 77%****; that, where a taxpayer's other income subject to income tax exceeds 150,000 Euros for an unmarried taxpayer,* ***the rate of taxation of these capital gains and economic benefits will increase at least to 68.2% or to 73.2%****; that* ***consequently, the new rates of taxation*** *resulting from the increase of the contribution provided for under Article L. 137−14 of the Social Security Code* ***impose an excessive burden on taxpayers having regard to this capacity to pay tax****; that* ***these rates breach the principle of equality in relation to public charges****; that accordingly, the overall amendments made to Article L. 137−14 of the Social Security Code provided for under letter D of paragraph II of Article 11 are unconstitutional*;"