INTERPRETING ESTATE AND GIFT TAX TREATIES
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# U.S. Estate and Gift Tax Treaties as of 1/1/19

<table>
<thead>
<tr>
<th>Country</th>
<th>Effective Date Treaty/Protocol</th>
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<tbody>
<tr>
<td>Australia (estate)</td>
<td>01/07/1954</td>
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<tr>
<td>Australia (gift)</td>
<td>12/14/1953</td>
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<td>07/01/1983</td>
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<td>United Kingdom (estate/gift)</td>
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**Terminated treaties:** Canada (but see the current income tax treaty), Sweden and Norway
Purposes of Estate and Gift Tax Treaties

• To eliminate double taxation where an individual donates or bequeathes property in a multijurisdictional situation

• To apportion taxing jurisdiction between the two countries (“Contracting States”) based upon various factors that vary among the treaties

• To enhance domestic tax administration by providing for exchange of tax information

• To do so without creating opportunities for double non-taxation
Principal Methods to Achieve Goals

• Does so by:
  • Establishing thresholds that must be met before the exercise of taxing jurisdiction
  • Limiting taxation by providing benefits not generally available to non-domiciled aliens
  • Requiring the State of residence/domicile to relieve double taxation by exempting assets, or providing credit, when the other State may tax in accordance with the treaty
  • Providing minimal non-discrimination protection
  • Otherwise “meshing” the tax systems of the Contracting States by providing tailor-made rules
Organization of Treaties

• All U.S. tax treaties are bilateral
• The older “situs-based” treaties entered into before 1971 vary substantially from the newer “domicile-based” treaties based upon the OECD Model
Important Rules of Interpretation

• Terms **not defined** in the treaty are interpreted in accordance with the domestic law of the country imposing the tax.

• Under § 7852(d)(1), neither Treaties nor U.S. revenue laws shall have preferential status because of their being Treaties or laws.

• In general, if a Treaty provision and regular U.S. law are inconsistent, the later in time of the Treaty or law will prevail, subject in part to whether Congress has otherwise spoken to the contrary. See, e.g., *Reid v. Covert*, 354 U.S. 1, 18 (1957).

• Section 894(a) specifies that the IRC is to be applied to any taxpayer “with due regard to any treaty obligation of the United States which applies to such taxpayer.”

• Treaty provisions effective on August 16, 1954 take precedence over the IRC, but in effect can be overridden by all subsequent IRC amendments.

• The IRS ordinarily will not issue rulings or determination letters on a number of §894-related issues.

• The “non-aggravation” rule – Taxpayers may choose to apply either domestic law or the treaty, but may not do so in an inconsistent manner (no “cherry-picking”).

• The U.S. imposes a “saving clause” to tax the estates and gifts of its citizens.
Saving Clauses

• Traditional U.S. position is that the treaty partner should provide benefits to U.S. persons and the United States should provide benefits to treaty partner’s residents/domiciliaries.

• Treaty generally is not intended to provide U.S. benefits to U.S. persons
  • Obviously driven in part by U.S. taxation of citizens on worldwide gifts and bequests, even if resident in a treaty partner

• The Austria, France, Germany, Ireland, Netherlands, and South Africa Treaties provide that notwithstanding any Treaty provision to the contrary, the U.S. reserves its right to tax the estates of its citizens on a worldwide basis.

• Treaties without a specific saving clause generally include related statements in the applicable U.S. Treaty Technical Explanations or Senate Foreign Relations Committee or State Department reports.

Specific Examples of How U.S. Estate Tax Treaties May Benefit Your Clients

• Estate and gift tax treaties in effect provide potential planning opportunities for multinational estates and families.

• Treaty domicile rules may exclude the estates of individuals otherwise subject to U.S. estate tax

• Narrower definitions of “U.S. situs assets” potentially included in the decedent’s gross estate

• Increased unified credit potential beyond the regularly applicable U.S. estate tax $13,000 credit/$60,000 exclusion for the estates of non-domiciled alien individuals

• Marital deduction and/or exclusion amounts may be available as an alternative to the use of a qualified domestic trust (“QDT”) to defer U.S. estate tax liability until the death of the surviving spouse

• Potential charitable deduction availability where otherwise precluded by U.S. tax law
Residence/Domicile Under Treaties

• The Treaties with Australia, Finland, Greece, Ireland, Italy, Japan, South Africa, and Switzerland provide that domicile (and in some cases, citizenship) is determined in accordance with the internal laws of each country

• **Under these Treaties, the regular U.S. domicile tests apply**

• In the Austria, Denmark, France, Germany, the Netherlands, and United Kingdom Treaties based upon the OECD Model, a series of **special “tie-breaker” tests** applies
Residence/Domicile Under Treaties

• In general, if both treaty countries treat the decedent as a resident, under certain treaties a residence “tie-breaker test” similar to those found in U.S. income tax treaties, tests are applied in the following order:

(a) where the decedent had a “permanent home”;
(b) if the decedent had a permanent home in both countries or neither country, then the treaty looks to the country “with which his personal and economic relations are closer (centre of vital interests);”
(c) if the decedent's centre of vital interests cannot be determined, then determine his “habitual abode;”
(d) if the decedent had an habitual abode in both countries or neither country, then the treaty refers to the country in which he was a citizen;
(e) if the decedent was a citizen of both countries or neither country, then the relevant person's residence is to be determined by mutual agreement.

• Certain treaties (Germany, France and the U.K. ) have additional specific rules.
Special Property Situs Rules

• Various transfer tax treaties significantly affect the regular U.S. estate tax rules defining “U.S. situs assets” (see, e.g., § 2104)

• The most common difference from general U.S. estate tax law is that certain treaties exclude the shares of a domestic corporation from U.S. estate tax—Austria, Denmark, France (subject to U.S. real property-related restrictions), Germany, the Netherlands and the United Kingdom

• Could this rule be used to “fix” a “bad” domestic single-member disregarded LLC holding structure by making a pre-death check-the-box election to classify the entity as a C corporation?

• Another potential advantage is the exclusion of otherwise U.S. situs tangible personal property under the Austria, Denmark, France (limited to “normal personal use” property of a French domiciliary), Germany, Netherlands and United Kingdom treaties
“Specific Exemption” Clause Under Older U.S. Treaties

• Rev. Rul. 81-303, 1981-2 C.B. 255, held that the term “specific exemption” referred to in the estate tax convention between the U.S. and Switzerland may not be construed to include the § 2010 unified credit

• Under that ruling, the U.S. estate of a Swiss resident (who is not a U.S. citizen) dying after December 31, 1976, was only entitled to the regular NRAD exemption allowed under § 2102(c)(1)
“Specific Exemption” Clause

• Article III of the U.S.-Switzerland Inheritance Tax Treaty states as follows:

In imposing the tax in the case of a decedent who at the time of death was not a citizen of the United States and was not domiciled therein, but who was at the time of his death a citizen of or domiciled in Switzerland, the United States shall allow a specific exemption which would be allowable under its law if the decedent had been domiciled in the United States in an amount not less than the proportion thereof which the value of the total property (both movable and immovable) subjected to its tax bears to the value of the total property (both movable and immovable) which would have been subjected to its tax if the decedent had been domiciled in the United States.
“Specific Exemption” = Proportionate Unified Credit

• The decisions in Mudry v. United States, 11 Cl. Ct. 207 (1986) and Estate of Burghardt v. Commissioner, 80 T.C. 705 (1983), aff'd., 734 F.2d 3 (3rd Cir. 1984) disagreed with the IRS' position in Rev. Rul. 81-303.

• IRC § 2102(c)(3)(A) provides that: “Coordination with treaties. To the extent required under any treaty obligation of the United States, the credit allowed under this subsection shall be equal to the amount which bears the same ratio to $192,800 as the value of the part of the decedent's gross estate which at the time of his death is situated in the United States bears to the value of his entire gross estate wherever situated.”

• In Rev. Rul. 90-101, 1990-2 CB 315, the IRS revoked Rev. Rul. 81-303, and now accepts that the term “specific exemption” referred to in an estate tax treaty includes the § 2010 unified credit.

• This ruling provides a significant potential planning opportunity for the estates of persons resident in Australia, Finland, Greece, Italy, Japan and Switzerland.
Treaty “Marital Deduction Equivalent” Provisions

• The estates of NRADs are generally not entitled to a marital deduction for U.S. estate tax purposes other than for property passing to a QDT or a surviving spouse that is a U.S. citizen—see §§ 2056(d)(1) and 2056A

• **Significant planning possibilities exist for individuals whose estates qualify for related benefits under a Treaty marital deduction clause**

• The Denmark, Netherlands and U.K. treaties have marital deduction provisions, but they currently have no significant effect for U.S. estate tax purposes

• The Canada, France and Germany treaties include marital credit, exclusion and/or deduction provisions.
Charitable Deduction Provisions

• Unlike the regular IRC rule that limits the deductibility of charitable bequests to certain domestic entities [§ 2106(a)(2)(A)], a number of treaties allow deductions for transfers to foreign charitable organizations.

• See, e.g., Denmark Treaty Article 9(1), Germany Treaty Article 10(2), France Treaty Article 10(1) and Canada Income Tax Treaty Article XXIX B(1).
“Specific Exemption” Treaty Planning Example

- Toshi Wealthamito, a resident/domiciliary of Japan, dies on June 1, 2019, with $1 million of U.S. situs assets and $10 million of worldwide assets.

- In the absence of an applicable U.S. transfer tax treaty, his estate should be subject to U.S. estate tax on $1 million reduced only by the standard $13,000 unified credit/$60,000 exemption amount for NRADs.

- However, under the “specific exemption” language of Article IV of the Japan Treaty, his estate should instead be entitled to 1/10 of the $4,505,800 (for 2019) unified credit ($450,580), which exceeds the $345,800 U.S. estate tax liability; thus, no U.S. tax should be due.

- See § 2102(b)(3)(A) and Reg. § 20.2102-1(c)(2).
Planning Under the Canada Income Tax Treaty

• **Worldwide Estate Does Not Exceed U.S. Applicable Exclusion Amount**—a Canadian resident whose gross worldwide estate amounts to U.S. $11,400,000 or less (as of 2019) should not be subject to U.S. estate tax, but if the value of the Estate’s U.S. assets exceeds US$60,000, a Form 706NA must be filed to claim the treaty benefit.

• **Proportionate Unified Credit**— A Canadian resident who passes away owning U.S. assets and an estate valued in excess of this amount is entitled to a credit against her U.S. estate tax liability in an amount equal to that proportion of the U.S. unified credit as her U.S. situated estate bears to his worldwide estate.

• **Marital Credit**—In addition to the proportionate unified credit, the U.S. will allow an election to be made for an additional “nonrefundable marital credit” up to the amount of the allowed proportionate unified credit amount.

• **Charitable Deduction**—a Canadian resident will also be allowed a U.S. estate tax deduction for a bequest to a qualifying exempt organization that is a Canadian corporation, so long as the transferred property was subject to U.S. estate tax. See Canada Treaty Article XXIX B(1).

Estate of Avrom A. Silver, 120 T.C. 430 (2003) indicates the limited scope of this rule—because the bequests were paid solely out of funds and property located outside the United States, the funds used to pay the bequests were not subject to U.S. estate tax, and thus the Canada Treaty did not change the result from that under the regularly applicable U.S. law (§ 2106).
Planning Under the Germany and French Treaties

• “Qualifying property” is that which under U.S. law passes to the decedent's surviving spouse and that would qualify for the estate tax marital deduction under U.S. law if the surviving spouse were a U.S. citizen and all applicable elections were properly made.

• Marital exclusion (equal to 50% of the value of the assets taxable by the U.S. under the Treaty) for property otherwise taxable by the U.S. under Articles 5, 6 or 7 passing from a spouse domiciled in the Treaty Country to a non-U.S. citizen spouse, not applicable to the estates of U.S. citizens domiciled in the Treaty Country or certain U.S. expatriates.

• Limited marital deduction equal to the lesser of the value of the qualifying property or the applicable exclusion amount, where at the time of the decedent's death (i) the decedent was domiciled in either the Treaty Country or the United States or was a citizen of the United States; (ii) the decedent's surviving spouse was domiciled in either the United States or the Treaty Country; and (iii) if both the decedent and the decedent's surviving spouse were domiciled in the United States at the time of the decedent's death, one or both was a citizen of the Treaty Country, must waive the ability to make a QDT election.

• Proportionate U.S. unified credit amount for the estate of a Treaty Country domiciliary/non-U.S. citizen (U.S. estate value/Worldwide estate value)—allowed only upon the provision of all information necessary to verify and compute the credit.
Under U.S.-U.K. Treaty Article 8(5), if a decedent who was a U.K. national owning U.S. situs property, but was neither a U.S. citizen or domiciliary, the Treaty limits the amount of U.S. estate tax owed on such property if the estate makes an appropriate claim.

The U.S. estate tax may not exceed the U.S. estate tax that could have been imposed on the decedent’s worldwide assets had the decedent become domiciled in the United States immediately before his death on the property that otherwise would in that event have been taxable.

If the amount of tax on the property exceeds that limit, the lower amount may be reported as the tax due on the Form 706-NA.

The estate's Form 706-NA must include a statement showing the alternate computation and claiming the benefit of the treaty provision using Form 8833.
In essence, if properly claimed, this treaty clause may in effect exempt all U.S. situs assets owned by the estate of such an individual from U.S. estate tax so long as their worldwide estate does not exceed the U.S. applicable exclusion amount ($11,400,000 for 2019).

We have seen the U.K. treaty situs provisions “bail out” a number of U.K. domiciliaries owning U.S. situs assets (e.g., U.S. stocks held through a U.K. brokerage account and Florida condominium units with substantial personal property) where they and their U.K. advisors clearly had no knowledge of U.S. estate tax law.
Expatriation—Do Treaties Block § 2801?

- No Estate Tax Treaty presently contemplates the expatriation-related rules of §§ 877A and 2801.

- The proposed § 2801 regulations include a number of examples referring to a covered expatriate making a transfer who is not a domiciliary of a country with which the U.S. has an applicable estate or gift tax treaty. The IRS apparently has yet to decide whether such a treaty may in effect override these provisions.

- Newer U.S. estate and gift tax treaties generally provide that if the property in question is not U.S. real estate or a trade or business that forms part of a U.S. permanent establishment of the donor or decedent, then it is not subject to tax when the donor is a resident of the Treaty Country.

- Therefore, § 2801 may ultimately only apply to gifts of U.S. real estate and gifts of U.S. business property connected to a U.S. permanent establishment.

- Gifts or bequests of stocks, and bonds or tangible personal property such as paintings or cars could thus be exempted from the tax. In addition, under older estate and gift tax treaties, the § 2801 tax may only apply to U.S. situs assets.
Estate Treaty-Based Return Position Reporting

- Attach Form 8833 to Form 706-NA to claim a treaty benefit.
- If an estate would not otherwise be required to file Form 706-NA, File Form 8833 at the IRS Service Center where the estate would normally file this return to make the treaty-based return position disclosure (Department of the Treasury, Internal Revenue Service Center, Cincinnati, OH 45999)
- **Query**—is timely filing required?
- The IRS can (and does) provide estate tax, gift tax and other tax and compliance returns and tax information to the other Treaty Country’s “competent authority” under a U.S. estate tax treaty
- Presume that information reported on a Form 706-NA or Form 8833 will be given to the tax authorities of the decedent’s home country where a Treaty applies, so such reporting should “match” in both countries as to the estate’s assets and their respective values.
Mutual Agreement Procedure

• Disagreements among tax authorities inevitably arise, so treaties include a mechanism to resolve disputes

• Government-to-government ("competent authority") process
  • Goal is to ensure that taxpayers do not suffer double taxation because of disagreements between the governments
  • However, taxpayers have very minimal role once process begins
Requesting Competent Authority Assistance

• The “competent authority” for issues arising under estate and gift tax treaties would be the Treaty Advice and Interpretation Team within the Large Business and International Division of the Internal Revenue Service.

• TAIT would work closely with the office of the Associate Chief Counsel (International).

• Process for requesting assistance spelled out in Revenue Procedure 2015-40, with fees adjusted each year
What Should A U.S. Taxpayer Do If Both Treaty Countries Tax The Same Assets?

• **Do** review your planning methods
  • The U.S. competent authority is unlikely to help save your tax planning

• **Do Not** use “self-help”
  • A taxpayer that simply pays a foreign tax without pursuing remedies that could reduce the tax potentially jeopardizes its FTC

• **Do Not** sign a closing agreement with the other tax authorities without discussing with U.S. CA to consider potential related U.S. adjustments

• **Do** contact the competent authority early
  • Treaties usually include timetables by which competent authority must be notified in order to override domestic statutes of limitation
  • Over-papering may be a good idea
Example: Multijurisdictional Estate

• Wealthy U.K. citizen who spends substantial time in the U.S. dies with assets located in both the U.S. and the U.K., including comparable personal residences and bequeaths them to a U.K. beneficiary.

• IRS determines that for U.S. estate tax purposes, the decedent was domiciled in the United States at death and subjects the entire estate to the U.S. 40% tax.

• HM Revenue and Customs determines that, for U.K. inheritance tax purposes, the decedent was domiciled in the United Kingdom at death, and subjects the same assets to the U.K. 40% tax.

• Double taxation could result unless:
  • The U.S.-U.K. treaty’s Article 4 domicile “tiebreaker test,” its situs rules (Articles 5, 6 and 7) and the deduction/exemption rules (Article 8) are applied to delineate each country’s respective taxing rights; or
  • Competent authorities agree on some other result.
Exchange of Information

• Three major modes
  • On request
  • Automatic or routine
  • Spontaneous

• Although IRS has engaged in automatic exchange of information with respect to financial/investment income for decades, FATCA, IGAs and OECD Common Reporting Standard have increased interest because of the amount of information being exchanged
Treaty Assistance in Collection of Taxes

- Under Article XXVIA of the Canada Treaty, each Treaty Country agrees to assist the other in the collection of a “finally determined” “revenue claim”) (in general, taxes together with any interest, costs, additions to such taxes and civil penalties) imposed by either of the treaty countries.

- A revenue claim is “finally determined” when the applicant Treaty Country has the right under its internal law to collect the revenue claim, all administrative and judicial rights of the taxpayer to restrain collection in such country have lapsed or been exhausted, and is so certified by the competent authority of such Treaty Country.

- See also Finland Treaty Article VIII

- For an example of a collection of taxes case under a U.S. income tax treaty (U.S.-Denmark), see Dileng v. Commissioner, 157 F. Supp. 3d 1336 (N.D. Ga. 2016), whereby the IRS was permitted to collect “finally determined” Danish taxes owed by the plaintiff through imposing a levy on his U.S. assets.
Conclusion

• Transfer tax treaties, in appropriate circumstances, should be part of every U.S. international tax practitioner’s toolkit

• Treaties can allow significantly more planning flexibility for qualified individuals than is generally available under U.S. tax law

• Even “bad” lifetime planning can be “cured” in part through taking advantage of applicable Treaty provisions
Usual Disclaimer

• These materials are not intended to constitute legal advice. Each client’s facts must be analyzed under the legal framework presented herein in order to reach a conclusion based on those particular facts (especially in light of law changes where guidance has not been issued). Thus, any legal conclusions contained in these materials (including any attachments) are not intended to be used, and cannot be used, as legal advice for any specific client matters.

• Furthermore, all inflation adjustment amounts should be checked for up to date numbers.

• Finally, please contact us, or other competent U.S. tax counsel, to have any specific matters reviewed in more detail.
Les Share is a shareholder in Packman, Neuwahl & Rosenberg, P.A., specializing in the areas of domestic and international tax, estate and wealth preservation planning. Mr. Share has advised clients in numerous and diverse areas such as Broadway theatrical productions, domestic and foreign real estate like-kind exchanges, Internet sales, services and licensing tax planning, advanced domestic and foreign wealth preservation techniques, U.S. tax treaties, Internal Revenue Service examinations and voluntary compliance programs and preferred structures for inbound and outbound business and investment planning.
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Scott has been named Florida Super Lawyers Rising Star from 2017-2019 in the area of tax law. Scott has been a frequent author and lecturer on topics of international taxation. He is also a member of numerous international tax-related groups and/or committees.
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