

# Making Sense of Four Transatlantic Estate Tax Treaties: US-Netherlands, US-Germany, US-France and US-UK

By Michael W. Galligan

## I. Introduction

The purpose of this paper is to present a summary of the principal rules for the allocation of estate taxes and the avoidance of double taxation under four of the most important estate tax treaties to which the United States is a party, namely, the treaties with the United Kingdom, France, the Netherlands and Germany. Each of these treaties follows the “modern” approach to estate tax treaties, where the determination of a decedent’s domicile (rather than the situs of the decedent’s property) is the principal criterion for determining the allocation of taxes and the distribution of related tax credits.

The next part of this paper describes the rules for determining domicile incorporated by these treaties, together with a description of the relevant variations contained in specific treaties. The third part of this paper describes the treatment under ten scenarios of the allocation of taxes and credits, again with a description of the relevant variations contained in specific treaties. The last part of the paper reviews certain provisions regarding the treatment of property passing to surviving spouses and charities.

## II. Domicile

Each reference to domicile in a treaty is a reference to domicile as determined under the relevant treaty. While treaty domicile is related to the determination of domicile or residence under the law of the taxing country, it is not necessarily the same.

### A. Generally

As a preliminary matter, a person is domiciled in a treaty country if that country considers the person domiciled under its internal transfer tax law.<sup>1</sup> There is, however, an exception: Under the US-UK Treaty, a US citizen is considered domiciled in the United States, as a preliminary matter, only if the US citizen was domiciled in the United States at some point during the three preceding years. This limitation does not preclude the US from worldwide taxation on the basis of citizenship even if the person did not meet this test.<sup>2</sup>

### B. Citizenship of One Country; Domicile in Another

European countries do not generally tax on the basis of citizenship. Nonetheless, in the case of a person who is a citizen of one country but domiciled in the

other under that other country’s laws, citizenship can be relevant to treaty domicile.

For example, under the US-UK Treaty, a US citizen who is not a UK citizen and who was resident for income tax purposes in the United Kingdom for fewer than seven of the preceding ten years (without regard to the issue of whether the person had a home there) is treated as a US treaty domiciliary. The same rule applies to a UK citizen living in the United States, except that the availability of a home in the US is not excluded from consideration in determining whether the person was a US income tax resident.<sup>3</sup>

### C. If Concurrent Domicile in Each Country

If each country considers a person its domiciliary, the following timing rules also apply:

- *US-Germany*: If the person is a citizen of one country only, the person cannot be considered a domiciliary of the other country until the person has been a domiciliary there for ten years.<sup>4</sup>
- *US-France*: If the person is a citizen of one country only, the other country cannot tax on the basis of domicile if the person was present for fewer than five out of seven years and maintained the intent to retain domicile in the citizenship country. The intent requirement is disregarded if the person was in the other country for employment reasons or was the spouse or other dependent of such a person. The period is extended to fewer than seven out of ten years if the person was in the other country by renewal of an assignment of employment or as a spouse or dependent of such a person.<sup>5</sup>
- *US-Netherlands*: If the person is a citizen of one country only, then the other country cannot tax on the basis of domicile if the person was present for fewer than seven out of ten years and the person was in the other country for professional, educational, tourism or similar purposes and did not have a “clear intention to remain indefinitely” in the other country. This rule applies to spouses and dependents also.<sup>6</sup>

### D. Tie Breakers

Each Treaty provides a set of “tie-breaker rules” in the event each country considers a person its domiciliary. The criteria are, in order:

- Where did the person have a permanent home?
- Where was the person's center of vital interests or personal relations?
- Where did the person have a habitual abode?
- In which country was the person a citizen?

There is, however, an exception to these tie-breaker rules. Under the US-Netherlands Treaty, the first criterion is "where did the person have a permanent home *for five years*," and the criterion regarding habitual abode is omitted. This Treaty uses closeness of personal relations for the second criterion, but this may be seen as equivalent to the center of vital interests, especially in light of the US-French Treaty, which treats them as the same.<sup>8</sup>

### III. Ten Scenarios Regarding the Allocation of Taxes and Tax Credits

#### A. European National who is European Country Domiciliary ("ENED") or United States Citizen who is European Country Domiciliary ("USCED") owns real estate in the United States.

US collects its estate tax on the US real property of ENED or USCED. The European Country (either the United Kingdom, France, the Netherlands or Germany—"EC") also imposes estate tax on the US real property, but gives ENED's or USCED's heirs a credit against the US tax.<sup>9</sup>

In addition, the ENED's or USCED's "business property of a permanent establishment and assets pertaining to a fixed base used for professional services" located in the United States would be taxed in the same manner.<sup>10</sup>

The US will also apply a pro-rata share of the unified credit available to US citizens and domiciliaries to the tax on the US property of a German domiciliary ("GD") who is not a US citizen.<sup>11</sup>

One exception of the foregoing is that France does not tax US real property or US business establishment property of a French domiciliary ("FD").<sup>12</sup> In addition, the United States does not tax US real property or business establishment property of a Netherlands national if the value is less than \$30,000; nor can the tax exceed the lesser of fifty percent of value in excess of \$30,000 or the amount of the tax determined in accordance with the Treaty after applying exemptions under US law.<sup>13</sup>

#### B. United States Domiciliary Citizen ("USCD") or European National who is United States Domiciliary ("ENUSD") owns real property in the EC.

The EC collects its tax on the EC real property of USCD. The US imposes its tax on the EC property as

well, but gives USCD's or ENUSD's estate a credit against US tax for the EC tax on the EC real property.<sup>14</sup>

In addition, the USCD's or the ENUSD's "business property of a permanent establishment and assets pertaining to a fixed base used for professional services" located in the EC would be taxed in the same manner.<sup>15</sup>

The Netherlands does not tax Netherlands real property or business establishment property of a US domiciliary if the value is less than \$30,000; nor can the tax exceed the lesser of fifty percent of value in excess of \$30,000 or the amount of the tax determined in accordance with the Treaty after applying exemptions under Netherlands law.<sup>16</sup>

#### C. ENED owns collection of paintings for personal use in the United States.

The US collects no tax on the US painting collection of the ENED. The EC imposes its tax on the collection.<sup>17</sup>

The same rule would generally apply to other forms of tangible property in the United States not connected with a business establishment owned by the ENED. In addition, the United States does not tax ships and aircraft engaged in international traffic belonging to the GD if the ships and aircraft are part of the GD's enterprise (presumably even if the enterprise constitutes a US business establishment).<sup>18</sup>

An exception to the foregoing is that, in the case of an FD, FD's tangible property (other than currency) located in US would be subject to US tax (except for property of certain persons, as discussed in Part II.C., who held tangible property for personal use).<sup>19</sup> Also, the FD's ships and aircraft operated in international traffic that are registered in the United States or that most frequently use the harbors and airports of the United States would be subject to US tax.<sup>20</sup> Under these circumstances, France would not tax FD's US tangible property.<sup>21</sup>

#### D. USCD owns collection of paintings for personal use in European Country.

The EC collects no tax on the EC painting collection owned by the USCD. The US imposes its tax on the collection.<sup>22</sup>

The same rule would generally apply to other forms of tangible property in the EC not connected with a business establishment owned by the USCD. In addition, Germany does not tax ships and aircraft engaged in international traffic belonging to the USCD if the ships and aircraft are part of the USCD's enterprise (presumably even if the enterprise constitutes a German business establishment).<sup>23</sup>

One exception is that, in the case of a USCD owned tangible property in France, such property (other

than currency) would be subject to French tax (except for property of certain persons, as discussed in Part II.C. above, who held tangible property for personal use).<sup>24</sup> Also, the USCD's ships and aircraft operated in international traffic that are registered in France or that most frequently use the harbors and airports of France would be subject to French tax.<sup>25</sup> Under these circumstances, the US would give a credit for the French tax.<sup>26</sup>

#### **E. An ENUSD owns collection of paintings for personal use in the EC.**

The US imposes its tax on the collection owned by the ENUSD. The EC is authorized to tax the collection of an EN on the basis of EN's nationality, although no EC currently does so on this basis alone. If it did, the EC should give credit against its tax for the US tax.<sup>27</sup>

The same rule would generally apply to other forms of tangible property in the EC not connected with a business establishment owned by the ENUSD. In addition, Germany does not tax ships and aircraft engaged in international traffic belonging to the USCD if the ships and aircraft are part of the USCD's enterprise (presumably even if the enterprise constitutes a German business establishment).<sup>28</sup>

Among those exceptions are the following.

- In the case of an ENUSD owning tangible property in France, such property (other than currency) would be subject to French tax (except for property of certain persons, as discussed in Part II.C., who held tangible property for personal use).<sup>29</sup> Also, the ENUSD's ships and aircraft operated in international traffic that are registered in France or that most frequently use the harbors and airports of France would be subject to French tax.<sup>30</sup> Under these circumstances, the US would give a credit for the French tax.<sup>31</sup>
- Germany is effectively not permitted to tax on the basis of citizenship alone, although it may tax a German beneficiary receiving tangible property from a US citizen or domiciliary.<sup>32</sup>
- In the case of a US domiciliary who is a Netherlands national, the Netherlands must give full credit for US tax only if the Netherlands national-US domiciliary was a US domiciliary for seven out of last ten years.<sup>33</sup> Otherwise, each of the Netherlands and the US gives credit for the amount that bears the same proportion to the lesser of its tax or other tax attributable to the intangible property as that amount bears to total of both taxes.<sup>34</sup>

#### **F. USCED owns collection of paintings for personal use in the United States.**

The US and the EC each impose its respective tax on the US collection of the USCED. The US gives a credit for the EC tax against the US tax.<sup>35</sup>

The same rule would generally apply to other forms of tangible property in the EC not connected with a business establishment owned by the USCED.

Exceptions to this rule include the following:

- France would not tax the US tangible property of a USCED.<sup>36</sup>
- In the case of a USCND who is not a Netherlands citizen, the US gives full credit for the Netherlands tax only if USCND was the Netherlands domiciliary for seven out of last ten years.<sup>37</sup> Otherwise, each of the US and the Netherlands gives credit for the amount that bears the same proportion to the lesser of its tax or other tax attributable to the intangible property as that amount bears to the total of both taxes.<sup>38</sup>

#### **G. ENED owns stock in US companies.**

US collects no tax on the US stock of the ENED. The EC imposes its tax on the stock.<sup>39</sup>

The same rule would generally apply to other forms of intangible property in the United States owned by the ENED. However, interests owned by the GD in partnerships holding US real property and business establishment property may be taxed by the United States, and Germany would give a credit against the US tax.<sup>40</sup>

#### **H. USCD owns stock in EC companies.**

The EC collects no tax on the EC stock. The US imposes its tax on the EC stock owned by the USCD.<sup>41</sup>

France does not tax US real property or US business establishment property.<sup>42</sup> The same rule would generally apply to other forms of intangible property in the European country owned by the USCD.

One exception is that interests owned by the USCD in partnerships holding German real property and business establishment property may be taxed by Germany, and the United States would give a credit against the German tax.<sup>43</sup>

#### **I. ENUSD owns stock in EC companies.**

US imposes its tax on the EC stock owned by the ENUSD. The EC is authorized to tax the stock. If it did, the EC should give credit against its tax for the US tax.<sup>44</sup> The same rule would generally apply to other forms of intangible property in the European Country owned by ENUSD.

The exceptions to the above rule include the following:

- While France is not precluded from taxing on the basis of French nationality, there is no effective credit under the US-France Treaty if it did.<sup>45</sup>
- Germany is effectively not permitted to tax on the basis of citizenship alone, although it may tax a German beneficiary receiving property from a US citizen or domiciliary.<sup>46</sup> Also, interests owned by the ENUSD in partnerships holding German real property and business establishment property may be taxed by Germany, and the United States would give a credit against the German tax.<sup>47</sup>
- In the case of a US domiciliary who is a Netherlands national, the Netherlands must give full credit for the US tax only if the USEN was a US domiciliary for seven out of the last ten years.<sup>48</sup> Otherwise, each of the Netherlands and the US gives credit for the amount that bears the same proportion to the lesser of its tax or other tax attributable to the intangible property as that amount bears to the total of both taxes.<sup>49</sup>

#### J. USCED owns stock in US companies.

The US and the EC each impose its respective tax on the US stock. The US gives a credit for the EC tax against the US tax.<sup>50</sup> The same rule would generally apply to other forms of intangible property in the United States owned by USCED.

The exceptions to the above rule include the following:

- Interests owned by the USCED in partnerships holding US real property and business establishment property may be taxed by the United States, and Germany would give a credit against the US tax.<sup>51</sup>
- In the case of a USCED who is not a Netherlands citizen, US gives full credit for the Netherlands tax only if USCED was a Netherlands domiciliary for seven out of the last ten years.<sup>52</sup> Otherwise, each of the US and the Netherlands gives credit for the amount that bears the same proportion to the lesser of its tax or other tax attributable to the intangible property as that amount bears to the total of both taxes.<sup>53</sup>

### IV. Other Topics

#### A. Charitable Deductions

There are no special rules in the US-UK or US-Netherlands Treaties.

In the US-Germany treaty, there is a reciprocal charitable deduction for donor country persons for transfers to charitable organizations and public bodies in the other country if the transfer would be exempt from tax in the donee country and the transfer would be exempt in the donor country if the gift were made to a similar charity or public body in the donor country.<sup>54</sup>

In the US-France treaty, essentially the same rule as with Germany applies, but the charitable organization must receive a substantial part of its support from contributions from the public or governmental funds.<sup>55</sup>

#### B. Marital Deductions

Under the US-UK treaty, in the case of property passing to the spouse of a decedent who is a US citizen or domiciliary, the UK will allow a fifty percent marital deduction, even if the spouse is not domiciled in the UK.<sup>56</sup>

Under the US-France treaty, property (other than community property) acquired during the marriage by a US citizen or domiciliary will be treated for French tax purposes as community property (in the absence of a contrary election).<sup>57</sup>

Under the US-Netherlands treaty, real property and business/professional establishment property (other than community property) passing to the surviving spouse from a US citizen or domiciliary will be included in the estate for purposes of the Netherlands death duty only to the extent its value exceeds fifty percent of all property taxable by the Netherlands. The value of the property is determined after taking into account allowable deductions but before taking into account the treaty exclusion of property with a value under \$30,000.<sup>58</sup>

Under the US-Germany treaty, real property, business/professional establishment property (other than community property), and certain ships and aircraft passing to a surviving spouse from a citizen or domiciliary of either country that may be taxed by a country because the property is located there may only be taxed to the extent its value exceeds fifty percent of all property taxable by that country.<sup>59</sup> There is also available a US marital deduction limited to the US applicable exclusion for property passing from a US or German domiciliary to a US or German surviving spouse, if an election not to use QDOT to secure a deduction is made.<sup>60</sup>

#### C. US State Death Taxes

According to the US-Germany Treaty, certain credits allowed by Germany may also include "taxes levied by political subdivisions of the United States."<sup>61</sup>

## Endnotes

The references to "UK," "FR," "NETH," and "GER" followed by a numbered reference refer to a particular section of the U.S. estate tax treaty with the United Kingdom, France, the Netherlands, and the Federal Republic of Germany, respectively.

1. UK4(1), FR4(1), NETH4(1), GER4(1).
2. UK4(1)(a), 5(1)(b).
3. UK4(2)&(3).
4. GER4(3).
5. FR4(3).
6. NETH4(2).
7. UK4(4); FR4(2); NETH4(3); GER4(2).
8. NETH4(3). *See also* FR4(2)(b).
9. UK6 and 9(2)(a), FR5 and 12(2)(a), NETH6 and 11(1); GER5 and 11(3)(a).
10. UK7; FR6; NETH7; GER6. The Netherlands Treaty clearly states that the fact that a decedent controlled a corporation that engaged in business in a country does not determine that the decedent had a permanent establishment in the country for estate or inheritance tax purposes. NETH7(7). The United Kingdom Treaty provides that the fact that a company residing in one country controls (or is controlled by) a company resident in the other country or doing business in the other country does not constitute either company a permanent establishment of the other. UK7(2)(g). The German Treaty has an analogous provision. GER6(2)(f). Finally, the French Treaty provides that the fact that an enterprise controlled a corporation that engaged in industrial or commercial activity in a country should not be taken into account in determining whether the enterprise had a permanent establishment in that country.
11. GER10(5).
12. FR12(2)(a).
13. NETH10(2).
14. UK6 and 9(1)(a); FR5 and 12(2)(b); NETH6 and 11(1); GER5 and 11(2)(a).
15. UK7; FR6; NETH7; GER6.
16. NETH10(2).
17. UK5(1)(a) (excludes from US tax all property except for US real property and US business establishment property), FR8 (excludes from US tax all property except for US real property, US business establishment property and certain US tangible property (including certain ships and aircraft)); NETH8 (excludes from Netherlands tax all property except for US real property and US business establishment property); GER9 (excludes from US tax all property except for US real property, US business establishment property, and interests in partnerships owning any of such US property).
18. GER7.
19. FR7(1)&(2).
20. FR7(3).
21. FR12(2)(a).
22. UK5(1)(a) (excludes from UK tax all property except for UK real property and UK business establishment property); FR8 (excludes from French tax all property except for French real property, French business establishment property and certain French tangible property (including certain ships and aircraft)); NETH8 (excludes from Netherlands tax all property except for Netherlands real property and Netherlands business establishment property); GER9 (excludes from German tax all property except for German real property, German business establish-
- ment property, certain German-connected ships and aircraft, and interests in partnerships owning any of such German property).
23. GER7.
24. FR7(1)&(2).
25. FR7(3).
26. FR12(2)(b).
27. UK5(1)(b) and 9(2); FR8 and 12(2)(a); NETH9 and 11(2).
28. GER7.
29. FR7(1)&(2).
30. FR7(3).
31. FR12(2)(b).
32. GER 4(1), 11(1)(b).
33. NETH11(2)(a).
34. NETH11(2)(c). Example: Say the intangible property is worth \$1 million, the NETH tax is forty percent and the US tax is fifty percent. The NETH tax would be \$400,000 and the US tax would be \$500,000 and the sum of both taxes would be \$900,000. NETH and US would each give a credit of 4/9 of its respective tax. The NETH tax would be \$222,222, the US tax would be \$277,777, and the total tax would be \$500,000. The objectives of the Treaty are fulfilled because the total of the two taxes does not exceed the higher of the two taxes.
35. UK5(1)(b) and 9(1)(b); FR8 and 12(3); NETH9 and 11(2)(c), *but see* 11(2)(a) and (c); GER11(1), 11(2)(b).
36. FR12(2)(a).
37. NETH11(2)(a).
38. NETH11(2)(c). Example: Say the intangible property is worth \$1 million, the NETH tax is forty percent and the US tax is fifty percent. The NETH tax would be \$400,000 and the US tax would be \$500,000 and the sum of both taxes would be \$900,000. NETH and US would each give a credit of 4/9 of its respective tax. The NETH tax would be \$222,222, the US tax would be \$277,777, and the total tax would be \$500,000. The objectives of the Treaty are fulfilled because the total of the two taxes does not exceed the higher of the two taxes.
39. UK5(1)(a) (excludes from US tax all property except for US real property and US business establishment property); FR8 (excludes from US tax all property except for US real property, US business establishment property and certain US tangible property (including certain ships and aircraft)); NETH8 (excludes from US tax all property except for US real property and US business establishment property); GER9 (excludes from US tax all property except for US real property, US business establishment property, certain US-connected ships and aircraft, and interests in partnerships owning any of such US property).
40. GER8 and 11(3)(a).
41. UK5(1)(a) (excludes from UK tax all property except for UK real property and UK business establishment property); FR8 (excludes from French tax all property except for French real property, French business establishment property and certain French tangible property (including certain ships and aircraft)); NETH8 (excludes from Netherlands tax all property except for Netherlands real property and Netherlands business establishment property); GER9 (excludes from German tax all property except for German real property, German business establishment property, certain German-connected ships and aircraft, and interests in partnerships owning any of such German property).
42. FR12(2)(a).
43. GER8 and 11(2)(a).

44. UK5(1)(b) and 6; FR5, 8 and 12(2)(a); NETH6, 9, 11(1)&(2); GER5 and 11(2)(a).
45. FR12(2)(a).
46. GER 4(1), 11(1).
47. GER8 and 11(2)(a).
48. NETH11(2)(a).
49. NETH11(2)(c). Example: Say the intangible property is worth \$1 million, the NETH tax is forty percent and the US tax is fifty percent. The NETH tax would be \$400,000 and the US tax would be \$500,000 and the sum of both taxes would be \$900,000. NETH and US would each give a credit of 4/9 of its respective tax. The NETH tax would be \$222,222, the US tax would be \$277,777, and the total tax would be \$500,000. The objectives of the Treaty are fulfilled because the total of the two taxes does not exceed the higher of the two taxes.
50. UK5(1)(b) and 9(1)(b); FR8 and 12(3); NETH9 and 11(2)(c), *but see* 11(2)(a) and (c); GER11(1), 11(2)(b).
51. GER8 and 11(3)(a).
52. NETH11(2)(a).
53. NETH11(2)(c). Example: Say the intangible property is worth \$1 million, the NETH tax is forty percent and the US tax is fifty percent. The NETH tax would be \$400,000 and the US tax would be \$500,000 and the sum of both taxes would be \$900,000. NETH and US would each give a credit of 4/9 of its respective

tax. The NETH tax would be \$222,222, the US tax would be \$277,777, and the total tax would be \$500,000. The objectives of the Treaty are fulfilled because the total of the two taxes does not exceed the higher of the two taxes.

54. *See* GER10(2).
55. FR10(2).
56. UK8(3).
57. FR11.
58. NETH10(1).
59. GER10(4).
60. GER10(6).
61. GER11(4).

**Mr. Galligan is a partner in the trusts and estates department of the New York City law firm of Phillips Nizer LLP.**

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