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## Chapter 1

# United States: Treaty-Based Foreign Tax Credits and Limitations<sup>1</sup>

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### 1.1. Introduction

This case involves fundamental questions about the United States (US) treaty obligations to allow foreign tax credits and the relationship between these obligations and the domestic foreign tax credit provisions.

### 1.2. Facts of the case

Plaintiffs Matthew and Katherine Kaess Christensen (“the Christensens”) filed a complaint with the United States (US) Court of Federal Claims seeking a refund of USD 3,851 paid to the Internal Revenue Service (IRS) as a net investment income tax (NIIT) for tax year 2015. The Christensens are a married couple, both US citizens residing in France. They claimed a credit based on article 24 (relief from double taxation) of the 1994 US-France tax treaty in effect.<sup>2</sup>

The subject of discussion was the NIIT, which was originally created in 2010, when the Health Care and Education Reconciliation Act of 2010 inserted §1411 into the Internal Revenue Code (IRC). The NIIT was located in a different IRC chapter than the normal income tax.

The Christensens argued that the NIIT should be characterized as an income tax since it was imposed using concepts identical to those of the normal income tax provisions and that it meets the IRC definition of a tax on income as that concept is understood in the foreign tax credit provisions.<sup>3</sup> They further explained that the NIIT did not exist at the time of the ratification

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1. *Matthew and Katherine Kaess Christensen v. United States*, United States Court of Federal Claims, case No. 20-935T.

2. Convention between the Government of the French Republic and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital, Aug. 31, 1994, 1963 U.N.T.S. 67 as amended by later protocols in 2005 and 2009.

3. Citing Treas. Reg. §§ 1.901-2(b)(4) (2022).

(or later amendments) of the US-France treaty, and hence, it is not specifically mentioned there but falls in the extension category of creditable taxes under the said provision.

The IRS rejected this argument, taking the position that the NIIT should be characterized as “a separate levy that is ‘in addition to’ the regular income tax imposed under Chapter 1.” It demonstrated that the taxes do not completely overlap and that there was clear guidance that the income tax’s foreign tax credit provisions were not intended to apply against the NIIT. The case included various procedural complications that are not relevant for the purposes of this conference, but it may be useful to note the unique circumstances of the Christensens as US citizens and residents of France, namely subject to two worldwide taxation claims. In these cases, the IRS interprets the foreign tax credits rules to apply in a particular manner known as the three-bites rule, which could be summarized as follows: First, the US taxes US source income (first bite), then France applies its worldwide taxation scheme, exempting or crediting for the first “bite” by the US (second bite). Finally, the US applies its worldwide taxation scheme taking into account (mostly in the form of credits) France’s second “bite”. The parties agreed that this rule applies to the case via article 24 of the treaty, yet they disagree on its application to the facts of this case. The dispute over this matter was deferred until after the Court decided on the creditability of foreign taxes against the NIIT, which is the matter discussed in this decision.

### **1.3. The Court’s decision**

Beyond some procedural matters, the Court began its analysis with the question of the weight it should give to the US interpretation of the relevant treaty. It rejected the position that such an interpretation (which rejects the grant of foreign tax credits in our case) should be given absolute deference, emphasizing that no evidence had been presented on the position of France in this matter or of it being even notified of the later enactment of the NIIT.

The Court then turned to the question as to whether the treaty and the code provisions conflict. The Christensens argued that conflicts do not arise when the code and a treaty could be reconciled, and they could be reconciled in this case with the grant of foreign tax credits against the NIIT. The IRS responded that there is a conflict since the code did not provide for foreign tax credits against the NIIT, and when there is a conflict, the traditional later-in-time canon of interpretation prevails, with the effect of foreign tax credit denial. A part of this disagreement involved the question whether

treaty override strictly requires its explicit acknowledgment by the overriding Congress, which did not happen in this case. Note that the primary IRS position was that no override happened because the NIIT was not mentioned in the scope of taxes to which the treaty applied. The Court decided to follow precedence: “Mindful of the principles set forth above, including the Supreme Court’s observation in *Murray v. Schooner Charming Betsy* “that an act of Congress ought never to be construed to violate the law of nations if any other possible construction remains”.<sup>4</sup>

The Court eventually divided its decision in two. First, it interpreted article 24(2)(a) of the treaty.

2. (a) *In accordance with the provisions and subject to the limitations of the law of the United States* (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a citizen or a resident of the United States as a credit against the United States income tax: (i) the French income tax paid by or on behalf of such citizen or resident; and (ii) in the case of a United States company owning at least 10 percent of the voting power of a company that is a resident of France and from which the United States company receives dividends, the French income tax paid by or on behalf of the distributing corporation with respect to the profits out of which the dividends are paid. (author’s emphasis)

The Court followed an earlier decision of the US Tax Court in *Toulouse v. Comm’r*,<sup>5</sup> accepting that “this ‘provisions’ and ‘limitations’ language is key to this Court’s interpretation of paragraph 2(a), just as it had been for the United States Tax Court in the Toulouse decision.” The Court viewed this language as an agreement by France that the extent of foreign tax credits given by the US will be similar to their grant under domestic law, namely that the commitment of the US in that case had been to provide foreign tax credits and to not discriminate against French taxes in this regard.

The Court therefore denied the Christensens’ claim regarding article 24(2) (a) of the treaty. Then the Court turned to article 24(2)(b):

(b) In the case of an individual who is both a resident of France and a citizen of the United States:  
(i) the United States shall allow as a credit against the United States income tax the French income tax paid after the credit referred to in subparagraph (a) (iii) of paragraph 2. However, the credit so allowed against United States in-

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4. *Murray v. Schooner Charming Betsy*, 6 U.S. 64 (1804), at 118.

5. *Toulouse v. Comm’r*, 157 T.C. No. 4 (Aug. 16, 2021).

come tax shall not reduce that portion of the United States income tax that is creditable against French income tax in accordance with subparagraph (a)(iii) of paragraph 2;

(ii) income referred to in paragraph 2 and income that, but for the citizenship of the taxpayer, would be exempt from United States income tax under the Convention, shall be considered income from sources within France to the extent necessary to give effect to the provisions of subparagraph (b)(i). The provisions of this subparagraph (b)(ii) shall apply only to the extent that an item of income is included in gross income for purposes of determining French tax. No provision of this subparagraph (b) relating to source of income shall apply in determining credits against United States income tax for foreign taxes other than French income tax as defined in subparagraph (e); and

The Court noted that this paragraph does not include a direct reference to domestic US law and hence accepted the Christensens' claim that it provides an independent (from article 24(2)(a) of the Treaty) authority to claim a foreign tax credit and that the claim was not subject to the conditions and limits under domestic US law.

### 1.4. Comments on the Court's reasoning

This case has already been appealed by the government of the US and it is expected to be reversed on appeal. The decision was surprising since US tax treaty jurisprudence quite consistently follows domestic law in foreign tax credit matters.

Nonetheless, the case raised a lively debate over a few important tax treaty matters that are mainly unique in the context of US tax law. Therefore, a few notes and observations are due.

First, one should note the application of the three-bite rule to American citizens who reside in tax treaty partners. In the current case, the treaty with France specifically accounts for this mode of application. One may argue, as did the IRS in this case that such account is merely that and that it is subject to general foreign tax credit rules, i.e., that it does not provide an independent obligation of the US under the double tax relief provisions. But, in *Christensen* the Court obviously thought differently when it decided to grant the foreign tax credits to the Christensens under article 24(2)(b). One could question the drafting of this provision, although the IRS could have been clearer in its argument and explain that such a provision must be read in its context and as a part of the general rule embedded in article 24 of the said treaty.

Second, and relatedly, the Court has not clearly answered the question of an independent foreign tax credit obligation that arises from tax treaty provisions for the US. Since the US grants such credits unilaterally, unlike essentially all other states, it has been consistently careful to include language in all its tax treaties that limit in one way or another its credit obligations to what it gives out anyway under domestic law. However, the very general limiting language, even if it convinced the courts (including that of the *Christensen* case), does not preclude in the view of some tax experts the possibility of an independent tax treaty credit.<sup>6</sup>

Third, the Court seemed to have had difficulties with the use of the US Treasury Technical explanation of the treaty. In general, the Court did the right thing when it concluded that this explanation should have no significance in this case because it was a unilateral, post-signature interpretation of the treaty. One should note, however, that arguing, as the Court did, that no French interpretation or agreement existed in this case, and therefore no weight should be given to the interpretation of the US, is nonsensical. The NIIT was enacted after the last amendment of the treaty so no one could expect direct reference to its status in this case. But, with respect to the general logic of the relief of double taxation provisions, a Court should visit the Treasury's technical explanation as the sole source of an interpretation that is "out there". This does not mean that it should be given much weight, but it should not be ignored in any interpretation exercise. One could argue that the explanation is "boiler plate" and hence should be ignored in the interpretation of a specific treaty, but this argument could be turned on its head since most treaty provisions repeat themselves, and clearly the double tax relief provisions do as well.

Finally, the Court only briefly mentions the controversial matter of treaty override and the implications of override under US law. There is an ongoing debate over the extent of Congress' obligation to acknowledge a tax treaty override and when it does so. Most notably, Professors Rosenbloom and Shaheen argued that precedence requires explicit acknowledgment. Professor Avi-Yonah interpreted precedence differently, arguing that so long as the overriding provision is clear, then treaty override is effective.<sup>7</sup> The *Christensen* Court raised the matter, but made no contribution to the debate, and in reality it bore no significance since its decision was that no treaty override existed there. This matter is significant and may result in

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6. See, e.g. Kim Blanchard, *The Tax Court's Erroneous Decision in Toulouse*, *International Tax Journal* (BNA), Oct. 1, 2021.

7. See H. David Rosenbloom and Fadi Shaheen, "Treaty Override: The False Conflict Between *Whitney* and *Cook*," *24 Fla. Tax Rev.* 375 (2021).

millions of refund suits, mainly related to the 2017 enacted base erosion tax known as the BEAT, but it is ancillary at best in the USD 4000 odd case in *Christensen*.

## **1.5. Conclusion**

*Christensen* may be reversed on appeal, but it raises a few interesting tax treaty questions and points to some vulnerabilities in the drafting of common US tax treaty provisions. Several ongoing cases challenge the existence of an independent treaty-based foreign tax credit under US tax treaty law, a question that will have to be resolved eventually by the courts. The author is more sceptical about the forthcoming resolution of the more fundamental questions of the status of the Treasury's Technical Explanations of tax treaties and the precise meaning of treaty override under US law. These purely legal questions are politically charged and therefore are unlikely to be simply resolved by the courts.

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## Chapter 2

### Belgium: Interpreting Article 2: A Case Study in Judicial (In)Consistency and the Belgian NAT

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#### 2.1. Introduction

Beginning on 1 January 2004, the Belgian annual tax on undertakings for collective investment (UCIs) also applied to foreign UCIs that market their products in Belgium. However, if the Belgian annual tax on UCIs (hereafter, Net Asset Tax (NAT)) is considered a tax on capital under a tax treaty, Belgium is precluded from applying the NAT to UCIs established in the other contracting state, given that most of the tax treaties entered into by Belgium allocate the taxing power of such a tax only to the taxpayer's state of residence (cf. article 22 of the Organization for Economic Co-operation and Development (OECD) Model Tax Convention).<sup>1</sup> There is varying case law on whether the Belgian NAT is considered a tax on capital for treaty purposes. Lower courts have held that the Belgian NAT is a tax on capital within the scope of the Belgium-Luxembourg Tax Treaty (1970) and the Belgium-Netherlands Tax Treaty (2001). In 2022, the Belgian *Cour de Cassation/Hof van Cassatie* (Supreme Court) ruled that the Belgian NAT is a tax on capital within the scope of the Belgium-Netherlands Tax Treaty (2001), but not within the scope of the Belgium-Luxembourg Tax Treaty (1970), based on a different wording of the "taxes covered" provision in those tax treaties.<sup>2</sup> In a 2023 judgment, as discussed below, the Brussels Court of Appeal did not follow the Supreme Court's position and ruled that the Belgian NAT is indeed a tax on capital under the Belgium-Luxembourg Tax Treaty, hence precluding Belgium from imposing the tax on foreign UCIs.<sup>3</sup> This chapter addresses the scope of article 2 of tax treaties, in particular with regard to the Belgian NAT.

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1. The tax treaties concluded by Belgium are largely in line with the OECD Model Tax Convention.

2. N. Bammens & F. Debelva, "What Is Tax on Capital for the Purposes of a Tax Treaty? An Analysis of Two Recent Belgian Supreme Court Decisions on the Belgian Net Asset Tax" *Bull. Intl. Taxn.*, pp. 379-399, (2022) *Tax Treaty Case Law Monitor IBFD*.

3. BE: Court of Appeal, Brussels, 2017/AF/174, 25 April 2023, available at [www.monkey.be](http://www.monkey.be) (accessed 1 July 2024).

## 2.2. Facts of the case

In the present case,<sup>4</sup> a Luxembourg *Société d'investissement à Capital Variable* (SICAV)<sup>5</sup> – an investment company with variable capital under Luxembourg law – was subject to both the Luxembourg subscription tax<sup>6</sup> and the Belgian NAT.<sup>7</sup> All UCIs<sup>8</sup> – with or without legal personality – domiciled in Luxembourg are subject to the Luxembourg subscription tax on the total amount of net assets, including for assets arising from amounts placed in Belgium. The nexus for the Luxembourg subscription tax is the seat of the UCI. Beginning 1 January 2004, the Belgian NAT, in accordance with the amendments made by articles 301 to 307 of the Programme Act of 23 December 2003, also applied to foreign UCIs to the extent that they market their products in Belgium. As a result of the said legislative amendment, the nexus of the Belgian NAT was changed from the seat criterion to the place where the products are commercialised. In other words, a Luxembourg SICAV with amounts placed in Belgium is subject to double taxation.

The (initial) claim concerned the question whether the Belgian NAT, levied pursuant to articles 161 et seq. of the Inheritance Tax Code, is contrary to article 22 section 4 of the Belgium-Luxembourg Tax Treaty (1970). Article 22 section 4 of the Belgium-Luxembourg Tax Treaty (1970) states that elements of capital – other than those referred to in sections 1, 2 and 3 – of a holder of residence in a contracting state are taxable only in that state. The question that arose is whether the SICAV could invoke this provision in order to contest the levying of the Belgian NAT. The Belgian tax administration argued that the Belgian NAT should be considered a tax on capital within the meaning of article 2 of the Belgium-Luxembourg Tax Treaty (1970), and also disagreed with the view that Belgium did not have the power to levy the Belgian NAT on UCIs under Luxembourg law on the basis of article 22 of the Belgium-Luxembourg Tax Treaty (1970). In addition, according to the Belgian tax administration, the SICAV did not qualify as a resident of Luxembourg and was therefore not entitled to access the benefits of the treaty in question. Moreover, the Belgian tax administration argued that the “owner” referred to in article 22 section 4 of the Belgium-Luxembourg Tax Treaty (1970) should be understood as the

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4. BE: Court of Appeal, Brussels, 2017/AF/174, 25 April 2023, available at [www.monkey.be](http://www.monkey.be) (accessed 1 May 2024).

5. In French, “*Société d'investissement à capital variable*”.

6. In French, “*Taxe d'abonnement*”.

7. In Dutch, “*Jaarlijkse taks op de collectieve beleggingsinstellingen*”.

8. In Dutch, “*Instelling voor collectieve belegging*” or “*ICB*”.

economic owner, and in their view the SICAV should not be regarded as the economic owner of the elements of equity as indicated on the asset side of the SICAV's balance sheet.

### 2.3. The Court's decision

In its decision, the Court first discussed whether the Belgian NAT was covered by article 2 of the Belgium-Luxembourg Tax Treaty. To this end, the Court set out the meaning and scope of article 2 section 2 and article 2 section 3 of the Belgium-Luxembourg Tax Treaty, and then analysed whether the Belgian NAT is a tax on capital. The Court considered, contrary to the Belgian tax administration, that the Belgium-Luxembourg Tax Treaty defined the concept of taxes on capital in article 2 section 2 of the Belgium-Luxembourg Tax Treaty. However, the Court also noted that the NAT was not enumerated in article 2 section 3 of the Belgium-Luxembourg Tax Treaty. The Court therefore explored whether article 2 section 3 of the Belgium-Luxembourg Tax Treaty included an exhaustive list of taxes covered. To this end, the Court referred to the OECD commentaries that supported the view that the enumeration of existing taxes in paragraph 3 of article 2 was exhaustive only insofar as paragraphs 1 and 2 of article 2 were omitted. As this was not the case, the Court stated that paragraphs 1 and 2 of article 2 determined the scope of the treaty in question.

The combination of article 2 section 1 and article 2 section 2 of a tax treaty with a list of taxes in article 2 section 3 of the tax treaty to which the tax treaty applies only results in the latter article having an amplifying effect on the aforementioned articles 2 section 1 and section 2 of the tax treaty. A future tax in such a case will be covered by the treaty provided it is a tax within the meaning of the general definition set out in paragraphs 1 and 2. By contrast, the Court argues that such a future tax should not necessarily be analogous or identical to the pre-existing taxes listed in paragraph 3. According to the Court, article 2 of the Belgium-Luxembourg Tax Treaty was in line with article 2 of the OECD Model. Therefore, the Court concluded that the contracting states have opted for an exhaustive enumeration in article 2 section 3 when both the first two paragraphs are not included in the tax treaty *and* an alternative clause without the wording "*in particular*" has been included. When article 2 includes a definition of the terms tax on income and capital, as in the tax treaty between Belgium and Luxembourg, the Court concluded that there was no intention to apply the tax treaty in a restrictive manner and to only include taxes listed in its scope *ratione materiae*. According to the Court, solely including an alternative clause

(i.e. omitting the words “in particular” from the standard wording) without deleting the first two paragraphs of article 2 of the OECD Model, this does not support the conclusion that the contracting states intended to include an exhaustive enumeration of taxes covered. Consequently, the Court concluded that article 2 section 3 of the Belgium-Luxembourg Tax Treaty did not contain an exhaustive enumeration, and thus confirmed the taxpayer’s position that, with regard to a future tax (i.e. the NAT), it is sufficient that it meets the general definition in paragraphs 1 and 2 of article 2 to fall within the scope of the tax treaty.

Afterwards, the court analysed whether the Belgian NAT would qualify as a tax on capital within the meaning of article 2 sections 1 and 2 of the Belgium-Luxembourg Tax Treaty. To this end, the Court analysed the qualification of the Belgian NAT based on internal (Belgian) legislation. In this regard, the Court stated that what matters is not the name of the tax or its inclusion in a particular code, but what the tax object is to determine the qualification of the tax. In this respect, article 161bis section 1 of the Inheritance Tax Code stipulates that the tax is due – by UCIs governed by foreign law to the extent they are registered with the Financial Services and Markets Authority – on the total net amounts outstanding in Belgium on 31 December of the previous year. The taxable matter is therefore not the placement as such (a one-off event), but the outstanding amounts (a continuous state of affairs). The Belgian NAT therefore targets the ownership and not the transfer of assets. In order to calculate the NAT, the value of assets at a certain point in time (i.e. 31 December of the previous calendar year) is determined and taxed. The legislator does not define the term “net outstanding amounts” but it is clear from the preparatory works of the 1993 Act that the term “net outstanding amounts” means the total assets of the investment vehicle less the repurchases made by the investment vehicle.

The Court also referred to the Minister of Finance who stated, on the occasion of the introduction of the NAT in 1993, that the fact from which the tax liability arose is the existence of a “mass of goods” in the investment company. The assets of the SICAV consist of “units”, and it is those units that are considered outstanding (and therefore taxable) in Belgium for the purposes of the Belgian NAT. Therefore, the NAT should be considered a tax on the assets of the SICAV because the assets of the SICAV consist of those units. The Belgian tax administration’s alternative reasoning that the NAT is not a tax on capital because it also affects mutual investment funds that do not have legal personality and therefore do not hold any assets was not followed by the Court. In Article 2, section 2 5bis CIR 1992, a mutual investment fund was defined as undivided assets that a management company of UCIs