[JOINT COMMITTEE PRINT]

EXPLANATION OF PROPOSED ESTATE AND GIFT TAX TREATY BETWEEN THE UNITED STATES AND THE KINGDOM OF DENMARK

SCHEDULED FOR A HEARING

BEFORE THE

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UNITED STATES SENATE

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INTRODUCTION

This pamphlet provides an explanation of the proposed estate, gift, and generation-skipping transfer tax treaty (gratuitous transfer tax treaty) between the United States the the Kingdom of Denmark ("The Convention Between the Government of the United States of America and the Government of the Kingdom of Denmark for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates, Inheritances, Gifts and Certain Other Transfers"). The proposed treaty was signed in Washington, D.C. on April 27, 1983, and the President has submitted it to the Senate for advice and consent to its ratification. The Senate Committee on Foreign Relations has scheduled a public hearing on the proposed treaty on April 26, 1984.

The proposed treaty is the first gratuitous transfer tax treaty between the United States and Denmark. It is similar to recent U.S. estate and gift tax treaties, and the U.S. model gratuitous transfer tax treaty. In the case of the United States, the treaty applies to the Federal estate tax, the Federal gift tax, and the Federal tax on generation-skipping transfers. In the case of Denmark, it applies to the inheritance tax and the gift tax.

The first part of the pamphlet is a summary of the principal provisions of the proposed treaty. The second part provides an overview of U.S. tax rules relating to international gratuitous transfers and U.S. estate and gift tax treaties in general. Part three is a detailed, article-by-article explanation of the proposed treaty.

I. SUMMARY

In general

In this proposed treaty, the United States and Denmark have sought to alleviate double imposition of tax on the estates, gifts, and generation-skipping transfers of their citizens and domiciliaries and to prevent evasion of those taxes. To alleviate double taxation, the treaty requires each country to relinquish taxing jurisdiction in two cases.

First, the treaty generally assigns to the country of domicile primary tax jurisdiction in the case of the estates, gifts, and deemed transfers of its domiciliaries (Article 8). However, real property and business property located in the other country ("situs country") are subject to primary tax jurisdiction in the situs country (Articles 5 and 6). In each case, the country without primary tax jurisdiction retains a residual right to tax property covered by Article 5 or Article 6.

The second waiver of taxing jurisdiction occurs in situations where both countries under their own domestic laws consider an individual to be a domiciliary. In those situations, the individual will be treated as having only one country of domicile for purposes of the taxes covered by the treaty. The treaty sets forth several criteria to determine which country is the country of domicile (Article 4).

In situations where both countries retain the right to tax transfers the treaty generally provides for relief from double taxation by the country of domicile or citizenship (Article 10). In these situations, the country of domicile or citizenship grants relief through a foreign tax credit for taxes imposed by the other country on a situs basis.

The treaty contains the standard provision (the "saving clause") contained in U.S. tax treaties that the United States retains the right to tax its citizens and domiciliaries as if the treaty had not come into effect (Article 1). In addition, it contains the standard provision that the treaty will not deny any taxpayer any benefits he would be entitled to under the domestic law of either country or under any other agreement between the two countries (Article 1); that is, the treaty will only benefit taxpayers.

The treaty also contains standard nondiscrimination provisions and provides for exchanges of information and administrative cooperation between the tax authorities of the two countries to avoid double taxation and prevent fiscal evasion.

Issue

The proposed treaty fully exempts interspousal transfers by Danish residents from U.S. tax, while interspousal transfers by U.S. residents will not be fully exempt from Danish tax (they will generally be taxable at half the rate applicable to other transfers subject to Danish tax).

During the negotiation of this provision, one-half of interspousal gratuitous transfers by U.S. citizens or residents (above a floor) were generally subject to U.S. tax. That is, U.S. law at that time was generally similar to current Danish law. Now U.S. law has become more generous than Danish law. The issue is whether the United States should give a full marital deduction to Danish residents while U.S. residents benefit from only a partial marital deduction under Danish law, or whether the United States should insist that Denmark fully exempt transfers by a U.S. citizen or resident (or his or her estate) to his or her spouse from its gratuitous transfer taxes. The Committee might consider a reservation on this provision.

II. OVERVIEW OF UNITED STATES TAXATION OF INTERNATIONAL GRATUITOUS TRANSFERS AND TAX TREATIES

A. United States Estate and Gift Tax Rules

Taxation of U.S. Citizens and Residents

The United States imposes its estate tax on the transfers of the worldwide assets of estates of individuals who were citizens or domiciliaries of the United States at death. The United States imposes its gift tax on all gifts made by U.S. citizens and domiciliaries.

The U.S. tax on generation-skipping transfers was enacted in 1976 to prevent the transfer of the use of property from one generation of the transferor's descendants to a younger generation without the payment of estate or gift taxes. In general, the tax on generation-skipping transfers is imposed when property passes through a trust from persons of one generation to persons of another generation and the transfer is not otherwise subject to estate or gift tax. This generation-skipping transfer tax applies to any property deemed transferred by a U.S. citizen or domiciliary and to certain U.S. situs property deemed transferred by certain nondomiciliary aliens.

A unified tax rate schedule applies to transfers at death, to gifts, and to generation-skipping transfers by U.S. citizens or domiciliaries. The highest marginal rate of tax is 55 percent in 1984, phasing down to 50 percent in 1985 and thereafter. A unified credit against the estate and gift taxes allows the cumulative tax-free transfer of up to $325,000 in 1984, increasing to $600,000 in 1987. In general, transfers to the spouse of the transferor are not subject to tax.

Because the United States taxes U.S. citizens (even if they are not domiciled in the United States) and domiciliaries on gratuitous transfers of property wherever located, double taxation of such transfers can arise when foreign countries subject to tax all transfers of property located within their boundaries. The United States seeks to mitigate this double taxation by allowing the estates of U.S. citizens and domiciliaries to credit foreign death taxes against the U.S. tax imposed on property located abroad. The credit cannot exceed the amount of foreign tax attributable to the property subject to double taxation. In addition, the credit for foreign death taxes cannot offset U.S. tax on property located in the United States. Therefore, the credit cannot exceed the amount of U.S. tax attributable to the property subject to double taxation.

No credit is available for foreign gift taxes or other transfer taxes other than death taxes.

Taxation of Nonresidents Not Citizens of the United States

Estate tax

The United States imposes its estate tax on the transfer of any property belonging to any nonresident not a citizen of the United States (hereinafter "nondomiciliary alien" of the United States) that is located in the United States at the time of his death. Special situs rules assign locations or deemed locations to certain property.

Whether tangible property is taxable generally depends on whether it was actually located in the United States on the date of death. Thus, all U.S. real property owned directly by a nondomiciliary alien is taxable. Generally, tangible personal property located in the United States on the date of death is taxable. The only statutory exception to this rule is that certain works of art on loan for U.S. exhibition are deemed located outside the United States and are thus not taxable.

The physical location of intangible property is generally irrelevant for estate tax purposes. Stock of any U.S. corporation (but not of foreign corporations) is deemed to be located in the United States. In general, debt obligations of U.S. citizens, residents, or entities are deemed located in the United States. Certain bank deposits and certain other debt obligations whose interest is treated for income tax purposes as foreign source income, however, are deemed located outside the United States. The proceeds of insurance on the life of a nondomiciliary alien of the United States are deemed located outside the United States.

The estate of a nondomiciliary alien is allowed certain deductions. If U.S. property is subject to nonrecourse indebtedness, that indebtedness directly reduces the value of the property for estate tax purposes.

Generally, however, expenses and other liabilities—including any personal liability of the decedent that is secured by U.S. or foreign property—are apportioned among the estate's worldwide assets and are deductible only on a pro rata basis. The amount deductible is limited to worldwide expenses and personal liabilities multiplied by a fraction the numerator of which is the U.S. gross estate and the denominator of which is the worldwide gross estate. Nonrecourse debt on non-U.S. property is not deductible for purposes of determining U.S. estate tax liability.

A charitable deduction is available to the estate of a nondomiciliary alien only if the recipient of the charitable transfer is the United States, a political subdivision of the United States, or a U.S. charitable corporation, or if the recipient is a trust or other association that will use the bequest within the United States.

Unless the estate shows the value of its worldwide assets, no pro rata deduction or charitable deduction is available. No marital deduction is available to the estate of a nondomiciliary alien.

The highest marginal tax rate applied to the estates of nondomiciliary aliens is 30 percent of the value of the U.S. situs assets. A credit allows the tax-free transfer at death of up to $60,000. A limited credit for state death taxes is also available, but there is no credit for death taxes paid to foreign governments.

Gift tax

Nondomiciliary aliens are subject to U.S. gift tax only on lifetime transfers of U.S. real property or tangible personal property located in the United States at the time of the gift. Gifts by nondomiciliary aliens of any intangible property (including stock in U.S. companies or obligations of U.S. debtors) are not subject to U.S. gift tax.

Nondomiciliary alien donors obtain no marital deduction; they are entitled to a charitable deduction like that available to the estates of nondomiciliaries. The tax rate on gifts by nondomiciliaries is not the estate tax rate for nondomiciliaries (with a 30-percent top marginal rate) but is rather the rate for gratuitous transfers by U.S. citizens and domiciliaries (with a 55-percent top marginal rate in 1984). No credit for state or foreign gift taxes is available.

Generation-skipping tax

If the deemed transferor of any generation-skipping transfer is a nondomiciliary alien of the United States, the generation-skipping transfer tax applies only to property to which an estate or gift tax would apply in similar circumstances in the case of an outright bequest or gift by the nondomiciliary alien. For example, the deemed transfer of real property located outside the United States by a nondomiciliary alien would not, were it outright, result in an estate or gift tax, so it would result in no generation-skipping transfer tax. The rate on all generation-skipping transfers deemed made by nondomiciliary aliens is the U.S. domestic transfer tax rate (with a 55-percent top marginal rate in 1984).

Determination of a Person's Tax Status

Under the estate and gift tax regulations (sections 20.0-1(b)(1) and 25.2501-1(b) respectively) a resident of the United States is defined as a person who had his domicile in the United States at the time of his death or at the time of the gift. The regulations go on to state that, "a person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accomplished by actual removal." Domicile for the U.S. estate and gift tax law is a matter of Federal law. It does not depend on state law and it does not incorporate any presumption that the domicile of one spouse controls the domicile of the other spouse. The definition of domicile for the purpose of U.S. estate and gift tax purposes does not coincide with the definition of residence for U.S. income tax purposes.

Taxation of Certain U.S. Expatriates

The United States generally taxes persons whose surrender of U.S. citizenship had a principal purpose of U.S. tax avoidance more heavily than other nondomiciliaries. The estates of such persons who die within ten years of loss of citizenship include stock in certain controlled foreign corporations owning U.S. property, and are subject to the higher tax rates applicable to U.S. citizens or domiciliaries. These estates (like the estates of other nondomiciliaries) obtain a credit equivalent to a $60,000 exemption from estate tax. Gifts of stock in a U.S. company or obligations of a U.S. entity by such persons are subject to U.S. gift tax, whereas similar gifts by other nondomiciliaries are tax exempt.

B. Causes of Double Taxation

Double taxation of gratuitous transfers can arise for a variety of reasons, including conflicts between the laws of the two countries regarding where a person has his domicile, conflicts as to criteria for imposing tax, differences in the basic system under which tax is imposed, and taxation of worldwide assets. Double taxation usually occurs in situations where a decedent either was domiciled in both countries or was domiciled in one country and owned property located in the other country.

Since each country has its own definition of domicile, it is possible that a person could be considered a domiciliary of both countries. As such, his estate would be subject to worldwide taxation by both countries.

When the decedent is considered domiciled in only one country but owned property in the other country at the time of his death, that property is subject to tax in the situs country regardless of the decedent's domicile. Thus, the country of domicile will tax the property, since it is included in the worldwide assets of the estate, and the situs country will tax the property because it was located within its boundaries at the time of the decedent's death.

In both of these situations, unless one of the two countries gives up its right to tax the property or allows a credit for the estate taxes paid to the other country, the estate will be subject to double taxation.

Furthermore, the United States imposes its taxes on its citizens wherever they reside. Accordingly, a transfer by a U.S. citizen domiciled in a foreign country that taxes the worldwide estates or gifts of its domiciliaries is likely to incur double tax, once by the United States and once by country of domicile. While the United States would allow a credit for foreign duties imposed in such a case, the credit is available only for duties imposed on non-United States property.

A similar situation exists for gifts where the donor is a domiciliary of both countries or where the donor is a domiciliary of one country and the property which is the subject of the gift is situated in another country. As in the case of estates, the country of domicile will tax the gifts made by its domiciliaries on a worldwide basis and the situs country will tax those same gifts to the extent the property is located within its boundaries. Again, unless one of the countries gives up its right to tax the transfer or allows a credit for the taxes paid to the other country, the gift will be subject to double taxation. The United States does not give a credit against its gift tax.

Also, some countries will tax not only the estate of a decedent domiciled in that country but also inheritances received by persons domiciled in that country when the decedent is domiciled in another country. In this case both countries might tax the same property.

C. United States Estate and Gift Tax Treaties

The traditional objectives of U.S. tax treaties are the avoidance of international double taxation and the prevention of tax avoidance and evasion. To a large extent, the treaty provisions designed to carry out these objectives supplement Code provisions having the same objectives and modify the generally applicable statutory rules with provisions which take into account the particular tax system of the treaty country. Given the diversity of tax systems in the world, it would be virtually impossible to develop in the Code rules which unilaterally would achieve these objectives for all countries.

Notwithstanding the unilateral relief measures of the United States and our treaty partners, double taxation might arise because of different jurisdictional standards, or because of dual domicile. Likewise, if both countries consider the same deduction allocable to foreign assets, double taxation can result.

Another related objective of U.S. tax treaties is the removal of a chilling effect on trade and capital flows caused by overlapping tax jurisdiction.

Early U.S. estate tax treaties attempted to relieve double taxation by providing rules for the determination of situs of assets. Under these treaties, the country of domicile would allow a credit for taxes paid to the situs country. These treaties did not attempt to assign a single domicile.

More recent estate and gift tax treaties eliminate double taxation by granting primary taxing jurisdiction to the country of domicile, and by providing rules to determine a single domicile. The country of domicile then generally allows a credit for taxes attributable to (or exempts from taxation) property taxed by the other country on the basis of situs. In addition, several of the more recent treaties expand coverage beyond death taxes to include gift taxes and the U.S. generation-skipping transfer tax. These treaties grant primary taxing jurisdiction on the basis of situs only for real property and business assets.

In its treaties the United States retains the right to tax its citizens and domiciliaries on their worldwide transfers as if the treaty had not come into effect. Double taxation can therefore still arise. This double taxation is generally mitigated by granting a credit for transfer taxes paid to the other country.

The treaties also provide for administrative cooperation between the countries. This cooperation includes a competent authority mechanism to resolve double taxation problems arising in individual cases, or more generally, by consultation between tax officials of the two governments.

Administrative cooperation also includes provision for exchange of tax-related information to help the United States and its treaty partners administer their tax laws. The treaties generally provide for the exchange of information between the tax authorities of the two countries when such information is necessary for carrying out the provisions of the treaty or of their domestic tax laws.

The Internal Revenue Service (and the treaty partner's tax authorities) can request specific tax information from a treaty partner. It can also provide information spontaneously. This can include information to be used in a criminal investigation or prosecution. The obligation to exchange information under the treaties typically does not require either country to carry out measures contrary to its laws or administrative practices or to supply information not obtainable under its laws or in the normal course of its administration, or to supply information which would disclose trade secrets or other information the disclosure of which would be contrary to public policy.

III. EXPLANATION OF PROPOSED TAX TREATY

A detailed, article-by-article explanation of the proposed estate and gift tax treaty between the United States and Denmark is presented below.

Article 1. Personal Scope

This Article describes the persons who may claim the benefits of the proposed treaty, and it contains the saving clause that preserves the right of the United States to tax its citizens wherever domiciled.

The proposed treaty will apply to the estate of any individual person who was a domiciliary of either or both countries at the time of his death. Similarly, the proposed treaty applies to all gifts made by donors who were domiciliaries of either or both countries at the time the gift was made. The treaty will also apply to generation-skipping transfers of deemed transferors who, at the time of the deemed transfer, were domiciliaries of either or both countries.

The proposed treaty will not in any way restrict any exclusion, exemption, deduction, credit, or other allowance granted by the internal law of either country or by any other agreement between them. Thus, the treaty cannot cause any person to pay U.S. tax at a higher rate than he would pay under the Code.

The proposed treaty preserves the right of each country to tax its domiciliaries, and to tax its citizens no matter where they are domiciled. Consistent with the Internal Revenue Code, the treaty also preserves the right of each country to tax former citizens whose loss of citizenship had as one of its principal purposes the avoidance of tax, including the avoidance of income tax, but only for a period of ten years following the loss (see secs. 2107 and 2501(a)(3)). Even absent a specific provision the Internal Revenue Service takes the position that the United States retains the right to impose income tax on former citizens resident in the treaty partner (Rev. Rul. 79-152, 1979-1 C.B. 237). This rationale would apply in the gratuitous transfer tax context also. Thus, the proposed treaty preserves the general United States rule of worldwide taxation of citizens and residents. The benefits contained in the provisions providing relief from double taxation (Article 10), the nondiscrimination provisions (Article 11), and the mutual agreement provisions (Article 12) are not subject to the saving clause. The benefits under the diplomatic agent provisions (Article 14) with respect to individuals who neither are citizens of nor have permanent residence in that country are also not subject to the saving clause.

Article 2. Taxes Covered

The proposed treaty generally applies to taxes on gratuitous transfers imposed by the United States and Denmark. In the case of the United States, the proposed treaty applies to the Federal estate tax, gift tax, and the tax on generation-skipping transfers. In the case of Denmark, the proposed treaty applies generally to the inheritance and gift duties.

Denmark imposes an inheritance tax on property transferred at death if the decedent had his fiscal domicile in Denmark and, in certain circumstances, where the transferred property is located in Denmark. Denmark imposes a gift tax at the same rates as the inheritance tax on gifts to a donor's spouse, descendants, and certain other relatives if the donor or the donee is domiciled in Denmark or, in certain circumstances, if the transferred property is located in Denmark. As a general rule, Denmark imposes income tax on gifts if the donee has fiscal domicile in Denmark, but there are several exceptions to this rule. One of the most important is that amounts received as an inheritance or as an advance on an inheritance are not taxed as income. Gifts to family members are not taxed as the donee's income, provided that the gifts are subject to the provisions on inheritance and gift taxes.

The proposed treaty provides that it will apply to any identical or substantially similar taxes or duties on estates, inheritances, gifts, and other transfers that either country may impose after the date of signature of the treaty (April 27, 1983) in addition to, or in place of, the existing duties and taxes. The competent authorities of the two countries must notify each other of any changes that occur in their respective tax laws and of any official published material concerning the application of the treaty, including explanations, regulations, rulings, and judicial decisions.

As is true of other U.S. estate tax treaties, the proposed treaty does not generally apply to death or gift taxes imposed by state or local governments. However, Denmark agrees to credit certain taxes of political subdivisions of the United States that the United States also credits (Article 10). Also, the nondiscrimination Article (Article 11) applies to all taxes of every kind imposed by the United States, Denmark, and their political subdivisions. The provisions relating to exchange of information in Article 13 apply to gratuitous transfer taxes and to all other taxes (including income taxes) imposed by the United States and Denmark.

Article 3. General Definitions

The standard definitions found in most U.S. estate and gift tax treaties are contained in the proposed treaty.

The proposed treaty defines the term "United States" to include the States and the District of Columbia but to exclude Puerto Rico, the Virgin Islands, Guam, and the other U.S. possessions and territories. When used in a geographical sense, the term "United States" includes any area outside the territorial sea of the United States which, in accordance with international law and the laws of the United States, has been or may hereafter be designated as an area within which the United States may exercise rights with respect to the exploration and exploitation of the natural resources of the seabed or its subsoil. Thus, when used in a geographical sense, the term includes the continental shelf.

The treaty defines the term "Denmark" to mean the Kingdom of Denmark, but to exclude the Faroe Islands and Greenland. When used in a geographical sense the term Denmark includes any area outside the territorial sea of Denmark which, in accordance with international law and the laws of Denmark, has been or may hereafter be designated as an area within which Denmark may exercise rights with respect to the exploration and exploitation of the natural resources of the seabed or its subsoil. Thus, when used in a geographical sense, the term includes the continental shelf.

The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean, respectively, an enterprise carried on by a domiciliary of one country and an enterprise carried on by a domiciliary of the other country.

The term "international traffic" means any transport by a ship or aircraft, except when such transport is solely between places in one of the countries.

The U.S. competent authority is the Secretary of the Treasury or his delegate. The Danish competent authority is the Minister for Inland Revenue, Customs and Excise or his authorized representative.

The terms "Contracting State" and "the other Contracting State" mean Denmark or the United States, as the context requires.

The proposed treaty also contains the standard provision that unless the context otherwise requires or the competent authorities of the two countries establish a common meaning, undefined terms are generally to have the meaning which they have under the applicable tax laws of the country applying the treaty.

Article 4. Fiscal Domicile

The concept of domicile is important because under the proposed treaty the country of domicile has the primary tax jurisdiction over all property transferred other than the property subject to situs taxation. The threshold test for determining the country of domicile is the domestic laws of each country. However, in those situations where both countries would treat an individual as a domiciliary, the treaty sets forth rules for establishing the country of domicile for purposes of the taxes covered by this treaty.

The proposed treaty provides that a person will be a domiciliary of the United States if he is a citizen or a "resident" of the United States. Article 3(2) of the treaty states that terms not defined in the treaty are defined by the estate and gift tax law of the country to which the term applies. Since the term "resident," as it applies to U.S persons, is not defined in the treaty, recourse to U.S. estate and gift tax law is necessary to determine whether a person is a U.S. resident. Under U.S. estate and gift tax law, a person is generally a "resident" of the United States if he had his domicile in the United States at the time of his death or at the time of the making of a gift. (Treas. Regs. sections 20.0-1(b)(1) and 25.2501-1(b).)

For purposes of the proposed treaty, a resident of a U.S. possession who is a U.S. citizen solely by reason of being a citizen of a possession or by reason of birth or residence in a possession is neither a U.S. citizen nor a U.S. domiciliary. Such persons are not subject to U.S. gratuitous transfer taxes as citizens or domiciliaries.

The treaty provides that a person will be a domiciliary of Denmark if he is a Danish resident under Danish law.

To provide relief from double taxation where the individual is considered domiciled in both countries, the proposed treaty provides a series of rules designed to establish a single country of domicile for the individual for purposes of the taxes covered by the treaty. The country so selected will then have the primary tax jurisdiction with respect to the worldwide estate of the decedent or with respect to his worldwide gifts, other than real property and assets of a permanent establishment or a fixed base situated in the other country. As described below, these rules reflect the concept that primary tax jurisdiction should be exercised either by the country of nationality, if the dual domicile individual has not been resident in the other country for a substantial period of time prior to his death or the making of the gift, or by the country in which he has his most significant contacts if the nationality test is not determinative.

Under the first of these rules, if the individual is a citizen of one country and not a citizen of the other country and has been domiciled in that other country for less than five years (including temporary absences) during the preceding seven-year period, then the individual will be considered a domiciliary of the country of his citizenship. Under this rule, for example, Denmark may not tax the estate or gifts of a U.S. citizen who has been domiciled in Denmark for less than five years as if the U.S. citizen were a Danish domiciliary. (This rule is reciprocal). If however, the individual has been domiciled in the country of which he is not a citizen for five or more years out of the seven-year period, his domicile for purposes of the treaty would be determined under the tie-breaker rules described below. The five out of seven-year period is shorter than the seven out of ten-year period in the U.S. model treaty.

This five-year rule may resolve most dual domicile situations. However, if a dual domicile problem still remains after application of this rule, the proposed treaty provides three additional tie-breaker rules to determine domicile. The rules (applied in the order presented) provide that the individual will be considered domiciled in the country (1) in which he had a permanent home available to him, (2) in which his personal and economic relations were closer (center of vital interests), or (3) in which he had a habitual abode. In cases where an individual's domicile cannot be determined by these tests, then the competent authorities of the countries are to settle the question by mutual agreement.

Article 5. Real Property

Under the proposed treaty, the transfer by an individual domiciled in a country of real property situated in the other country may be taxed by the situs country. A similar rule applies to assets of a permanent establishment or fixed base (Article 6). Not all transfers of real property are taxed on a situs basis; real property situated in the country of domicile or in a third country is taxable by the country of domicile.

The determination of whether an item is real property is to be made under the laws of the country in which the property is located. Real property is specifically defined to include:

1. Property accessory to real property;
2. Livestock and equipment used in agriculture and forestry;

3. Rights to which the provisions of general law respecting landed property apply;

4. Usufruct of real property; and

5. Rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources.

Real property does not include ships or aircraft.

Article 6. Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services

Under the proposed treaty, the second type of property owned by a nondomiciliary over which the situs country has primary tax jurisdiction is the business assets of such person's permanent establishment which is located in the situs country and the assets pertaining to a fixed base of such person which is situated in that country and is used for the performance of independent personal services. Primary jurisdiction to tax the real property of either enterprise remains in the country in which the real property is situated, as provided in Article 5, however. Also, primary jurisdiction to tax ships, aircraft, and related personal property used in international traffic by either enterprise remains in the country of the transferor's domicile, as provided in Article 7.

The proposed treaty contains a definition of the term "permanent establishment" which is similar to the definition found in recent U.S. income tax treaties, the U.S. model and the O.E.C.D. model.

Generally, any fixed place of business through which the business of an enterprise is wholly or partly carried on is considered a permanent establishment. A permanent establishment includes a place of management, a branch, office, factory, workship, mine, oil or gas well, quarry, or any other place of extraction of natural resources. A permanent establishment also includes any building site or construction or installation project, but only if it has remained in the country for more than 12 months.

The proposed treaty modifies this general rule by providing that a fixed place of business which is used for certain activities specified in the treaty will not be considered a permanent establishment. These activities include, for example, the warehousing of goods for purposes of storage, display, or delivery, or for processing by another person. They also include maintenance of a fixed place of business for the purpose of purchasing merchandise or collecting information, or for carrying on activities of a preparatory or auxiliary character.

If an enterprise of one country does business in the other country through a person who has, and habitually exercises, the authority to enter into contracts in that other country in the name of the enterprise, then the enterprise will be deemed to have a permanent establishment in the other country. This rule does not apply where the activities of the agent are limited to those activities (described above) such as storage, display, or delivery of merchandise which are excluded from the definition of permanent establishment. The proposed treaty contains the usual provision that the agency rule will not apply if the agent is a broker, general commission agent, or other agent of independent status acting in the ordinary course of its business.

Article 7. Ships and Aircraft

This article provides rules for transfers and deemed transfers of (1) ships and aircraft that belong to a domiciliary of one of the countries and that are operated in international traffic, and (2) movable (*i.e.*, personal) property (including containers) pertaining to the operation of such ships and aircraft. These transfers and deemed transfers are taxable only in the country of the owner's domicile. The country not of the owner's domicile waives jurisdiction to tax these transfers and deemed transfers on the basis of the presence of a permanent establishment or fixed base. The saving clause applies to this article, however, so that the United States preserves its residual right to tax such transfers by a Danish resident who is a U.S. citizen.

Article 8. Property Not Expressly Mentioned

This article sets forth the general treaty rule that the country of domicile, as determined under the treaty, has primary tax jurisdiction over the transfers of its domiciliaries, other than the property specifically reserved for situs taxation.[1] The proposed treaty generally provides that property (other than real property (Article 5), business assets (Article 6), and transportation property (Article 7)) will be subject to tax only in the country of domicile of the decedent, donor, or deemed transferor. Thus, tangible personal property not connected with a business will be subject to tax only in the country of domicile, regardless of location at the time of transfer or deemed transfer. Similarly, stock, debt obligations, and other intangible personal property not connected with a business will be subject to tax only in the country of domicile, regardless of the identity of any issuer or the physical location of any instrument evidencing the intangible property.

However, this rule of exclusive jurisdiction to tax in the country of domicile does not apply if the domiciliary is a citizen of the United States or (in certain cases) expatriated himself to avoid U.S. tax (see Article 1). Since the United States imposes its tax on the basis of citizenship as well as domicile, there is still the possibility of double taxation if an individual is a U.S. citizen and an Danish domiciliary. The tax credit structure in Article 10 alleviates this double taxation.

Article 9. Reductions

Like the U.S. model treaty and other recent U.S. estate and gift tax treaties, the proposed treaty provides special rules for the deduction of charitable gifts to foreign entities and for a marital deduction.

The proposed treaty requires each country to treat certain contributions made to charitable or public organizations in the other country like contributions to similar organizations in the taxing country. This treatment is required only if the transfer is exempt

[1] Transportation property (Article 7) is subject to primary tax jurisdiction in its owner's domicile even if it is business property located in the other country.

from tax or taxed at a reduced rate in the recipient's country. Transfers to any recipient that is a private charitable organization qualify for this treatment only if the organization is operated exclusively for religious, charitable, scientific or educational purposes.

The proposed treaty allows U.S. domiciliaries to elect to treat property which is subject to the Danish tax as being subject to Danish matrimonial property law. Generally, this means that Denmark will tax the gifts made by a person to his spouse only if they exceed minimum amounts and if they become the recipient's separate property, and it will generally subject to inheritance tax as much as one-half of the property that passes from a decedent to his spouse.

Reciprocally, Danish domiciliaries may, in computing their U.S. tax, take the marital deduction that would be allowed to a U.S. domiciliary. The marital deduction now generally exempts all gratuitous transfers by a U.S. citizen or resident (or his or her estate) to his or her spouse. Currently a nondomiciliary alien does not get a marital deduction, but is entitled to lower tax rates than those applicable to domiciliaries and citizens. If a Danish domiciliary claims the marital deduction allowed by this article, he or she is required to compute his or her tax at the rates applicable to U.S. citizens and domiciliaries. However, a Danish domiciliary will be taxed at the rates applicable to nondomiciliary aliens without a marital deduction, if the tax computed on that basis is lower than the tax computed by allowing a marital deduction and applying the higher rates.

Thus, the proposed treaty fully exempts interspousal transfers by Danish residents from U.S. tax, while interspousal transfers by U.S. residents are subject to Danish tax (generally at up to half the rate applicable to other transfers subject to Danish tax).

Article 10. Relief from Double Taxation

In general, double taxation is avoided because each country allows a credit for taxes paid to the other on property subject to situs taxation in the other country.

Under the treaty, the United States is obligated to grant a credit against its estate, gift or generation-skipping transfer tax imposed on a U.S. citizen or domiciliary in two cases.

First, the United States will allow a credit against its tax for taxes paid to Denmark on the transfer of property where, under the proposed treaty, the property is subject to situs taxation in Denmark (Articles 5 and 6). The credit is to be calculated according to U.S. law, and is not to exceed the U.S. tax attributable to the property.

Second, the United States will grant a credit for Danish inheritance or gift taxes paid on account of a U.S. citizen's domicile in Denmark at the date of his death, gift, or deemed transfer. However, the credit is not available for Danish taxes imposed on the transfer of U.S. situs real estate or business property taxable by the United States under Articles 5 or 6. Thus, the United States retains primary taxing jurisdiction over real property (Article 5) and business assets (Article 6) located in the United States. In any case, the credit cannot exceed the U.S. tax attributable to the property taxed by Denmark.

Denmark will allow a credit against its tax for taxes paid to the United States on the transfer of property where, under the proposed treaty, the property is subject to situs taxation in the United states (Articles 5 and 6). The credit is to be calculated according to Danish law, and is not to exceed the Danish tax attributable to the property.

In order to avoid double taxation, each country will take into account in allowing credits against its estate tax any taxes imposed by the other on prior gifts (or deemed transfers) of a decedent where the property is in the taxable estate of the former country. However, the proposed treaty does not allow a country to reduce its death tax credit by any credit that the other country allowed for taxes paid on prior transfers or deemed transfers.

The proposed treaty requires Denmark to credit taxes imposed by political subdivisions of the United States as if they were U.S. taxes, but only to the extent that the United States allows those taxes as credits against U.S. tax.

Under the Internal Revenue Code, a claim for credit or refund of U.S. taxes by reason of the payment of foreign death taxes generally must be made within four years from the date the return was filed. The proposed treaty provides a period of limitation during which claims for credit or refund of taxes based on the provisions of the treaty may be made which, in some cases, may be longer than that allowed by the Internal Revenue Code. It is provided that a claim for a credit or refund of taxes based on the provisions of the treaty must be made within two years from the final determination and payment of a tax for which a credit is claimed under the treaty (provided the determination and payment occur within ten years from the date of the decedent's death, the date of the gift, or the date of the deemed transfer). The competent authorities may extend the ten-year limitation if circumstances prevented the determination of the tax within that ten-year period.

The proposed treaty follows the approach of other U.S. estate tax treaties and provides that any refund based on the provisions of the treaty is to be without interest.

Article 11. Nondiscrimination

The proposed treaty contains a comprehensive nondiscrimination provision relating to all taxes of every kind imposed at the national, state, or local level. It is similar to provisions which have been embodied in other recent U.S. tax treaties. The purpose of the nondiscrimination provision is to prohibit a country from using its tax system to discriminate against residents of the other country.

Under this provision, neither country can discriminate by imposing more burdensome taxes (or other requirements connected with taxes) on citizens of the other country than it imposes on its own citizens who are in the same circumstances. The provision applies to citizens who are not domiciled in a Contracting State. For this purpose, a U.S. citizen not domiciled in the United States is not in the same circumstances as a Danish citizen not domiciled in the United States, because the U.S. citizen is taxed by the United

States on his worldwide transfers and income while the Danish citizen is not.

Similarly, neither country may impose more burdensome taxation on the transfer or deemed transfer of a permanent establishment of an enterprise of the other country than it would impose if its own enterprise were involved. This provision does not require either country to grant to nondomiciliaries any personal allowances, reliefs, or reductions on account of civil status or family responsibilities that it grants to its domiciliaries.

Article 12. Mutual Agreement Procedure

The proposed treaty contains the standard mutual agreement provision which authorizes the competent authorities of the United States and Denmark to consult together to attempt to alleviate individual cases of double taxation or cases of taxation not in accordance with the proposed treaty.

Under the proposed article a person who considers that the action of the countries or either of them will cause him to pay a tax not in accordance with the treaty may present his case to the competent authority of either country. The presentation must be made within one year after a claim, under the proposed treaty, has been finally settled or rejected. The competent authority then makes a determination as to whether or not the claim has merit. If it is determined that the claim does have merit, and if the competent authority cannot unilaterally solve the problem, that competent authority endeavors to come to an agreement with the competent authority of the other country to eliminate taxation which is not in accordance with the provisions of the treaty.

The provision requires the waiver of the statute of limitations of either country so as to permit the issuance of a refund or credit notwithstanding the statute of limitations. The provision, however, does not authorize the imposition of additional taxes after the statute of limitations has run.

The competent authorities are also directed to resolve any difficulties or doubts arising as to the application of the convention. Under this authority, the Internal Revenue Service from time to time issues rulings defining terms in a treaty.

The treaty authorizes the competent authorities to communicate with each other directly for purposes of reaching an agreement in the sense of the mutual agreement provision. It also authorizes them to meet together for an oral exchange of opinions. These provisions make clear that it is not necessary to go through normal diplomatic channels to discuss problems arising in the application of the treaty.

Article 13. Exchange of Information

This article forms the basis for cooperation between the two countries in their efforts to deal with avoidance or evasion of their respective taxes and to enable them to obtain information so that they can properly administer the treaty.

The proposed treaty provides for the exchange between the countries of tax-related information and information necessary to carry out the provisions of the proposed treaty or the tax laws of one of the countries, insofar as its taxation is not contrary to the proposed treaty. The information is not limited to information about the transfer taxes covered in the proposed treaty; this exchange of information provision applies to all taxes (including income taxes) imposed by the United States and Denmark. This provision does not apply to political subdivisions of the two countries, however.

Information exchanged is to be treated as secret in the same manner as information obtained under the domestic laws of the receiving country. Such information, however, may be disclosed to persons involved in the administration, assessment, or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes to which the Article applies. Moreover, it is understood by the countries that the appropriate committees of Congress and their agents (such as, for example, the U.S. General Accounting Office), in the exercise of their oversight responsibilities, could have access to information obtained under the treaty.

The proposed treaty contains limitations on the obligations of the countries to supply requested information. A country is not required to carry out administrative measures contrary to its law or administrative practice or the law or administrative practice of the other country, to supply particulars not obtainable under its law or in the normal course of administration, or to supply information that would disclose a trade secret or the disclosure of which would be contrary to public policy.

The proposed treaty provides that a country receiving a request will endeavor to obtain the information requested as if its own taxation were involved. Upon specific request of the competent authority of the other country, a requested country is to produce depositions of witnesses and authenticated copies of original documents to the extent obtainable to enforce its own tax laws.

Article 14. Diplomatic Agents and Consular Officials

The proposed treaty contains the standard provision that it is not to affect the fiscal privileges which diplomatic and consular officials enjoy under the general rules of international law or the provisions of special agreements.

Article 15. Entry into Force

The proposed treaty is subject to the ratification procedures of each country and requires that the instruments of ratification be exchanged in Washington as soon as possible. The treaty will enter into force on the first day of the third month after the month of exchange of instruments of ratification and will apply to estates of persons dying, gifts made, and generation-skipping transfers deemed made on or after the that date.

Article 16. Termination

The proposed treaty will continue in force indefinitely. However, either country may terminate the treaty after it has been in force for five years if at least six months prior notice has been given. If terminated, the treaty will not apply to estates of persons dying, gifts made, or generation-skipping transfers deemed made after the December 31 next following the date of termination specified in the notice of termination.

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