CHRISTENSEN V. U.S. – REDUCING THE N.I.I.T. BY CLAIMING AN F.T.C.

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INTRODUCTION

The reliance on smartphone G.P.S. applications is nearly ubiquitous in today's world. These "map apps" not only furnish diverse routes to destinations but routinely identify roadblocks and traffic disruptions, ensuring the selection of the most efficient route. Like a map app, the *Christensen* case delineated two distinct paths for taxpayers to claim a foreign tax credit ("F.T.C.") – either through the Internal Revenue Code (the "Code") or an applicable income tax treaty. As highlighted in the case, one pathway may be a backroad gem when the other is blocked.

In *Christensen*, the Federal Claims Court allowed U.S. citizen/French tax resident taxpayers to claim the F.T.C. to reduce the net investment income tax ("N.I.I.T.") using Article 24(2)(b) of the France-U.S. Income Tax Treaty ("France-U.S. Treaty").[1] This approach countered the Code's explicit disallowance of the F.T.C. as a way to reduce the N.I.I.T. The Federal Claims Court decision built upon the Tax Court's previous decision in *Toulouse*, where the Tax Court denied an F.T.C. claimed against the N.I.I.T. by a U.S. citizen/French resident taxpayer.[2] The disparity in outcomes did not stem from a conflict in reasoning. Rather, it resulted from the application of different provisions of the treaty. The taxpayer in *Toulouse* relied solely on Article 24(2)(a). The taxpayer did not raise the Article 24(2)(b) argument presented in *Christensen*. This simple change made all the difference and reinforced the principle that an income tax treaty can serve as the source of an F.T.C.

The decision proves timely, considering the N.I.I.T. applies to tax years beginning in 2013, and the statute of limitations for an F.T.C. claim is ten years.[3] Accordingly, the deadline for filing an amended return for the inaugural N.I.I.T. year is April 15, 2024.

An appeal by the U.S. is anticipated, but as of now, the *Christensen* decision has opened an avenue for U.S. citizens residing in a treaty jurisdiction to pursue an F.T.C. claim in order to reduce liability for the N.I.I.T. The unfolding of time will determine the degree to which taxpayers are broadly allowed to adopt this new path or if the U.S. successfully closes it. If the case is not reversed on appeal, the only course of action to prevent taxpayers from claiming the F.T.C. would involve a bilateral revision to the French Treaty or a unilateral revision to U.S. tax law for the sole purpose of removing the benefit.

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1 *Christensen v. United States*, No 20-935T (2023).

2 *Toulouse v. Commr.,* 157 T.C. No. 4 (2021).

3 Code §6511(d)(3)(A).

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NET INVESTMENT INCOME TAX

The N.I.I.T. is a separate levy from the regular income tax imposed on investment income under Chapter 1 of the Code. The N.I.I.T. under Code §1411 appears in its own separate chapter in the Code, Chapter 2A "Unearned Income Medicare Contribution." It first came into effect in 2013 as a means to fund the Affordable Care Act, which is the health care reform law enacted under the Obama administration. Code §1411 imposes a 3.8% tax on individuals on the lesser of net investment income or the excess, if any, of modified adjusted gross income over specified thresholds. Investment income includes interest, dividends, capital gains, rents, royalties, and other types of passive income. The tax typically is owed by higher-income taxpayers who earn a higher proportion of their income from investments.

FACTS OF THE CASE

Christensen involved a married couple, Matthew and Katherine Kaess Christensen, both U.S. citizens living in Paris and classified as tax residents of France. The couple timely filed their 2015 U.S. Federal income tax return and reported the following categories of income:

- Earned income of $369,373
- U.S. source passive income of $7,976
- Foreign source passive income of $101,353

Prior to factoring in any foreign tax credits, the couple faced a $76,376 U.S. Federal income tax liability under Chapter 1 of the Code. The couple also paid N.I.I.T. of 3.8% on both their U.S. source and foreign source passive income, which resulted in N.I.I.T. of $4,155. Of that amount, $3,851 related to foreign source passive income and the remaining $304 was attributed to U.S. source passive income. France exclusively taxed the foreign source portion of their investment income.

In the originally filed tax return, the Christensens did not claim an F.T.C. for either portion of N.I.I.T. In 2020, they filed an amended return claiming an F.T.C. against the N.I.I.T. attributed to their foreign source passive income. This resulted in a claim for a refund of $3,851.

The couple attached Form 8833 (Treaty-Based Return Position Disclosure Under Section 6114 or 7701(b)) to their amended tax return to disclose the basis of their position and refund claim. In relevant part, the couple asserted that Article 24 of the France-U.S. Treaty permitted an F.T.C. against the N.I.I.T. imposed on foreign source passive income. The I.R.S. denied the refund claim, resulting in a substantial 33.8% effective tax rate on their foreign source passive income (30% French capital gain rate plus the 3.8% N.I.I.T. rate). An F.T.C. was allowed against the "regular" income taxes due under Chapter 1 of the Code.

Because U.S. tax was already paid, the Christensens initiated legal proceedings in the U.S. Court of Federal Claims. The U.S. Tax Court did not have jurisdiction.

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TAXPAYERS' POSITION

The Christensens acknowledged that the Code does not provide for an F.T.C. against the N.I.I.T. The origin of the F.T.C. is found in Code §27, which provides as follows:

> The amount of taxes imposed by foreign countries and possessions of the United States shall be allowed as a credit against the tax imposed by [Chapter 1] to the extent provided in section 901.

Code §901 provides that the tax imposed by Chapter 1 can be reduced by a credit for foreign income taxes. It provides as follows:

> If the taxpayer chooses to have the benefits of this subpart, the tax imposed by this chapter shall, subject to the limitation of section 904, be credited with the amounts provided in the applicable paragraph of subsection (b) * * *.

The relevant portion of subsection (b) provides the following:

> (1) Citizens and domestic corporations.
>
> In the case of a citizen of the United States * * *, the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States * * *.

". . . the court asserted its responsibility to interpret the Treaty in line with the shared expectations of both the U.S. and France."

It is crucial to note that the N.I.I.T. does not fall under Chapter 1 but rather resides in Chapter 2A of the Code; hence the lack of availability of an F.T.C. against the N.I.I.T. strictly through the Code. Nonetheless, the couple argued that the F.T.C. was available against the N.I.I.T. under the France-U.S. Treaty either under paragraph (2)(a) or (2)(b) of Article 24.

D.O.J. POSITION ON BEHALF OF THE I.R.S.

The Department of Justice ("D.O.J."), representing the I.R.S. in the case, contended that the court should afford deference to the U.S.'s interpretation of the France-U.S. Treaty. However, the court asserted its responsibility to interpret the Treaty in line with the shared expectations of both the U.S. and France.

The D.O.J. argued that the French government acquiesced to the U.S. interpretation, specifically that no F.T.C. is allowed for the N.I.I.T. under the France-U.S. Treaty. To support this assertion, the D.O.J. sought reliance on the interpretations of the Treaty issued by the U.S. Treasury Department, namely the Technical Explanation prepared by the I.R.S. at the time the treaty was submitted to the Senate for approval. The D.O.J. also referred to the 2004 Protocol and the 2009 Protocol to the France-U.S. Treaty and the U.S. Model Treaty in various iterations.

HOLDING OF THE FEDERAL CLAIMS COURT

The Federal Claims Court refused to consider the Treasury Department's interpretations, as it solely represented the U.S. viewpoint and lacked any indication that it played a role in the negotiations. This marked a departure from the Tax Court

approach in *Toulouse*, where deference was accorded to the Technical Explanation of the France-U.S. Treaty.

The court pointed out the lack of certainty on whether France had an opportunity to object, or indeed objected, to the U.S. interpretation of the Treaty, as it related to the N.I.I.T. No evidence was presented that the U.S. "notified" the French government of the enactment of the N.I.I.T. The court expressed that it should not presume France's concurrence with the U.S. viewpoint based solely on the absence of any indication as to the French government's position. Silence is not acquiescence when governments are involved. Due to the lack of evidence regarding the French government's position, the court could not defer to the U.S. position as to the F.T.C.

When provisions of a treaty and of a statute appear inconsistent, the Supreme Court has consistently held that, if possible, the two provisions should be harmonized to the maximum extent possible to avoid an actual conflict.[4] The D.O.J. contended for a later-in-time rule, asserting that when Congress enacts a statute with terms incongruent to a preexisting treaty, the statute's text alone suffices to demonstrate Congress's intent to override the treaty. In addition, the D.O.J. maintained that, if the Court were ever required to break a tie between two equally plausible interpretations of the Treaty – one permitting a tax credit and the other denying it – the tax credit should be denied consistent with domestic tax credit principles.

The court remained unpersuaded. Under the Constitution, a treaty is accorded the same status as an act of the legislature, and the later-in-time rule does not prevail if the treaty stipulation is not self-executing. Instead, the court embraced the perspective that the treaty should be liberally construed, favoring an interpretation that broadens the rights that may be claimed under a treaty.

The court also took into consideration Treasury Decision 9644, which specifically addressed the question of whether the N.I.I.T. is eligible for F.T.C.'s, with a focus on income tax treaties entered into by the U.S. According to the Treasury Decision, the N.I.I.T. is categorized not as a Chapter 1 tax and is, therefore, ineligible for credits under Code §§27 and 901, as pointed out in Treas. Reg. §1.1411-1(e).

The decision addresses whether U.S. income tax treaties can provide an independent basis for crediting foreign taxes against the N.I.I.T.:

> The Treasury Department and the [I.R.S.] do not believe that these regulations are an appropriate vehicle for guidance with respect to specific treaties. An analysis of each United States income tax treaty would be required to determine whether the United States would have an obligation under that treaty to provide a credit against the section 1411 tax for foreign income taxes paid to the other country.

The Treasury also recognized that if a treaty solely contains language similar to Article 23(2) of the 2006 U.S. Model Treaty (which is virtually the same as Article 24(2)(a) of the France-U.S. Treaty), the treaty would not provide an independent basis for a credit against the N.I.I.T.

By indicating that treaty provisions other than those similar to Article 23(2) of the 2006 U.S. Model Treaty, could provide a credit, the Treasury opened the door for applying the F.T.C. against the N.I.I.T.

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4 *Weinberger v. Rossi*, 456 U.S. 25, 32 (1982).

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COMPARISON WITH THE *TOULOUSE* CASE

The Federal Claims Court examined the holding in *Toulouse*. In *Toulouse*, the Tax Court scrutinized the permissibility of claiming an F.T.C. against the N.I.I.T. under both the France-U.S. Treaty and the Italy-U.S. Income Tax Treaty. However, in *Toulouse*, the taxpayer asserted only an entitlement to an F.T.C. under Article 24(2)(a) and omitted any reference to Article 24(2)(b). The Tax Court's verdict in *Toulouse* rested on the determination that Article 24(2)(a) did not authorize an F.T.C. against the N.I.I.T. due to the "provisions" and "limitations" language, which established a link between the treaty and the relevant Code provisions limiting F.T.C.'s to Chater 1 taxes, as discussed below.

Article 24(2)(a) of the France-U.S. Treaty provides as follows in relevant part:

> 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: the French income tax paid by or on behalf of such citizen or resident.

The taxpayers argued that the "provisions" and "limitations" language specifically pertained to the basket limitations under in Code §904. However, the Federal Claims Court observed that the Treaty provision did not explicitly mention Code §904, nor could an exclusive reference to Code §904 be inferred solely from the use of "limitations." Emphasizing that the terms "provisions" and "limitations" encompassed a broad scope, the court indicated that F.T.C.'s were subject not only to the limitation of Code §904 but also to the provisions of the Code, including Code §§27 and 901. Consequently, the Tax Court rejected the couple's assertion that an F.T.C. was available for the N.I.I.T. under Article 24(2)(a), pointing out that Code §27 and 901 precluded an F.T.C. for taxes arising outside of Chapter 1.

This conclusion aligned with the holding in *Toulouse*. Like T.D. 9644, though, the *Toulouse* court left the door open for a possible Article 24(2)(b) argument. While denying a treaty based F.T.C. against the N.I.I.T. under Article 24(2)(a), the *Toulouse* court stated:

> Petitioner questions the purpose of the Treaties if there is no independent, treaty-based credit and a credit is allowable only if it is provided in the Code. But we do not so hold. Other provisions of the Treaties may well provide for credits that are unavailable under the Code. Petitioner, however, relies on provisions that by their express terms do not.

Article 24(2)(b) permits an F.T.C. for U.S. citizens resident in France. However, it does not include the language referencing the "provisions" and "limitations" of U.S. law. Accordingly, the Christensens contended that this provision does not trigger Code §§27 and 901.

To independently interpret paragraph 2(b) of Article 24 of the Treaty from paragraph 2(a), the court emphasized the need to harmonize the Treaty with the Code without conflict. Adhering to the principle that an act of Congress should not be construed to violate the law of nations if any other possible construction is available, the court

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construed the Treaty liberally and upheld the shared expectations of the U.S. and France regarding Article 24(2)(b).

The court rejected the position of the D.O.J. that an inference should be drawn that Congress intended to exclude the N.I.I.T. from all foreign tax credits from its placement in Chapter 2A. None of Code §§27, 901, and 1411 should be interpreted in a way that is contrary to the international obligations of Article 24(2)(b). Rather, Article 24(2)(b) should be interpreted to permit its own F.T.C.'s in a way that is independent of Code §§27 and 901.

The court determined that Code §27 should be read to impose a Chapter 1 restriction on the F.T.C. only to the extent the F.T.C. arises from Code §901. This interpretation contemplates the existence of an F.T.C. not bound to Chapter 1 when the F.T.C. obligation originates outside the Code. Code §904 can be read to apply only when the F.T.C. is taken under section 901(a). This implies the existence of F.T.C.'s that are not restricted to those taken against taxes imposed by Chapter 1, as they arise from sources other than the Code.

"The court rejected the position of the D.O.J. that an inference should be drawn that Congress intended to exclude the N.I.I.T. from all foreign tax credits merely because of the placement from its placement in Chapter 2A."

This interpretation of Code §§27 and 904 mitigates a potential conflict between the Code and the Treaty, recognizing the presence of two distinct categories of F.T.C.'s in U.S. law: statutory F.T.C.'s under Code §901 restricted to Chapter 1 taxes, and treaty F.T.C.'s not bound by Code restrictions unless specified by the treaty. Because an F.T.C. arising under Article 24(2)(b) of the France-U.S. Treaty is not a credit taken under Code §901, it may be claimed in regard to taxes arising outside of Chapter 1, such as the N.I.I.T.

This differentiation between Code-based and treaty-based F.T.C.'s finds additional support under Code §6511(d)(3)(A), which applies a 10-year statute of limitations for claiming an F.T.C. as a result of an adjustment to foreign income taxes made by a foreign tax authority. It provides as follows:

> Special period of limitation with respect to foreign taxes paid or accrued. If the claim for credit or refund relates to an overpayment attributable to any taxes paid or accrued to any foreign country or to any possession of the United States for which credit is allowed against the tax imposed by subtitle A in accordance with the provisions of section 901 *or the provisions of any treaty to which the United States is a party*, in lieu of the 3-year period of limitation prescribed in subsection (a) , the period shall be 10 years from the date prescribed by law for filing the return for the year in which such taxes were actually paid or accrued. [Empasis added.]

The use of the disjunctive "or" distinguishes an F.T.C. under the Code from an F.T.C. under a treaty.

In sum, the court concluded that Article 24(2)(b) of the France-U.S. Treaty enables the couple to claim an F.T.C. against the N.I.I.T., aligning with the apparent shared intent of the U.S. and France within the principles of treaty interpretation law and without conflicting with relevant provisions of the Code.

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CONCLUSION

The *Christensen* case illuminates the complexity of navigating F.T.C.'s, particularly concerning the N.I.I.T. The court's careful consideration of treaty interpretation principles and the distinction between Code-based and Treaty-based F.T.C.'s provides insights for high-income U.S. taxpayers resident in treaty jurisdictions. The holding reconciles the conflicting outcome in *Toulouse* by relying on a different provision of the France-U.S. Treaty. The timing of this case is noteworthy, as the statute of limitations for F.T.C. claims spans ten years. Considering that the N.I.I.T. applies to tax years commencing after December 31, 2012, the deadline for filing an amended return for the inaugural N.I.I.T. year extends to April 15, 2024. Even though the D.O.J. is likely to appeal, this decision has the potential to unleash a wave of refund claims from taxpayers residing in treaty jurisdictions.

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