No. 24-1284

IN THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

MATTHEW CHRISTENSEN, KATHERINE KAESS CHRISTENSEN,

Plaintiffs-Appellees

v.

UNITED STATES,

Defendant-Appellant

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES COURT OF FEDERAL CLAIMS No. 20-935; SENIOR JUDGE MARIAN BLANK HORN

REPLY BRIEF FOR THE UNITED STATES

DAVID A. HUBBERT
Deputy Assistant Attorney General

JACOB EARL CHRISTENSEN **(202) 307-0878**
KATHLEEN E. LYON **(202) 307-6370**
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

August 28, 2024

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REPLY BRIEF FOR THE UNITED STATES

The United States' opening brief demonstrates the errors in the Court of Federal Claims' ("CFC") ruling below that Article 24(2)(b) of the bilateral tax treaty between the United States and France allows U.S. citizens residing in France to claim a foreign tax credit against the net investment income tax imposed by I.R.C. § 1411, even though the Internal Revenue Code does not authorize such credit. The Christensens ("Taxpayers") rightly concede (Red Br. 2 n.2) that the Code does not allow them to credit foreign taxes paid to France against their § 1411 tax liability to the United States. So they argue instead that either Article 24(2)(a) or Article 24(2)(b) of the Treaty allows such credit, irrespective of the Code's restrictions on foreign tax credits.[1]

The CFC correctly rejected their argument under Article 24(2)(a) because that provision explicitly restricts the credit referenced therein "in accordance with the provisions and subject to the limitations of the law of the United States." As the CFC held, the law of the United States permits a foreign tax credit, but only against the income taxes

[1] The Treaty, as originally signed in 1994 and before renumbering by the 2009 Protocol (*see* Blue Br. 10 n.4), is reproduced in the Addendum to the United States' opening brief. (Add1–42.)

imposed by Chapter 1 of the Internal Revenue Code, *see* I.R.C. §§ 27, 901, so a foreign tax credit cannot be taken against the tax on net investment income imposed by I.R.C. § 1411 in Chapter 2A. (Appx84–86.) But the CFC nonetheless went on to mistakenly interpret Article 24(2)(b)—a special provision dealing with a subset of U.S. citizens who are also residents of France—to allow a credit against the § 1411 tax because subparagraph (b) does not repeat subparagraph (a)'s introductory language restricting the credit in accordance with U.S. law. The CFC thus held that Article 24(2)(b) allows a treaty-based foreign tax credit for U.S. citizens who are residents of France that is unrestricted by the provisions and limitations of the Internal Revenue Code. (Appx86–92.)

As set forth in our opening brief, the text and context of Article 24(2) demonstrate that subparagraph (a)'s introductory language restricting the foreign tax credit under the Treaty in accordance with U.S. law provides the context for what follows in the rest of paragraph 2 and applies equally to the credit in subparagraph (b). The CFC's contrary interpretation reads subparagraph (b)(i) in isolation and ignores the special re-sourcing rule in subparagraph (b)(ii) that treats

certain U.S.-source income as French-source income—a rule the treaty parties had no reason to include unless they understood the credit in Article 24(2)(b) to be subject to the Code's source-based limitation in I.R.C. § 904. The Technical Explanation of the Treaty prepared contemporaneously by the U.S. Treasury Department, the agency charged with the negotiation and enforcement of the Treaty, confirms that understanding exactly. It explains that Article 24(2)(b)(ii)'s re-sourcing rule was necessary "to permit the additional credit to fit within the foreign tax credit limitation of Code Section 904." (Appx361.) Both the Treaty's text and Treasury's contemporaneous explanation reflect the treaty parties' understanding that the credit in Article 24(2)(b) is subject to the "provisions" and "limitations" of U.S. law referenced in Article 24(2)(a).

Taxpayers' attempt to conjure up some other explanation for Article 24(2)(b)(ii) falls flat. Specifically, their mischaracterization of subparagraph (b)(ii) as "introducing a source-based limitation" "like that contained [in] Code Sec. 904(a)" (Red Br. 34, 37) has no textual basis. Subparagraph (b)(ii) simply recharacterizes the source of certain income from U.S-source to French-source; it does not introduce any

limitation to the credit based on the income's source, which is consistent with the treaty parties' understanding that the source-based limitation *itself* is supplied by § 904 of the Internal Revenue Code, which governs the credit in Article 24(2)(b).

Taxpayers also renew their argument for a credit under Article 24(2)(a), relying on an overbroad reading of the parenthetical language in that provision, which the CFC properly rejected. By enacting the § 1411 tax without providing a foreign tax credit to offset that particular levy, Congress did not change the "general principle" of Article 24 of the Treaty to provide relief from double taxation by means of a foreign tax credit. From its inception, Article 24 has conditioned the allowance of a credit in accordance with the provisions and subject to the limitations of U.S. law, and the Internal Revenue Code's statutory scheme to relieve double taxation through a foreign tax credit against Chapter 1 income taxes remains substantially unaltered since the Treaty was signed in 1994. Indeed, Taxpayers themselves benefited significantly from the Code's statutory scheme providing them with relief from double taxation for their tax year 2015, the year at issue. (Blue Br. 50.) Article 24(2)(a)'s parenthetical language requires nothing

more. Neither Article 24 of the Treaty nor the Internal Revenue Code was meant to provide absolute protection from double taxation, and the allowance of a credit against U.S. tax that is unrestricted by the provisions of U.S. law would contravene the treaty parties' agreement and violate the Treaty's equal purpose of preventing fiscal evasion of tax. Taxpayers' arguments to the contrary are without merit.

A. Article 24(2)(b) does not authorize a foreign tax credit against the net investment income tax

1. The credit in Article 24(2)(b) is subject to the provisions and limitations of the Internal Revenue Code

In Article 24(2) of the Treaty (as renumbered by the 2009 Protocol), the United States agreed generally to relieve double taxation by means of a foreign tax credit allowed to U.S. citizens and residents for taxes paid to France. In doing so, however, the introductory words of paragraph 2 provide a significant restriction on the credit authorized by the Treaty: "*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 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." Article 24(2)(a) (emphasis added). Notably, this subparagraph (a), with its introductory caveat, applies to all U.S. citizens and residents. The subparagraphs that follow then describe specific additional rules that apply in unique individual cases, including subparagraph (b) that addresses the case of an individual who is both a U.S. citizen and a resident of France. Article 24(2)(b). The text of subparagraph (b) reflects the treaty parties' understanding that the credit referenced therein is subject to subparagraph 2(a)'s introductory language restricting the credit in accordance with U.S. law. *Cf. O'Connor v. United States*, 479 U.S. 27, 30–32 (1986) (Scalia, J.) (reading restrictive language in the first paragraph of an article of an agreement implementing a treaty to apply to subsequent paragraphs of the same article).

We know this was the treaty parties' understanding of these provisions because they included a special re-sourcing rule in subparagraph (b)(ii) "to give effect to the provisions of subparagraph (b)(i)" providing the credit. Article 24(2)(b)(ii). Under U.S. law, taxes paid to a foreign country on income from U.S. sources cannot be claimed as a foreign tax credit because of I.R.C. § 904(a)'s source-based

limitation. (Blue Br. 5–7.) Consequently, the treaty parties had to include a re-sourcing rule to treat the individual's U.S.-source income as foreign-source income "to give effect to" the credit against U.S. tax in Article 24(2)(b); otherwise, § 904(a) would have precluded the credit.

In addition to the plain text, the Treasury Department's contemporaneous Technical Explanation of the Treaty makes clear the general rule that "[t]he credits provided under the Convention are allowed in accordance with the provisions and subject to the limitations of U.S. law" and that the purpose of Article 24(2)(b)(ii)'s re-sourcing rule is "to permit the additional credit to fit within the foreign tax credit limitation of Code Section 904." (Appx361.) If the drafters had instead believed that the Code's provisions and limitations (including § 904) did *not* apply to the credit in Article 24(2)(b), as the CFC held and as Taxpayers argue, then there would have been no reason for them to include subparagraph (b)(ii)'s re-sourcing rule because the source of the income would not have mattered.[2]

[2] Article 24(2)(b)(ii)'s re-sourcing rule operates the same way as its predecessor, which was introduced in the 1978 Protocol amending the prior tax treaty between the United States and France. (Blue Br. 23–25.)

2. Taxpayers' counterarguments are meritless

a. Article 24(2)(b)(ii) does not introduce a source-based limitation

Taxpayers ask the Court to ignore Treasury's contemporaneous explanation for including Article 24(2)(b)(ii)'s re-sourcing rule in the Treaty, but they cannot offer a plausible alternative explanation. Their argument is that subparagraph (b)(ii) "introduc[es] a source-based limitation" "like that contained [in] Code Sec. 904(a)" in order "to prevent unlimited cross-crediting" on an "item-by-item" basis. (Red Br. 34, 37.)

Fiddlesticks. The fact is Article 24(2)(b)(ii) is nothing at all like I.R.C. § 904(a). The former is a mere re-sourcing rule that recharacterizes the source of certain income from U.S-source to French-source. Unlike § 904(a), Article 24(2)(b)(ii) does not introduce any *limitation* to the credit *based on* the income's source. Taxpayers do not and cannot point to any language in subparagraph (b)(ii) or elsewhere in the Treaty that introduces a substantive, source-based limitation on the credit in Article 24(2)(b). As we have explained, the source-based limitation itself is not in the Treaty but rather is supplied by § 904(a) of the Internal Revenue Code, which actually *does* limit foreign tax credits

based on the source of the income. Taxpayers maintain, however, that the Code provisions, including § 904, do not apply to the credit in Article 24(2)(b). But if the Code provisions do not apply, as they contend, then Article 24(2)(b)(ii)'s re-sourcing provision is completely meaningless because, in the absence of a substantive source-based limitation on the credit in Article 24(2)(b), the income's source simply does not matter.

Taxpayers cite the example in the Technical Explanation as support for their theory (Red Br. 35–36), but the example only confirms the Government's interpretation. (*See* Appx362.) Indeed, the example is based on the application of I.R.C. § 904(a)'s source-based limitation. In the Technical Explanation, the example is preceded by Treasury's explanation of Article 24(2)(b)(i)'s ordering rule (*see* Blue Br. 25–26) and of Article 24(2)(b)(ii)'s re-sourcing rule, which Treasury said "provides that certain U.S. source income will be treated as French source income to permit the additional credit to fit within the foreign tax credit limitation of Code Section 904." (Appx361.) Treasury then gave an example to "illustrate[ ] how subparagraph [2](b) works," using certain

assumptions about U.S. and French tax rates for illustration purposes.[3] (Appx362.) The relevant takeaway from the example is that without subparagraph (b)(ii)'s special re-sourcing rule, there would be "no foreign credit" against U.S. tax "because the dividend is from U.S. sources." (Appx362.) The example presumes that the credit in Article 24(2)(b) is subject to I.R.C. § 904's source-based limitation.

b. Treasury's Technical Explanation is entitled to deference

Article 24(2)(b) read in context is clear enough, even without Treasury's explanation, but Taxpayers are also wrong about the deference owed to Treasury's contemporaneous Technical Explanation for the reasons explained in our opening brief. (Blue Br. 37–46.) They erroneously assert (Red Br. 8–9 & n.3) that the cases cited by the Government are not persuasive because there was evidence in those cases that the United States' treaty partners either agreed with, or acquiesced to, the Executive branch's views. As we explained, the Supreme Court has not conditioned deference to the Executive branch's

[3] The example includes a typographical error on lines 6–7 where it posits a "U.S. tax of 22 percent" on the dividend income. The intended rate appears to be 28 percent, as all subsequent references to the U.S. tax rate in the example are 28 percent. (Appx362.)

interpretation of a treaty on proof of the other contracting party's acquiescence or agreement. In four of the five cases we cited (Blue Br. 41–42), the Supreme Court clearly considered the deference due to the Executive branch's views independent of its consideration of other evidence. *See Sumitomo Shoji Am., Inc. v. Avagliano*, 457 U.S. 176, 184–85 (1982); *Abbott v. Abbott*, 560 U.S. 1, 15 (2010); *Medellin v. Texas*, 552 U.S. 491, 513 (2008); *United States v. Stuart*, 489 U.S. 353, 369 (1989). In the fifth case, *Kolovrat v. Oregon*, 366 U.S. 187, 194 (1961), the Supreme Court considered the deference due to the Executive branch's interpretation of a treaty in the context of diplomatic notes exchanged by the United States and Yugoslavia and diplomatic correspondence issued by the State Department, but the Court did not condition the "great weight" given to the Executive branch's interpretation of the treaty on evidence of Yugoslavia's views.

The cases Taxpayers cite (Red Br. 9, 11) are not to the contrary. In *Iceland Steamship Co. v. U.S. Dept. of the Army*, 201 F.3d 451, 460 (D.C. Cir. 2000), the D.C. Circuit deferred to the interpretation of a U.S.-Iceland defense treaty in a diplomatic note issued by the U.S. State Department, even without Iceland's views.

In *National Westminster Bank, PLC v. United States*, 512 F.3d 1347, 1359 (Fed. Cir. 2008), this Court declined to follow an interpretation first espoused by the Treasury Department nine years after a treaty was signed, where the interpretation was inconsistent with the United States' expectations when the treaty was negotiated and where it contravened the treaty's text, negotiation history, and contemporaneous expectations of the United Kingdom. In contrast, Treasury's Technical Explanation of the Treaty in this case was prepared contemporaneously as "an official guide to the Convention" reflecting "the policies behind the particular Convention provisions, as well as understandings reached with respect to the application and interpretation of the Convention" (Appx323), and it was relied on by the Senate in ratifying the Treaty. S. Exec. Rep. 104-7, at 6, 9, 13, 19, 20 n.9, 34, 35 (Aug. 10, 1995); *see* Blue Br. 38, 42.

In *Eshel v. Commissioner*, 831 F.3d 512 (D.C. Cir. 2016), the D.C. Circuit reversed the Tax Court's interpretation of a totalization agreement between the U.S. and France because the Tax Court relied on "nontextual sources," including dictionary definitions, "rather than looking to the text of the [agreement]." *Id.* at 518, 520. There was also

evidence suggesting "a conflict between the French and American provisions, not a shared understanding," *id.* at 521, and the Commissioner presented documents which did not "purport[ ] to offer an authoritative statement of the view of the United States," *id.* at 520. Here, by contrast, Treasury's Technical Explanation is an authoritative "official guide" (Appx323) that corroborates the plain meaning of the Treaty's text.

And in *Snap-On Tools, Inc. v. United States*, 26 Cl. Ct. 1045, 1072 (1992), *aff'd without opinion*, 26 F.3d 137 (Fed. Cir. 1994) (table), the Technical Explanation of the U.S.-United Kingdom tax treaty conflicted with a Senate report prepared during the ratification process, which is not the case here.[4]

c. Taxpayers' interpretation produces anomalous results

Our opening brief explains the anomalous results produced by Taxpayers' interpretation of Article 24(2)(b) to authorize a foreign tax

[4] Taxpayers also cite *North West Life Insurance Co. of Canada v. Commissioner*, 107 T.C. 363 (1996), for a different proposition, but in that case, too, "other evidence in the record undermine[d] the plausibility of" the Executive branch's interpretation of the United States's tax treaty with Canada. *Id.* at 381.

credit that is unrestricted by the provisions and limitations of the Code. (Blue Br. 34–37.) One of the examples we gave was that of U.S. citizens residing in France who elect to exclude their "foreign earned income" (e.g., French salary) from U.S. tax under I.R.C. § 911(a), while also claiming an unrestricted foreign tax credit against their U.S. tax under Article 24(2)(b) for taxes paid to France on that excluded income. These taxpayers not only would avoid paying U.S. tax on their French salary but, under Taxpayers' interpretation, they would also get a credit under the Treaty for the taxes paid to France on that excluded income, which they could use to offset U.S. tax imposed on their other, taxable income for the year. Although we observed that such other income might include "unrelated U.S.-source income" (Blue Br. 34), whether or not that is the case does not impact the resulting double tax benefit at the expense of the U.S. Treasury under Taxpayers' interpretation.

As we said, Congress recognized and addressed this issue in the Code by precluding a foreign tax credit that is "allocable to or chargeable against amounts excluded from gross income" under § 911(a). I.R.C. § 911(d)(6). Under Taxpayers' interpretation of the

Treaty, however, the Code's provisions do not apply and, therefore, would not prevent this significant anomaly.

Taxpayers respond by denying the problem exists and by claiming that the "unrelated U.S.-source income" would either be "exempt from French tax" or would be "subject to limited re-sourcing." (Red Br. 40.) That answer, however, is not responsive. First, as we demonstrated already, Article 24(2)(b)(ii)'s re-sourcing rule does not impose any substantive limitation on the credit in Article 24(2)(b), and nothing in subparagraph (b)(ii) can be construed as performing the function of § 911(d)(6) in preventing the double tax benefits described. Second, whether the taxpayer's other income in this scenario—that is, income *other than* the foreign earned income—is "exempt from French tax" is irrelevant. The harm to the U.S. Treasury is caused because, under Taxpayers' interpretation of Article 24(2)(b), a taxpayer can claim *both* § 911(a)'s generous exclusion for foreign earned income (e.g., French salary) *and* claim a credit for the tax paid to France on that income to offset U.S. tax imposed on other (worldwide) income. Claiming that the other income is "exempt from French tax" does not resolve the harm to the U.S. Treasury caused by this substantial double tax benefit.

Taxpayers' interpretation of the Treaty that assumes the signatory parties intended this result, or simply failed to account for it, is implausible.[5]

As for the other anomalous results identified in our opening brief (Blue Br. 35–36), Taxpayers do not even respond to the fact that their interpretation would provide U.S. citizens residing in France with a far more generous foreign tax credit than would be available to U.S. citizens residing in the United States, nor do they explain why the treaty parties would have given such preferential treatment to a subset of U.S. citizens.

In sum, Article 24(2)(b)'s text and context reflect the treaty parties' understanding that Article 24(2)(a)'s introductory language restricting the foreign tax credit in accordance with U.S. law applies equally to the credit in Article 24(2)(b), and Treasury's contemporaneous explanation confirming that understanding is entitled to deference.

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[5] We note that France likewise does not allow a credit for U.S. taxes paid on income arising in the United States that is "exempted from company tax according to French domestic law." Article 24(1)(a).

B. Article 24(2)(a) does not authorize a foreign tax credit against the net investment income tax

The CFC correctly rejected Taxpayers' argument that Article 24(2)(a) authorizes a foreign tax credit against the net investment income tax. (Appx84–86.) That is because the credit in Article 24(2)(a) is expressly allowed only "in accordance with the provisions and subject to the limitations of the law of the United States," and U.S. law does not permit a foreign tax credit against income taxes imposed outside of Chapter 1 of the Internal Revenue Code, so the Treaty does not authorize a credit against the net investment income tax imposed by I.R.C. § 1411 in Chapter 2A. As the CFC did here, each court that has considered this taxpayer argument has rejected it, *see Toulouse v. Commissioner*, 157 T.C. 49 (2021); *cf. Kim v. United States*, 664 F. Supp. 3d 1062, 1080–86 (C.D. Cal. 2023) (interpreting identical language in the U.S.-South Korea tax treaty), and this Court should as well.

1. The credit in Article 24(2)(a) is subject to the provisions and limitations of the Internal Revenue Code

In Article 24(2)(a), the United States and France agreed that a credit against U.S. income tax for income tax paid to France would be

allowed, but only "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) . . . ." Article 24(2)(a). The law of the United States includes the Internal Revenue Code, codified as Title 26 of the United States Code; therefore, the credit under Article 24(2)(a) must be "in accordance with the provisions" and "subject to the limitations" of the Internal Revenue Code that govern foreign tax credits. *Toulouse*, 157 T.C. at 58 ("Under the express terms of [Article 24(2)(a)], any allowable foreign tax credit must be determined in accordance with the Code and is limited by the Code's provision of a credit.").

Under the Internal Revenue Code, a foreign tax credit is available only against income taxes imposed by Chapter 1 of the Code. Section 27 allows foreign tax credits to offset taxes imposed under "this chapter" (i.e., Chapter 1) to the extent provided in § 901, and § 901 allows certain foreign taxes to be credited against "the tax imposed by this chapter" (again, Chapter 1), "subject to the limitation of section 904." *See* I.R.C. §§ 27(a), 901(a) (2015) (the year at issue). These provisions were identical when the Treaty was signed in 1994.

But the tax on net investment income is imposed by I.R.C. § 1411 in Chapter 2A. Section 1411 is the only section in that chapter. Congress created that chapter when it enacted the tax in 2010. (Blue Br. 12–13.) Congress's placement of the § 1411 tax by itself in a newly created chapter, rather than in Chapter 1, is significant. For one thing, it means that a foreign tax credit is not allowed to offset the § 1411 tax under the Code. "The enactment of a 3.8% net investment income tax as part of chapter 2A is a clear expression of congressional intent that credits against section 1 not apply against the section 1411 tax." *Toulouse*, 157 T.C. at 60. Because the Code does not allow a foreign tax credit against the § 1411 tax, and the credit under Article 24(2)(a) must be in accordance with the Code, no credit is allowed against the § 1411 tax under Article 24(2)(a) either.

Taxpayers' argument (Red Br. 18) that the term "limitations" in Article 24(2)(a) affects only the *amount* of the credit, not the availability of a credit, ignores Article 24(2)(a)'s requirement that the allowance of a credit must be "in accordance with the provisions" of the Code such that the Code must provide the credit if one exists. *Toulouse*, 157 T.C. at 60. Similarly, just because the § 1411 tax is a "covered" tax under Article

2(2) of the Treaty does not mean that Article 24(2)(a) authorizes a credit to offset the tax, as Taxpayers claim (Red Br. 18–19). Article 24(2)(a) must be applied according to its terms. Moreover, Taxpayers undermine their own argument by pointing out that in other treaties containing the same "provisions" and "limitations" language as in Article 24(2)(a), the United States has *explicitly* agreed to credit certain taxes where such credit otherwise would not be allowed under the Code. (Red Br. 24–25.) Here, by contrast, the United States did no such thing.

Treasury's Technical Explanation confirms that Article 24(2)(a) provides for foreign tax credits against U.S. income taxes only to the extent that the Code allows them. (Appx361.) The Technical Explanation reflects a longstanding U.S. policy that double-taxation provisions in tax treaties should provide foreign tax credits in accordance with U.S. domestic law, as demonstrated in Treasury's model tax treaties and their technical explanations addressing introductory language identical to that in Article 24(2)(a). *See* 1996 U.S. Model Tax Convention, Art. 23(1) (Appx514, Appx532); Technical Explanation to 1996 U.S. Model Tax Convention, Art. 23(1) (Appx581, Appx 653); 2006 U.S. Model Tax Convention, Art 23(2) (Appx538,

Appx572); Technical Explanation to 2006 U.S. Model Income Tax Convention, Art. 23(2) (Appx672, Appx745).

Consistent with that longstanding position, Treasury also enacted regulations providing that foreign tax credits may not be applied against the § 1411 tax. 26 C.F.R. § 1.1411-1(e). Treasury also clearly stated that any treaty (such as the U.S.-France Treaty here) whose double-taxation provision "refers to the limitations of United States law" would "not provide an independent basis for a credit against the section 1411 tax." Final Regulations, Net Investment Income Tax, 78 Fed. Reg. 72394-01, 72396 (Dec. 2, 2013), *as corrected by* 79 Fed. Reg. 18161 (April 21, 2014). As the agency charged with the negotiation and enforcement of the Treaty, Treasury's interpretation in the Technical Explanation and in the Treasury Regulations is entitled to deference.

2. Taxpayers' reading of the parenthetical in Article 24(2)(a) is overbroad

The CFC correctly rejected Taxpayers' reading of the parenthetical in Article 24(2)(a) as overbroad. (Appx85.) The parenthetical recognizes that the law of the United States governing the availability of a credit under Article 24(2)(a) "may be amended from time to time without changing the general principle hereof." Article

24(2)(a). The parenthetical thus clarifies that the credit available under the Treaty is subject to the provisions and limitations of the Internal Revenue Code *as amended* after ratification of the Treaty, the only caveat being that subsequent amendments to the Code not "chang[e] the general principle hereof." The phrase "general principle hereof" refers to the general principle of Article 24. *See* Technical Explanation (Appx361).

Contrary to Taxpayers' argument, the general principle of Article 24 was never to provide absolute protection from double taxation and does not guarantee a foreign tax credit in every situation. *Toulouse*, 157 T.C. at 50; *cf. Kim*, 664 F. Supp. 3d at 1085; *see also* Blue Br. 47–49. Rather, when the Treaty was signed, the general principle of Article 24, so far as the United States' obligations were concerned, was to provide relief from double taxation by means of a foreign tax credit "*in accordance with the provisions and subject to the limitations of the law of the United States*." Article 24(2)(a) (emphasis added). The United States and France thus understood and mutually agreed that the credit in Article 24(2)(a) is not unrestricted as Taxpayers now argue. Therefore, the treaty parties' "shared expectation" (Red Br. 19) was

always that the United States would allow a credit in accordance with the provisions and subject to the limitations of the Code. The Treaty's text is the best evidence of the parties' shared expectations. *Xerox Corp. v. United States*, 41 F.3d 647, 652 (Fed. Cir. 1994).

Long before the Treaty was signed in 1994, as well as at the time it was signed, Sections 27 and 901 of the Code restricted the foreign tax credit to apply only against income taxes imposed by Chapter 1. I.R.C. §§ 27(a), 901(a) (1994). Importantly, §§ 27 and 901 were part of "the law of the United States" that the United States and France expressly incorporated into Article 24(2) as a condition on the credit. Congress's subsequent enactment in 2010 of a new 3.8% tax on net investment income under I.R.C. § 1411 in Chapter 2A did not change the Code's long-standing statutory scheme for relieving double taxation by means of a foreign tax credit against Chapter 1 income taxes—and only against Chapter 1 income taxes. Thus, the same statutory scheme for relieving double taxation that existed in 1994, when the Treaty was signed, continued to apply after § 1411's enactment and during 2015, the year at issue. Because the Code's foreign tax credit scheme for relieving double taxation was unaffected by § 1411's enactment in

Chapter 2A, § 1411's enactment did not change the "general principle" of Article 24 for relieving double taxation. As we have explained (Blue Br. 50), Taxpayers benefited substantially from the Code's statutory scheme providing them with relief from double taxation for their tax year 2015.[6]

Taxpayers cannot plausibly argue that France's expectations under the Treaty would be upset by the Code's restriction on foreign tax credits against a later-enacted income tax outside of Chapter 1, as is the case with the § 1411 tax. As set forth above, these same Code restrictions applied when France signed the Treaty, and the Treaty expressly incorporated the Code's restrictions into Article 24(2), so France had every reason to know that the foreign tax credit would be restricted under the Treaty to Chapter 1 income taxes.

Taxpayers suggest that if the "general principle" of Article 24 simply requires the United States to "maintain a Code-based foreign tax credit system," then the provision has "all the binding effect of a New

[6] Taxpayers complain that they may not be able to offset all of their excess French credits in other tax years under I.R.C. § 904(c) because French tax rates "generally exceed" U.S. rates. (Red Br. 19 n.11.) That, however, is a function of each country's current tax rates, not of the Treaty's provisions.

Year's resolution" because Congress could at any time repeal the Code's foreign tax credit. (Red Br. 15–16.) But the Treaty's meaning cannot change simply because Congress has the authority to enact legislation to override treaty provisions. *See Whitney v. Robertson*, 124 U.S. 190, 194 (1888) (holding that where a treaty and a statute are "inconsistent, the one last in date will control the other"). By Taxpayers' faulty reasoning, no U.S. treaty has any purpose because Congress may override it in a subsequently-enacted statute.

Also, the fact that Article 24(2)(a)'s parenthetical language differs from the double-taxation provision of a tax treaty recently signed by the United States and Croatia (but not yet ratified by the Senate) does not support Taxpayers' broad interpretation, as they claim (Red Br. 17 n.8). Whatever the drafters of the Croatia treaty may have intended by the language they chose sheds no light on the meaning intended by the parenthetical in Article 24(2)(a) drafted thirty years ago.[7]

Nor do the cases Taxpayers cite (Red Br. 22–23) support their view that the "general principle" of Article 24 requires the allowance of

[7] The Government also disputes Taxpayers' characterizations (Red Br. 10 n.4) pertaining to ongoing litigation involving the U.S.-Canada tax treaty.

a foreign tax credit against any U.S. income tax enacted after the Treaty became effective. None of those cases involved the Treaty at issue here, and although the treaties in those cases included provisions with language similar or identical to that in Article 24(2)(a), none of them even addressed the meaning of the "general principle" language in those provisions. *See, e.g.*, *Haver v. Commissioner*, 444 F.3d 656, 659 (D.C. Cir. 2006). In fact each of those cases held, consistent with the Government's position here, that the taxpayers could not obtain a foreign tax credit under the applicable treaties where the Code did not provide for a credit. *Id*. at 658; *Kappus v. Commissioner*, 337 F.3d 1053, 1060 (D.C. Cir. 2003); *Jamieson v. Commissioner*, 584 F.3d 1074, 1076 (D.C. Cir. 2009).

3. Article 29's saving clause does not render Article 24(2) superfluous

Taxpayers' argument (Red Br. 27) that Article 29's saving clause renders Article 24(2) superfluous if the availability of the credit is determined solely by the Code is also mistaken. The saving clause reserves the United States' right to "tax its residents . . . and its citizens as if the Convention had not come into effect," but the saving clause has exceptions by which, among other things, it does "not affect . . . the

benefits conferred under . . . Article[ ] 24." Article 29(2), (3). The exception "prevent[s the saving clause] from applying where it would contravene provisions of the Convention that are intended to extend U.S. benefits to U.S. citizens and residents." Technical Explanation (Appx325). *See generally* Lori Hellkamp & Alden Dilanni-Morton, *Demystifying the Saving Clause and Re-Sourcing Rules in Treaties*, Tax Notes Federal, vol. 172, August 16, 2021 (reproduced at Add76–81).

Article 24(2) extends significant benefits to U.S. citizens and residents while restricting the availability of a foreign tax credit in accordance with U.S. law. One such benefit, discussed at length in our briefing in this case, is subparagraph (b)(ii)'s re-sourcing rule that treats certain U.S.-source income as French-source income so that the credit against U.S. tax referenced in subparagraph (b)(i) is not precluded by I.R.C. § 904(a)'s source-based limitation. Subparagraphs (c) (deleted by the 2009 Protocol) and (d) are also re-sourcing rules that function in the same way to permit a foreign tax credit in the situations specified therein that fits within § 904(a)'s source-based limitation. These are significant and well-recognized benefits provided by Article 24(2) of the Treaty to relieve double taxation. *E.g.*, Lori Hellkamp &

Alden Dilanni-Morton, *supra*, at 1107–08 (Add78–79); Blue Br. 40 n.13 (citing other legal articles addressing the benefits of re-sourcing provisions in U.S. treaties).

4. Taxpayers' "reciprocity" argument is atextual

Taxpayers further argue that general notions of "reciprocity" require that "whichever sovereign has primary taxing rights may impose its treaty-defined taxes and the other sovereign must allow an offset to its treaty-defined taxes." (Red Br. 20.) The Treaty's text does not support this contention.

As noted above, the mere fact that an income tax is "covered" by the Treaty under Article 2 does not mean a credit against that tax is required under Article 24, which must be applied according to its own terms. France's and the United States' obligations to relieve double taxation under the Treaty are governed by the specific terms set forth in Article 24(1) and Article 24(2) respectively, not by general notions of reciprocity. In Article 24(1), France generally agreed to permit French residents a credit for U.S. tax paid on certain income and capital, but it placed specific restrictions on the credit that differed depending on the type of income or capital; and in the case of income that is exempt from

France's company tax "according to French domestic law," France precluded the credit altogether. Article 24(1)(a), (c). The United States, for its part, agreed to allow a credit "in accordance with the provisions and subject to the limitations of" U.S. law. Article 24(2)(a). But nothing in Article 24's text resembles Taxpayers' claim that "whichever sovereign has primary taxing rights may impose its treaty-defined taxes and the other sovereign must allow an offset to its treaty-defined taxes." (Red Br. 20.)[8]

Nor is there any requirement that the terms by which the United States and France agreed, respectively, to relieve double taxation in Article 24 be identical to each other or that they achieve some nebulous concept of "equilibrium" as Taxpayers contend (Red Br. 21). The Supreme Court's decision in *O'Connor*, *supra*, 479 U.S. 27, does not support that idea. Rather, as the Government urges here, the Court's analysis there focused on the treaty's text and its context. *Id*. at 31.

[8] Taxpayers incorrectly suggest that their 2015 tax liability under I.R.C. § 1411 is based solely on net investment income from French sources. (Red Br. 31.) Taxpayers reported investment income from U.S. sources on their 2015 return that is subject to § 1411's tax on net investment income. (*See* Blue Br. 13–14.) Therefore, their liability for tax under § 1411 also arises from U.S. sources.

Treaties, like contracts, have nonreciprocal results that depend on the parties' respective objectives, tradeoffs, and bargaining power during the negotiations.

Finally, we note that in Taxpayers' hypothetical of a U.S. taxpayer selling French-situs real estate (Red Br. 20), the taxpayer would still receive relief from double taxation under Article 24(2), which authorizes a credit, in accordance with the Code, against all income taxes imposed in Chapter 1, but not against the 3.8% net investment income tax in Chapter 2A. France also places restrictions on the credit it allows under Article 24(1).

For the reasons above, Article 24(2)(a)'s plain text allows a foreign tax credit only to the extent one is allowed by the Code, and because the Code does not authorize a credit against the § 1411 tax, neither does Article 24(2)(a).

C. Taxpayers misconstrue the Treaty's purpose

Against the Treaty's plain text, Taxpayers invite the Court to adopt a "liberal" construction that achieves the purported "principal purpose" of the Treaty "to avoid double taxation." (Red Br. 7.) But,

ultimately, "it is [the Court's] duty to interpret the treaty according to its terms. These must be fairly construed, but [the Court] cannot add or detract from them." *Xerox Corp. v. United States*, 41 F.3d 647, 652 (Fed. Cir. 1994) (quoting *Valentine v. United States*, 299 U.S. 5, 11 (1936)). Thus, "when construing a treaty, the clear import of treaty language controls unless application of the words of the treaty according to their obvious meaning effects a result inconsistent with the intent or expectations of its signatories." *Nat'l Westminster Bank, PLC v. United States*, 512 F.3d 1347, 1353 (Fed. Cir. 2008) (quoting *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 180 (1982)).

As demonstrated in this reply brief and in our opening brief, the clear meaning of Article 24(2)'s text is that foreign tax credits are allowed under the Treaty against U.S. income taxes only to the extent they are permitted by the Internal Revenue Code. That is the agreement the United States and France made, and Treasury's Technical Explanation confirms that this is how the United States understood Article 24(2) when it signed the Treaty. So Taxpayers cannot possibly show that this plain-meaning result is "inconsistent with the intent or expectations of its signatories." *Id.*

In any event, Taxpayers misconstrue the Treaty's purpose. According to them, double taxation is an "evil" to be tolerated only in "unavoidable instances," and the Treaty should therefore be construed to eliminate it in all other circumstances. (Red Br. 8.) The fact of the matter is, however, that double taxation is always avoidable and could without much difficulty be eliminated entirely if that were truly the goal. But it is not. Rather, "the fundamental purpose of a tax treaty is to avoid uncoordinated taxation of an individual's income by two different countries." *Goosen v. Commissioner*, 136 T.C. 547, 568 (2011). In general, such treaties "seek to avoid double taxation as well as prevent fiscal evasion." *Id.*

The title of the Treaty here reflects its dual purposes of "the avoidance of double taxation" and "the prevention of fiscal evasion" with respect to taxes on income and capital. We have demonstrated in this brief, *supra* p. 22–23, and in our opening brief (Blue Br. 47–49) that the purpose of the Treaty was never to provide absolute protection from double taxation. *Toulouse*, 157 T.C. at 50. Rather, the Treaty was designed to reduce double taxation through a foreign tax credit that, from its inception, was restricted in accordance with the provisions and

subject to the limitations of the Internal Revenue Code, which demonstrates the treaty parties' understanding that double taxation would occur in those situations where the Code restricts the credit.

Notably, Article 24 is not one-sided in this regard. France, likewise, does not permit unrestricted tax benefits to eliminate all double taxation. To the contrary, like the Code's restrictions on the foreign tax credit against U.S. tax that are incorporated in Article 24(2), Article 24(1) governing France's obligation to relieve double taxation also restricts the tax benefits given by France, raising the potential for double taxation. *See* Article 24(1)(a) (precluding a credit against French tax for U.S. tax paid on income that is "exempted from company tax according to French domestic law"); Article 24(1)(a) (restricting the credit against French tax for U.S. tax paid on income to "the amount of French tax attributable to such income"); Article 24(1)(c) (restricting the credit against French tax for U.S. tax paid on capital to "the amount of the French tax attributable to such capital"); Article 24(1)(d) (defining the terms "amount of French tax attributable to such income" and "amount of the French tax attributable to such capital"). Plainly, the treaty parties—by careful design—agreed to restrictions on the relief

they would provide from double taxation and never intended to eliminate all double taxation as Taxpayers claim.

Moreover, Taxpayers ignore the Treaty's other purpose of preventing fiscal evasion of tax. The CFC's judgment and Taxpayers' interpretation of Article 24(2) are inconsistent with that equal purpose of the Treaty because the allowance of a foreign tax credit that is unrestricted by the Code would result in significant windfalls for taxpayers at the expense of the U.S. Treasury that were not intended by the treaty parties. *See supra*, pp. 13–16; Blue Br. 34–35, 51. Therefore, any consideration of the Treaty's purposes must take both of them into account, which Taxpayers' position fails to do.

CONCLUSION

The judgment of the Court of Federal Claims should be reversed and the case should be remanded with instructions to dismiss the complaint.

Respectfully submitted,

DAVID A. HUBBERT
Deputy Assistant Attorney General

/s/ Jacob Christensen

JACOB EARL CHRISTENSEN (202) 307-0878
KATHLEEN E. LYON (202) 307-6370
Attorneys
Tax Division
Department of Justice
Post Office Box 502
Washington, D.C. 20044

AUGUST 28, 2024

UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

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