

# United States

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## 1. Types of tax

### 1.1 Estate tax

The United States (US) imposes an estate tax on the transfer of a decedent's taxable estate, also known as the gross estate, at death. US citizens and residents dying after 31 December 2012 are subject to a top estate tax rate of 40% and are entitled to a US\$5 million estate tax exemption, which is adjusted annually for inflation (US\$5.45 million for 2016). Nonresident aliens are also subject to a top estate tax rate of 40%, but their estate tax exemption amount is only US\$60,000 and is not indexed for inflation.

The US imposes an estate tax liability on all US citizens and residents. See Section 2.2 for a discussion of who is a US resident and a nonresident alien for estate tax purposes. The estate tax will ultimately be assessed upon the gross estate, less applicable deductions. For a US citizen or resident, the gross estate is the fair market value (FMV) of a decedent's worldwide assets at date of death; the taxpayer may also elect an alternative valuation date six months after date of death. See Section 5.1 for filing procedures.

For an individual who is neither a US citizen nor a US resident (i.e., a nonresident alien), the gross estate includes only US *situs* property owned at death. US *situs* property includes real and tangible personal property located in the US, stock or options issued by a US corporation, debt of a US person (except portfolio debt), deferred compensation and pensions paid by US persons, and annuity contracts enforceable against US obligors. It does not include US bank deposits, insurance on the life of a nonresident alien, or pensions payable by non-US persons.

The Internal Revenue Code (IRC) determines the *situs* of different types of property, the treatment of which may be modified through the application of estate and gift tax treaties that the US has concluded with various countries (see Section 11).



## Retained interests

Due to retained interest rules, the reach of the estate tax is broader than simply the assets a decedent owned at death. Notwithstanding attempts to make lifetime transfers, some transferred property may be deemed to remain within the decedent's gross estate at his or her death. The following retained interests may be included in a decedent's gross estate:

- Certain gifts made within three years of death
- Transfers with a retained life estate
- Transfers taking effect at death
- Certain annuities
- Interests owned jointly
- Transfers that provide for broad powers of appointment
- Revocable transfers

The retained interest rules also apply to the estate of a nonresident alien. The definition of the gross estate of a nonresident alien is "that part of his gross estate ... which at the time of his death is situated in the United States." Therefore, the estate will be subject to the same definitions of retained interests or powers as those that apply to the estate of a US citizen or resident alien – limited by the *situs* rules.

*Situs* rules provide that property subject to the retained interest transfer rules will be deemed situated in the US if such property was so situated either at the time of transfer or the time of death. This presents a number of issues for estate planning with respect to nonresident aliens. A transferor should therefore remain aware that transferring US property into a foreign entity may not convert the property to foreign *situs* property, even if the foreign entity no longer holds US property at the date of death.

## Basis

All property subject to the estate tax receives a step-up in basis to its FMV on the day of the decedent's death. Each transferee's basis in property received by a decedent is its FMV for federal income tax purposes regardless of the transferor's historical cost or basis adjustments.

## State estate tax

Many states have a state-level estate tax. Where such taxes apply, the state-level estate tax is normally significant. Also, state tax rules for determining residence do not necessarily parallel the federal rules. Therefore, any nonresident alien should also seek state tax advice to determine potential estate tax and informational filing requirements for property situated in a given state. A decedent's estate may be permitted an estate tax deduction at the federal level for any state estate taxes paid.

## 1.2 Gift tax

US citizens and resident aliens are subject to gift tax on transfers of all property, tangible and intangible, regardless of the location of the property. See Section 2.2 for a discussion of who is a US resident and a US nonresident alien for gift tax purposes. Gift tax applies to the FMV of the transferred assets as of the date of the gift.



US citizens and resident aliens are subject to a top gift tax rate of 40% and are entitled to a US\$5 million gift tax exemption, which is adjusted annually for inflation (US\$5.45 million for 2016). The US gift and estate tax are unified – there is only one exemption for both gift and estate tax purposes. Therefore, gifts made during an individual's lifetime will reduce his or her estate tax exemption.

Unlike US citizens and residents, nonresident alien individuals do not receive a lifetime gift tax exemption, but are entitled to use of the annual exclusion amount. Thus, every transfer of US *situs* property by a nonresident alien in excess of the gift tax annual exclusion (US\$14,000 in 2016) is subject to gift tax. Nonresident aliens must generally pay gift tax on transfers of real property and tangible property located in the US. Intangible property, including stocks and bonds, is generally exempt. Nonresident aliens, citizens and residents share the same gift tax rates. See Section 2.2 for a discussion of who is a US resident and a US nonresident alien for gift tax purposes.

Generally, the donee takes the gifted property at the same income tax basis as it had in the hands of the donor. However, if the FMV of the property at the time of the gift is lower than the donor's adjusted basis, the donee must use the FMV at the time of gift as the basis for computing loss on a subsequent sale of the property. Additionally, the donee's basis may be increased by all or part of the gift tax actually paid by the donor.

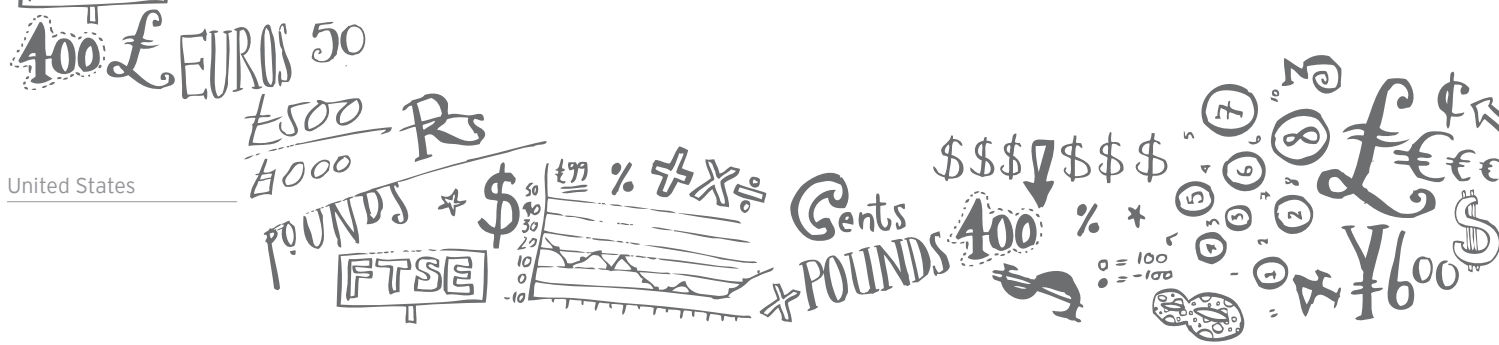
Currently, only Connecticut imposes a state-level gift tax, at rates ranging up to 12%.

Individual states, counties and municipalities may impose a transfer or recordation tax on conveyances of real property. Generally, the transferor (individual or entity) remains liable for any tax due upon transfer; however, local customs vary as to how such costs are allocated among the transferor and transferee. Furthermore, indirect transfers of real estate through the sale or exchange of stock or partnership interests may also result in transfer taxes if the entity itself owns real estate. Although no federal transfer or recordation tax exists upon a transfer of real estate, if the underlying transfer constitutes a sale, the transaction may trigger both state and federal income taxes. Exceptions may apply in situations where no change in the beneficial ownership of the property occurs (e.g., when the transfer occurs for purposes of securing financing or if the owner transfers property to a revocable trust controlled by the original property owner).

No endowment tax laws exist in the US.

The US does not impose an inheritance tax at the federal level. However, a minority of states independently retain inheritance tax regimes. Generally, inheritance tax provisions do not impose taxes on transfers to spouses and descendants. Although, in the limited circumstances where inheritance taxes do apply, the impact can result in significant tax burdens, with rates ranging up to 20%.





## General

A nonresident alien can transfer non-US *situs* property without the transfer triggering GST tax, but transfers of US *situs* property do trigger GST tax – whether covered by applicable exclusions or exemptions or taxable in nature. The definition of US *situs* property depends upon whether the transfer constitutes a gift or bequest. Lifetime gift transfers use the same *situs* rules as the gift tax, and bequests use the same *situs* rules as the estate tax. In addition to the application of the general *situs* rules, estate and gift tax treaties the US has concluded with various countries may also modify the *situs* and treatment of an asset. See Section 11. Additionally, the GST tax also excludes property exempt from taxation by the gift tax annual exclusion or the qualified educational and medical expenses exclusion.

A taxpayer may irrevocably allocate GST tax exemption to any property transferred during life or at death. The individual or the individual's executor can make the election on a timely filed gift or estate tax return. GST tax exemption is automatically allocated to direct skip transfers and indirect skip transfers (a transfer to a trust in which skip persons are beneficiaries) up to the total amount of the transferor's remaining GST tax exemption, without further action by the transferor to affirmatively alter this allocation.

## 2.1 Residency

US law imposes income taxes on US persons – defined as US citizens and US residents – with respect to their worldwide income and imposes transfer taxes on their worldwide assets. However, income tax law determines residence differently from the way that the US transfer tax (gift, estate, and GST tax) law determines residence.

US income taxation based on residence applies to US citizens and US residents. US residence is determined under two tests – substantial presence test and green card test. The substantial presence test calculates residence based on the number of days an individual spends in the US over a three-year period. An individual who is in the US 183 or more days in the current year or for 183 days or more during a three-year period calculated using a weighted average formula is a US resident for income tax purposes.





The green card test is based on an individual's US immigration status and treats a person as a resident for US income tax purposes if the individual obtains lawful permanent resident status. A person who is not a US citizen and fails the substantial presence test and the green card test is considered a US nonresident alien for income tax purposes. In addition to these regulatory tests under US law, income tax treaties entered into between the US and other jurisdictions can alter the residence inquiries. Each treaty should be analyzed separately for residence impact.

During the first year of US residency, special rules apply to determine the exact start date of US residency. If an individual is considered a US resident during a specific year, but was not a US resident at any time during the preceding calendar year, that individual is only a US resident for a portion of the year in question. The determination of the start date of residency depends upon which test the individual satisfies for US resident status (e.g., substantial presence or green card). Under the substantial presence test, residency generally begins on the first day of presence in the US for the year, but up to 10 days of actual presence can be ignored if the individual had a closer connection to a foreign country and maintained a tax home in a foreign country. Under the green card test, residency begins on the first day of the calendar year in which the individual was present in the US as a lawful permanent resident. If a person meets both residency tests, residency begins on the earlier of the first day of presence under the substantial presence test or the first day as a lawful permanent resident.

## 2.2 Domicile

In contrast to income tax residence, the US transfer tax laws determine domicile in a more subjective manner. A person acquires a domicile by living at a location – even for a brief period – while possessing no definite, present intention of later removing therefrom. Domicile depends on the facts and circumstances of each particular case. An individual has exactly one domicile – no more, no less – and once established, the individual must explicitly exhibit the intent to leave the old domicile in favor of a new one. Courts in the US have relied on several distinct factors when attempting to discern an individual's domicile. These include written statements of intention, such as those included in wills, visa applications, trust agreements and deeds, the time spent in the US in comparison to other countries, the location and size of the individual's residences, as well as business, family, social, and religious attachments. No single factor is determinative, and each case will depend upon the totality of the circumstances.

### Nonresident aliens

A nonresident alien is defined as any individual who is not a US citizen or resident. For transfer tax purposes, residence is defined by domicile, so a person is a nonresident alien when the person is not domiciled in the US. Nonresident aliens are not considered US persons for estate, gift, and GST tax purposes. Nonresident aliens for estate and gift tax purposes do not receive the same gift and estate tax exemption as US residents. Nonresident aliens are not subject to taxation on worldwide assets; instead, their US estates include only those assets deemed situated in the US.

## 3. Rates

A unified tax rate schedule applies to gift and estate taxes. The estate tax directs the application of this unified schedule for computation of tax to lifetime transfers and transfers at death, cumulatively, and then subtracting the amounts previously subject to gift tax on lifetime transfers. In doing so, the unified rate schedule attempts to subject all property transfers to tax liability under the gift tax or estate tax, and in return, each individual receives the benefit of a single unified credit.

The following gift and estate tax rate schedule applies to transfers of property by gift for US citizens and residents and transfers of US *situs* property by gift for nonresident aliens occurring in 2016. For US citizens and US residents, a US\$5.45 million gift and estate exemption amount exists in 2016. The US estate tax limits nonresident aliens to a US\$60,000 estate tax exemption and a US\$0 gift tax exemption, other than the gift tax annual exclusion. The same rate schedule applies.



## 4. Exemptions and reliefs

### Administrative expenses, debts, taxes and losses

## Charitable deduction

## Marital deduction for bequests to US spouse

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The estate tax allows portability of the estate tax exemption of a deceased US citizen or US resident to a US citizen or US resident surviving spouse. The availability of a portability election on behalf of a non-US citizen, non-US resident surviving spouse is limited to certain circumstances, including application of certain treaties. Portability of the estate tax exemption permits a surviving spouse to utilize any remaining unused estate tax exemption of the predeceased spouse. A major focus of US estate tax planning for married couples is to make certain that each spouse fully utilizes his or her estate tax exemption, because full utilization of both exemptions allows a married couple to double the amount that they pass free of estate tax. Portability allows for this full use of the estate tax exemption without the need to utilize tax savings trusts or other tax planning techniques on the first spouse's death. However, because these rules are not applicable to non-citizens and nonresidents, traditional estate tax planning minimization techniques should be considered for such persons. Portability of the estate tax exemption is claimed by filing an estate tax return.

### Marital deduction for bequests to non-US spouse

The law prohibits a marital deduction for a transfer to a non-US citizen spouse, even by a US citizen decedent. Instead, a special marital trust called a qualified domestic trust (QDOT) allows for the deferral of the tax at the first death. This trust must have at least one US trustee possessing the obligation to withhold US estate tax from principal distributions from the trust. The deferred tax (at the rate applicable to the first decedent's estate, but applied on the current asset value) becomes payable at the death of the surviving spouse or on earlier distributions of principal from the QDOT. The US has estate and gift tax treaties with some countries that allow an increased marital deduction for transfers to a non-citizen spouse without requiring that the assets be placed in a QDOT.

### Exemption

In 2016, estates of US citizens and residents receive a credit against the estate tax that exempts the first US\$5.45 million in assets from taxation. This estate tax exemption unifies with the gift tax exemption in the sense that lifetime transfers of property in excess of the statutory annual exclusion amounts reduce the estate tax exemption. The estate of a nonresident alien receives an estate tax exemption of US\$60,000. Some US estate tax treaties allow a higher amount. Effectively, this means that US estate tax will capture many estates of nonresident aliens who die owning US *situs* assets.

## 5. Filing procedures

### 5.1 Estate tax

The decedent's estate – a separate legal entity and taxpayer – comes into existence on the date of the decedent's death and continues to exist until the personal representative (also referred to as an executor or administrator) has distributed all of the decedent's property from the estate and properly taken action to close the estate. Therefore, the estate may have US income tax filing obligations during the years between the date of death and the date all property is distributed by the estate. The naming of the personal representative may occur through nomination in the decedent's will or by appointment in court if the decedent dies intestate (without a will). For estates of nonresident aliens, if no qualified US personal representative is appointed, then every person in possession of the decedent's property is required to file an estate tax return and may be liable for any US estate tax due.

The estate tax return for a US citizen or resident is Form 706. For nonresident aliens, it is Form 706-NA. All Forms 706-NA are filed with the Internal Revenue Service Center in Cincinnati, Ohio. The location for filing Form 706 will vary with the US citizen's or resident's domicile at death. The original due date for estate tax returns for all estates is nine months following the date of death. An estate can request an extension of an additional six months to file the return, but the tax must be paid by the original due date to avoid interest and potential penalties.





## 5.2 Gift and GST

In addition to GST tax, taxpayers should also report allocations of GST exemption on a timely filed Form 709. Timely filed returns result in allocations effective as of the day of the transfer; late filed allocations result in allocations effective on the date of the filing. In the year of death, the decedent's executor may make an allocation election on a timely filed estate tax return.

The primary liability for the gift tax due to the IRS falls on the donor of the gift. This liability transfers to the executor or administrator of the estate of the decedent as a liability of the estate, if the tax remains unpaid at the time of death. In the event gift tax remains unpaid, gift tax liability can also be enforced on the donee or through the imposition of a gift tax lien for up to 10 years on the transferred property. The donor of property must pay the gift tax at the time and place for filing the gift tax return – as determined without regard to filing extensions. Furthermore, if a donor dies before filing any required gift tax returns, the executor or administrator of the estate of the decedent must file such returns. The primary liability for GST tax rests with the transferee on payments of taxable distributions, rests with the trustee on taxable termination events, and rests with the transferor on direct skip transfers. Secondary liability is determined in the same manner as secondary liability for gift taxes.

Unlike the estate, gift, and GST taxes, the Section 2801 tax is paid by the donee of a gift or bequest from a covered expatriate. The donee must file Form 708 to report gifts and bequests from covered expatriates in excess of the gift tax annual exclusion amount (US\$14,000 in 2016). The requirements to file Form 708 and pay the Section 2801 tax are suspended until the IRS issues final regulations.



## 6. Assessments and valuations

The value of a US citizen's or resident's gross estate is the value at the time of his or her death of all property, real or personal, tangible or intangible, wherever situated. The IRC does not prescribe how this value is to be determined. The estate and gift tax regulations, however, prescribe extensive valuation rules. These valuation rules are accompanied by prescribed actuarial and interest rate tables.

The general rule prescribed in the U.S. Treasury Regulations for determining value for estate and gift tax purposes is to determine an asset's FMV. FMV is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts. The FMV of a particular item of property includable in the decedent's gross estate, or for purposes of computing the value of a taxable gift, is not to be determined by a forced sale price.

Also, the FMV of an item of property is not to be determined by the sale price of the item in a market other than that in which the item is most commonly sold to the public, taking into account the location of the item wherever appropriate. The latter rule contemplates that when property of a US taxpayer (perhaps resident in a foreign jurisdiction) is outside the US, the valuation should occur in the relevant foreign market, rather than by reference to values for that or similar property existing in a US market.

## 7. Trusts, foundations and private purpose funds

### 7.1 In general

As a practical matter, US succession planners use trusts when a donor wishes to place certain constraints on the access of the proposed donee to the trust property. If succession serves as the objective of the transfer in trust, the donor must retain neither influence nor control over the trustees or the property placed in trust to avoid having the property placed in trust being brought back into the donor's estate and subject to estate tax.

### 7.2 Types of trusts

Various types of trusts exist in the US, but most fit the classification of either grantor, simple or complex. Grantor trusts are ignored for US income tax purposes as separate taxable entities from the grantor as a consequence of the grantor's retention of certain powers over the property in the trust. In the case of a grantor trust, the grantor is treated as owning the property held by the trust for US income tax purposes (although not necessarily for estate tax purposes). Simple trusts are non-grantor trusts that require trustees to distribute all of the trust's current income to one or more beneficiaries annually. Trusts that are not grantor or simple are complex. Absent specific powers vested in a beneficiary, the law does not require estate inclusion of the underlying trust assets in the beneficiaries' estates. Trusts work extensively in conjunction with probate avoidance and estate planning for non-US citizens; specifically, a common practice is to use a QDOT trust created by will to benefit a non-US citizen spouse (see discussion under "Marital deduction for bequests to non-US spouse" in Section 4.1) or a qualified terminable interest property (QTIP) trust for US citizen spouses.

### 7.3 Trust location

Non-US persons who obtain US residence and who are settlors or beneficiaries of trusts that have been created for estate or gift tax planning in other jurisdictions may encounter unexpected US tax results if they do not seek advice before establishing US residence. This occurs because the US rules that apply to foreign trusts with US beneficiaries and settlors may apply once they become US residents. We outline these onerous rules briefly below, but non-US persons who subsequently acquire US tax residence while retaining an interest in a non-US trust should seek advice of a US tax professional.



#### 7.4 Outbound transfers by US person or domestic trust

A US citizen or resident who creates a foreign trust over which he or she has no control or power may nevertheless be subject to tax on the income under the US grantor trust rules. These rules provide that, in a year where the trust has a beneficiary who is a US person, any transfer made by a US resident or citizen to a foreign trust will cause grantor trust treatment, at least as to the portion attributable to that transfer to the US resident beneficiary. The grantor trust rules presume foreign trusts have US beneficiaries, unless the transferor can establish that no part of the income or principal of the trust benefits or could benefit a US person. Grantor trust treatment may also extend to transfers made to foreign trusts by foreign individuals who later become US residents within five years of the transfer (for further discussion, see Section 7.6). The US tax law treats any transfers made within that five-year period as though the foreign settlor made the transfer on the date the settlor's US residence begins.

The taxation of a foreign beneficiary who becomes a US income tax resident will be impacted by the classification of the trust as a foreign grantor trust or as a foreign nongrantor trust. First, if the settlor of the trust was not a US person, then under very limited circumstances will the trust be classified as a grantor trust, causing the beneficiary to receive a gift, rather than a taxable distribution. Next, if the trust was created by a US person and is classified as a grantor trust, then the income tax ramifications flow to the settlor. The more complex case is where a trust is or has become a foreign nongrantor trust; a US beneficiary is subject to tax on distributions from a foreign nongrantor trust and it is possible that an additional throwback tax on accumulated income and interest charge could apply.



## 8. Grants

With regard to estate taxes, there are no specific rules in the US.

## 9. Life insurance

Life insurance can serve as an important asset on the life of a decedent in the US. A person with an insurable interest – an articulable interest in the continued life of a person – can choose one or more varieties of policies, including whole life, term life, accidental death, joint life, universal life and variable life. The person or entity that retains incidents of ownership (e.g., power to change a beneficiary, assign the policy, use the policy as collateral for loans, reversionary interest, settlement options or surrender the policy) over the policy garners treatment as the owner for US tax purposes. The concept of incidents of ownership is intentionally broader than the technical definition and concept of ownership in other areas of the law.

Life insurance ownership can provide many benefits to an estate and survivors of a deceased individual. First, life insurance proceeds can provide enough cash without having to liquidate assets within the estate to pay debts that survive a decedent and any tax bills arising as a result of death. Second, the death benefit can create a larger pool of assets for more modest estates to assure adequate security and funds for survivors. Third, amounts paid from a life insurance policy can assist business colleagues of the decedent to accumulate funds sufficient to purchase ownership interests left for their procurement.

While life insurance can provide many benefits to a broad group of individuals surviving a decedent, it does not come without limitations. First, if the owner of a life insurance policy is also the person insured by the policy, the death benefit paid is included in his or her estate without regard to the identity of the recipient. This creates the potential for transfer tax implications (e.g., a GST tax liability may arise if a payment is made to a skip person, or an estate tax liability could arise if the value of the policy included in the gross estate calculation takes the value of the estate over the estate tax exemption amount in the year of death). A possible solution to the transfer tax implications is to have a person (other than the insured) or an irrevocable life insurance trust own a policy on the life of the insured. When properly structured and implemented, an irrevocable life insurance trust can purchase the policy on the life of an individual without the insured having any incidents of ownership with respect to the policy, thus allowing policy proceeds to escape US estate tax in the estate of the insured. Where the insured already owns a policy on his or her own life, in order to keep the proceeds of the policy out of the estate of the insured, the policy can either be purchased by an irrevocable life insurance trust for full and adequate consideration in money or money's worth or transferred to the irrevocable life insurance trust, but such transfer must be made more than three years before death because of the retained interest rule that brings assets transferred within three years of death back into an estate.

The method of permissible beneficiary designation on life insurance policies differs from that of most other assets a decedent owns at death. An individual cannot name a beneficiary of a life insurance policy in a will or other at-death declaration; instead the owner must make explicit recognition of the identity of the beneficiary of a policy prior to the death of the insured to the issuing company in the manner it requires.

Because life insurance is not considered a US *situs* asset to a nonresident, it can be an efficient mechanism for mitigating US estate tax exposure on US *situs* assets such as real property and the equity securities of US issuers.







## 11. Estate tax treaties

The following table provides details on the US estate tax, gift tax, and combined estate and gift tax treaties currently in effect.

Country	Separate estate tax treaty	Separate gift tax treaty	Combined estate and gift tax treaty	Other	Signed	Transfers made on or after	Comments	
Australia	No	Yes	No	No	May 1953	14 December 1953		PR-UC***
Australia	Yes	No	No	No	May 1953	7 January 1954	Old *	PR-UC
Austria	No	No	Yes	No	June 1982	1 July 1954	New *	
Canada	No	No	No	1995 Protocol	March 1995	9 November 1995**	Estate tax only	PR-UC
Denmark	No	No	Yes	No	April 1983	7 November 1984	New	
Finland	Yes	No	No	No	March 1952	18 December 1952	Old	PR-UC
France	No	No	Yes	No	November 1978	1 October 1980	New	PR-UC (Protocol)
Germany	No	No	Yes	No	December 1980	1 January 1979	New	PR-UC (Protocol)
Greece	Yes	No	No	No	February 1950	30 December 1953	Old	PR-UC
Ireland	Yes	No	No	No	September 1949	20 December 1951	Old	
Italy	Yes	No	No	No	March 1955	26 October 1956	Old	PR-UC
Japan	No	No	Yes	No	April 1954	1 April 1955	Old	PR-UC
Netherlands	Yes	No	No	No	July 1969	3 February 1971	New	
Norway	Yes	No	No	No	June 1949	11 December 1951	Old	PR-UC
South Africa	Yes	No	No	No	April 1947	15 July 1952	Old	
Sweden	No	No	Yes	No	June 1983	5 September 1984 (through 31 December 2007)	New (ended 1 January 2008)	
Switzerland	Yes	No	No	No	July 1951	17 September 1952	Old	PR-UC
UK	No	No	Yes	No	October 1978	11 November 1979	New	

\* Old or new refers to whether the treaty has the old situs rules, or the new provisions that generally restrict the US to taxing nonresident aliens' US real estate and business property.

\*\* The 1995 Canada-US Protocol had retroactive effect to Technical and Miscellaneous Revenue Act of 1988 (TAMRA). Claims for refund based upon the treaty had to be filed by 9 November 1996.

\*\*\* "PR-UC" in comments section above refers to a pro-rata unified credit provision. (The pro-rata unified credit provisions in the German and French treaties apply only to estate tax, not to gift tax.)