

PUBLIC CONSULTATION PAPER

Possible approaches to tackling cross-border inheritance tax obstacles within the EU

Note:

This document is being circulated for consultation.

The sole purpose of this public consultation is to collect feedback on the possible solutions to deal with cross-border inheritance tax problems and help the Commission develop its thinking in this area.

This document does not necessarily reflect the views of the European Commission and should not be interpreted as a commitment by the Commission to any official initiative in this area.

The parties concerned are invited to submit their comments no later than **22/9/2010**

Comments may be sent by letter, fax or electronic mail to the following address:

European Commission
Directorate-General for Taxation and Customs Union
Unit D2 – Direct Tax Policy & Cooperation
Rue de Spa 3
B-1049 Brussels
Belgium

E-mail: TAXUD-D2-CONSULTATION@ec.europa.eu

1. WHAT IS THE AIM OF THIS CONSULTATION?

Prior to 2003 the Court of Justice of the EU never had cause to examine whether the inheritance tax rules of Member States were compatible with EU Treaty rules. However, since then it has ruled in eight inheritance tax cases that Member States' national courts referred for preliminary rulings. At the same time the European Commission is receiving an increasing number of complaints about cross-border inheritance tax issues. It seems, therefore, that this area is becoming one of growing concern to EU citizens. It is possible that EU Member States' inheritance tax rules as applied in cross-border situations are hindering EU citizens from benefiting fully from their right to move and operate freely across borders within the Internal Market. These rules may also be creating difficulties for the transfer of small businesses on the death of owners.

The Commission is currently working on several different fronts to obtain more evidence of the extent of any cross-border inheritance tax problems within the EU and to find solutions to any problems identified. The Commission is launching the present public consultation to obtain views from all interested stakeholders and individuals on the extent of the problem and ideas on possible solutions.

2. WHO IS CONSULTED?

The Commission would like to draw on the expertise and experience of all parties interested in commenting on cross-border inheritance tax issues, All stakeholders – individual citizens, businesses, Member States, tax administrations, intergovernmental, non-governmental and business organisations, tax practitioners and academia - are invited to provide their views on this matter.

3. BACKGROUND

The Commission's research so far indicates that citizens and business can face two types of inheritance tax problems in cross-border situations.

First, they may be exposed to **discriminatory application of Member States' inheritance tax rules in cross-border situations**. Second, there is the risk of **unrelieved double or even multiple taxation of a single inheritance by several Member States**, which, in the absence of appropriate tax relief mechanisms, could lead to an excessively high rate of overall taxation.

As for the first problem, the Court of Justice of the EU ruled in six out of eight cases examined since 2003¹ that the inheritance tax laws of the Member States in question were incompatible with the EU treaty rules on free movement of capital because the laws provided for less favourable rules where either the assets or the beneficiaries were located outside the Member State under examination. In the light of this case-law, Member States' inheritance tax provisions may be considered in breach of the free movement of capital when:

¹ Case C-364/01 *Barbier* was the first case, followed by case C-513/03 *van Hilten-van der Heijden*, case C-464/05 *Geurts*, case C-256/06 *Jager*, case C-11/07 *Eckelkamp*, case C-43/07 *Arens-Sikken*, case C-67/08 *Block*, and case C-510/08 *Mattner* as the most recent example.

- they provide for different rules for the valuation of assets that are part of the inheritance, depending on where these assets are located;
- they restrict the deductibility of debts/liabilities related to assets that are part of the inheritance of non-residents;
- they provide for lower tax allowances with respect to non-residents.

The above list of incompatible features is not exhaustive and is simply intended to give examples on the basis of relevant cases already examined by the Court of Justice. Other inheritance tax rules distinguishing between purely domestic situations and situations with cross-border elements may be challenged by the Court of Justice if they restrict the free movement of capital.

As for the second problem, the significant differences in the civil and tax legislation of the Member States in the field of inheritances can potentially result in double, or even multiple, taxation by several Member States in the case of cross-border inheritances. Even though the EU Court of Justice concluded that the Treaty does not oblige Member States to eliminate the double taxation of inheritances that may arise due to the parallel exercise of tax competence by two Member States², it is clear that international double taxation is an obstacle to cross-border activity and investment within the EU.

Most EU Member States levy taxes upon the death of a person. Some Member States apply a tax on the heirs, while other Member States apply a tax on basis of the estate. In both cases tax liability is determined on the basis of a nexus that can be personal or territorial. In addition, the existence of the nexus is determined on the basis of a variety of connecting factors (i.e. the residence, domicile or nationality of the deceased and/or of the beneficiary; and/or the location of property) which can apply concurrently and which may differ in definition and meaning in the various jurisdictions. This situation may potentially lead to double or even multiple taxation of the same inheritance in different Member States. Double taxation problems could also arise due to the fact that Member States apply different valuation methods for the same assets and debts and may be exacerbated by the fact that some Member States apply high inheritance tax rates for certain group of beneficiaries (the rate may even reach 80% over a certain threshold in cases where the deceased and the beneficiary are not related).

Many Member States have adopted a mechanism to avoid double taxation of inheritances under domestic law. However, it is our understanding that such a relief would not, in most cases, provide complete relief from double taxation. In addition, Member States have concluded very few bilateral tax treaties for the avoidance of double taxation on estate and inheritance tax (there are, in fact, only 33 bilateral inheritance tax treaties between Member States out of a possible total of 351). Consequently, there is currently no comprehensive solution to any problems of double taxation of inheritances that may arise.

Furthermore, even high inheritance taxes in one country alone can significantly hinder the transfer of business of small and medium-sized enterprises (SMEs). Unrelieved double taxation in case of cross-border transfers could be an even greater threat and could, if it arises, lead to small businesses' withdrawal from the Internal Market.

² Case C-67/08 *Block*

To obtain a picture of the real size of the problem and its financial impact, the Commission is currently collecting more evidence of cross-border inheritance tax problems. In this regard:

- An external study was launched in December 2009 with results expected by June/July 2010. The study is designed to provide more information about: the compatibility of Member States' inheritance tax legislation with EU law; the precise extent of any problems of double taxation of inheritances within the EU; any inheritance tax problems related to transfer of business in case of death of an SME owner; and possible solutions aimed at resolving the problem of unrelieved double taxation of inheritances. The final study will be published on the website of the Directorate General for Taxation and the Customs Union in the European Commission in July. All contributing parties to the present consultation will be able to access the findings of the study there.
- The Commission has launched a public consultation to obtain data on actual cases of double taxation of income, capital and inheritances which will run until the end of June 2010. The Commission services will publish a summary of the results in due course. See: http://ec.europa.eu/taxation_customs/common/consultations/tax/2010_04_doubletax_en.htm

4. POSSIBLE APPROACHES TO CROSS-BORDER INHERITANCE TAX PROBLEMS

Stakeholders are invited to suggest solutions to deal with the above-mentioned actual or potential cross-border inheritance tax problems. Suggestions already mentioned in literature and commentaries include the following:

A. Guidance on interpretation of the European case law on abolition of discriminatory features of the legislation of Member States that apply inheritance taxes.

Experience has shown that it is not always easy for Member States to ensure that their tax legislation is compatible with the non-discrimination principle. States sometimes adapt their laws to taken account of Court's decisions in an asymmetrical or incomplete way, or in a way that worsens the positions of taxpayers. With the increasing cross-border movement of EU citizens, the number of complaints about aspects of Member States' inheritance tax laws may also increase which may in turn lead to an increased number of referrals to the Court of Justice of inheritance tax related questions. Therefore, it may be helpful to draw up a set of principles, based on the relevant case law that should govern the design of inheritance tax systems. The drafting of such principles would have to take into account that this is an evolving area, with the possibility in time of new case law of the Court.

B. Ideas for solutions to problem of double taxation of inheritances

Member States could be encouraged to adopt mechanisms to eliminate double taxation of inheritances such as:

- completing a full network of bilateral double taxation treaties, or
- including inheritance tax rules within the scope of bilateral income tax treaties, or
- where domestic relief is not granted at all, adopting domestic mechanisms to eliminate double taxation in cross-border situations.

Note, however, that existing domestic mechanisms aimed at eliminating double taxation of inheritances usually only provide a limited solution to this problem and might have to be improved if they were to be chosen mechanism to relieve double taxation.

Note also that bilateral tax treaties for the avoidance of double taxation on estate and inheritance could address a larger number of issues that are not covered by a simple mechanism of unilateral tax relief. A greater treaty coverage might therefore be able to resolve the problem of double taxation of inheritances in a more effective and satisfactory way than a mechanism of unilateral relief. However, the OECD Model Convention on Inheritance and Estate Tax has not been updated for some time (the latest version dates back to 1982) and might need to be adapted if it were to be used as a basis for such bilateral conventions.

Note also that the inclusion of inheritance tax rules in bilateral income tax treaties has been adopted as a solution by a few Member States.

Another, or an additional, approach for the elimination of double taxation could be to introduce an EU-wide binding mechanism to eliminate double taxation of inheritances. The issue to be assessed would be the nature of any such mechanism and Member States' openness to it.

5. KEY QUESTIONS

- 1) Have you any information on cross-border inheritance tax problems in the EU that you would like to provide?
- 2) Which or which combination of the above outlined approaches do you consider as most appropriate to tackle any cross-border inheritance problems that exist? Why do you prefer that option?
- 3) Would you prefer a completely different solution and if so what solution do you suggest?
- 4) What, if anything, else do you think could be done at European level to overcome any difficulties that exist in the area of inheritance taxes?
- 5) Do you have knowledge of cross-border inheritance tax problems faced by SMEs and, if so, do you think that the above-mentioned or different solutions are needed for any such problems?
- 6) Do you have any other comment or thoughts to share as regards cross-border inheritance tax issues?