



Brussels,

Summary of replies to the public consultation on cross-border inheritance tax obstacles within the EU and possible solutions

1. INTRODUCTION

The Commission is currently examining whether Member States' inheritance tax rules as applied in cross-border situations hinder EU citizens from benefiting fully from their right to move and operate freely across borders within the Internal Market. Another question is whether these rules create difficulties for the transfer of small businesses on the death of owners.

The Commission's research so far indicates that citizens and businesses 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, as illustrated in the recent inheritance tax case law of the Court of Justice of the European Union ("CJ"). Second, there is the potential for unrelieved double or even multiple taxation of a single inheritance by several Member States, because of the different tax rules applied by Member States and the lack of comprehensive solutions to double taxation. This double taxation can potentially lead to an excessively high rate of overall taxation.

The Commission launched the present public consultation on the internet to obtain views from all interested stakeholders and individuals on the extent of the problems in this area and ideas on possible solutions. Stakeholders were also invited to comment on any actual or potential cross-border inheritance tax problems of which they are aware and to suggest solutions to these problems. The consultation paper listed possible solutions already mentioned in literature and commentaries, such as guidance on interpretation of EU case law to help Member States in designing their inheritance tax systems in a way that is compatible with EU law; and unilateral, bilateral and EU-level solutions to the problem of double taxation.

The key questions to which stakeholders were invited to reply were the following:

- 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?*

The Commission published, as a reference document to this consultation, a study by external consultants on inheritance taxes in EU Member States and possible mechanisms to resolve problems of double inheritance taxation in the EU¹. The study explored the nature of cross-border inheritance tax problems, i.e. discrimination and double taxation; the economic significance of the problems; and possible policy solutions to the problems.

The consultation ran from 25 June to 22 September 2010, but at the request of several stakeholders, the deadline was later extended to 22 October 2010. The Commission also accepted a number of contributions received after the deadline.

There were in total 232 replies to the consultation from a broad range of stakeholders, including 205 individual citizens (23 replied directly while 183 responses were submitted through a newspaper with one overlap in that one of those contributions was also sent directly to the Commission), 13 academics and tax practitioners individually or through their associations, 3 non-registered and 9 registered organisations, and 2 public authorities.

This summary also takes on board the replies on inheritance tax sent in response to the more general public consultation on double taxation problems that the European Commission conducted from 24 April to 30 June 2010². There were 2 such replies and some stakeholders expressed their views in reply to both consultations.

The consultation paper and the external study can be accessed at:

http://ec.europa.eu/taxation_customs/common/consultations/tax/2010_06_inheritance_en.htm

2. GENERAL COMMENTS

In general, respondents expressed their appreciation at the launch of this public consultation initiative and emphasised that there was a strong need to tackle tax obstacles to cross-border inheritances. The majority of replies also concurred with the main findings of the external study and with the Commission's own research.

¹ Copenhagen Economics: *Study on Inheritance Taxes in EU Member States and on Possible Mechanisms to Resolve Problems of Double Inheritance Taxation in the EU*, August 2010.

² http://ec.europa.eu/taxation_customs/common/consultations/tax/2010_04_doubletax_en.htm

Some stakeholders, including tax practitioners and associations, also drew attention to the in-depth discussion of cross-border inheritance tax issues at the 64th Annual Congress of the International Fiscal Association (IFA) in Rome in September. Several contributors emphasised that as people increasingly move across borders within the EU, the problems related to cross-border inheritance taxation can only increase in the future. Stakeholders therefore welcomed the Commission's efforts to put this issue on the political agenda.

3. KEY ISSUES

A. Evidence of the existence of cross-border inheritance tax problems within the EU

1) The discrimination problem

Many respondents of all types (individual citizens, academic representatives, tax practitioners and organisations) reported on possible discriminatory provisions of domestic inheritance tax legislation. The competent Commission services are currently examining these complaints about discrimination with a view to asking Member States to amend the relevant laws if they do indeed involve a conflict with the Treaty on the functioning of the EU.

2) The double taxation problem

In the recent public consultation on actual cases of double taxation, including of inheritances, some contributors, including tax practitioners and citizens provided real-life examples of double taxation of inheritances. Others provided similar responses to the present consultation.

The majority of the replies described as the underlying causes of this phenomenon the various types of mismatches between different national inheritance rules.

Many pointed out that, to start with, Member States differ considerably both as regards their civil legislation and their tax legislation in the field of inheritances. The basic difference in concept between the civil law and common law systems concerns the transfer of assets. While civil law countries follow the principle of direct transmission, where the inheritance is directly transferred from the deceased person to the heirs, under common law the assets, rights and obligations are first transferred to a personal representative who deals with the administration of the estate and then transfers the net assets to the heirs. Some contributors, including tax practitioners and lawyers, noted also the difficulties concerning the civil law countries' treatment of trusts and personal representatives, which are characteristic features of the common law concept of inheritances. For instance, double taxation may arise if a civil law Member State considers the trust or a personal representative as a different taxable person to the beneficiary or regards the testator as the owner of the trust property and charges tax on the trust on the death of the testator.

Respondents also pointed to discrepancies between Member States' inheritance tax systems as there are great varieties in the rules, leading to different taxable persons, different taxable events and different bases of taxation.

Some Member States apply a tax on the heirs, while other Member States apply a tax on the basis of the estate. In both cases tax liability is determined on the basis of a connecting factor

or "nexus", which can be the residence, domicile or nationality of the deceased, or the residence, domicile or nationality of the beneficiary, or the location of the inherited property, or a combination of these factors. Furthermore definitions and meanings of these terms can differ from jurisdiction to jurisdiction, so for instance an individual can be "domiciled" for inheritance tax law purposes in one country and at the same time be "habitually resident" under the inheritance tax law of another. In addition, several Member States apply anti-abuse measures which provide for an extended concept of residence or domicile. Difficulties with determining the tax residence of the deceased were also highlighted, such as possible complications related to temporary residence.

Other significant differences between Member States' rules that respondents emphasised were different valuation methods regarding real estates, and usufruct of personal assets and business assets; and the diverging conditions for deducting debts and liabilities. Double taxation problems could also be exacerbated by the fact that some Member States apply high inheritance tax rates for certain groups of beneficiaries. Many stakeholders, mostly individual citizens, pointed to inordinately high rates and the lack of exemptions for non-relatives or distant relatives. This was particularly a problem in regard to stepchildren.

As for the existing mechanisms in place to eliminate double taxation of cross-border inheritances, the situation is far from ideal in the view of stakeholders. They complained about the very low number of bilateral tax treaties concluded between Member States 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) and they also pointed out that the current OECD Model Convention on Inheritance and Estate Tax has not been updated since 1982. Limited availability of treaty relief for foreign located property and varying rules regarding allocation of taxing rights in those tax treaties were also mentioned as shortcomings in the existing bilateral tax relief mechanisms.

Turning to the limitations of the current measures of double taxation relief under domestic law -the so-called unilateral relief mechanisms - many mismatches were pointed out which lead either to incomplete or non-availability of relief. Mismatches can also occur as a result of differences between common law and civil law systems. There can be different characterisations of the transfer of assets, and there can be different tax rules in place regarding what is a taxable event and who is the taxable person.

In addition, unilateral reliefs may have a limited scope as regards the taxes covered, such as applying only to inheritance or estate tax and not, for example, to income taxes on inheritances. In this respect, many contributors emphasised the importance of clear rules regarding the characterisation of taxes which apply on death.

Furthermore, it may not always be possible to credit foreign local inheritance taxes, i.e. taxes applied by political subdivisions at local rather than national level.

In addition, unilateral reliefs may not cover all cases of double taxation, for instance due to the narrow definition of "foreign located assets" used in the domestic provisions for granting tax credit. In this regard, the conflicting definitions of domestic and foreign located assets, in particular in relation to bank assets, were identified as a serious concern for stakeholders³.

³ In this respect a great deal of reference was made to the *Block* case (case C-67/08 *Block*), where bank assets held abroad did not qualify as foreign located asset for being eligible for unilateral relief. Nevertheless, the CJEU

Another general problem pointed out was the limitation of credit to foreign tax paid on foreign property, thereby excluding foreign tax on assets located within the territory of the Member State granting relief.

Many contributors mentioned further limitations of the existing tax credits concerning the material scope. This included divergence between the different tax systems regarding the definition of immovable versus movable property, or when relief is limited only to real estate.

Incomplete tax credit due to different valuation methods or the different allocation of debts was also widely reported as a serious shortcoming.

Relief that was subject to reciprocity or to the discretion of the competent authority was also considered problematic.

As a general remark concerning the above-mentioned problems of double taxation of a single inheritance, some stakeholders, including individual citizens and tax practitioners also pointed out that expert advice is highly needed, which can prove costly and time consuming.

3) *Miscellaneous*

A large number of individual citizens expressed their frustration with the substantive inheritance law applicable to their cross-border successions. Their particular concern is about the forced heirship rules under civil law that allow testators less freedom about whom to make their beneficiaries.

In this context, it is worth noting that on 14 October 2009 the Commission presented a legislative proposal for a Regulation dealing with cross-border successions and wills⁴. This Regulation would provide for the use of a single basis for determining the competent authorities and the applicable law that would apply in the case of a succession. It would also enable citizens living abroad to choose to have the law of their country of nationality made the law applicable to their entire succession.

The proposed Regulation does not deal with tax matters so would not, therefore, reduce the number of situations where citizens taking advantage of the Internal Market are exposed to double taxation or to discriminatory rules on inheritances. In this respect, some stakeholders pointed out that a proposal to address cross-border inheritance tax obstacles would be a timely initiative.

B. Possible approaches to cross-border inheritance tax problems

1) *Solutions to the discrimination problem*

stated that Member States are not obliged to eliminate double taxation on inheritance based on a parallel exercise of two tax jurisdictions.

⁴ Proposal for a Regulation of the European Parliament and of the Council on jurisdiction, applicable law, recognition and enforcement of decisions and authentic instruments in matters of succession and the creation of a European Certificate of Succession, COM(2009)154 fin. of 14 October 2009.

To tackle the discrimination problem, some stakeholders agreed that it could be helpful if the Commission provided the Member States with guidelines on how to bring their inheritance tax systems into line with EU law. Some also suggested that the principles set out in the relevant European case law should be established as compulsory rules at EU level.

2) *Solutions to the double taxation problem*

Stakeholders were asked for their views on the most appropriate solution or solutions to address the issue of unrelieved double or multiple taxation of a single inheritance. Many suggested several different solutions.

A quarter of the opinions on the suggested solutions concerned the unilateral relief mechanisms. Even though some contributors, including tax practitioners, pointed out possible shortcomings of such a system (for instance its inability to address all double taxation problems), the vast majority advocated the need to improve such unilateral solutions.

Many of them envisaged unilateral solutions as short term measures, or as complementary solutions to completing the gaps in the relevant bilateral treaty network.

In addition, some stakeholders, including tax practitioners, suggested introducing either an EU model relief provision or an EU-wide standard in the form of a Directive.

A third of the opinions on the suggested approach concerned bilateral solutions. Some expressed the view that it would be unrealistic to expect Member States to complete the relevant treaty network. On the other hand, more stakeholders, including individual citizens, tax practitioners, organisations and a public authority, argued for a comprehensive treaty network in this area, stressing the effectiveness of such a network, even if the negotiation and conclusion of such treaties could be time-consuming. Some contributors also explicitly expressed a preference for greater treaty coverage, either by the update of the OECD Model Convention on Inheritance and Estate Tax which has remained unchanged since 1982, or by drawing up an EU Model Treaty. A few argued for including inheritance tax provisions within the scope of bilateral income tax treaties. Another idea suggested was to establish EU minimum standard common rules for bilateral conventions.

Around half of the opinions on the suggested approach concerned solutions at EU level. While a few stakeholders, including associations, considered that the introduction of binding mechanisms in this area was not an EU competence, many contributors suggested EU wide solutions to cover all situations which unilateral or bilateral solutions could not address. Many argued for harmonised common concepts and definitions – such as for location (situs) of inheritances or for the residence or permanent residence of the testator/beneficiary. Some suggested introducing an Arbitration Convention or a Multilateral Treaty. The majority of stakeholders, including individual citizens, academics, tax practitioners, organisations and a public authority advocated the establishment of common rules to determine the basis of taxation. Most of these were in favour of common rules regarding taxation on the basis of the location of the assets of an inheritance, though some suggested adopting as the basis of taxation that of the (last permanent) residence of the deceased, with in some cases an exception for immovable property.

As for the form of any possible EU-wide binding mechanism, more explicitly favoured a Directive than a Regulation. In addition, some stakeholders, including tax practitioners, raised the abolition of inheritance taxes as a possible solution to eliminate double taxation.

3) *Miscellaneous*

Some stakeholders, including tax practitioners and associations suggested that a future initiative on inheritance taxation should cover gift taxes as well.

In other contributors' views, any upcoming proposal should also address the tax treatment of usufructs, donations and distributions out of trusts and foundations.

Other stakeholders, including also tax practitioners and associations, pointed out that improved transparency in this area would be very helpful; to this end, several suggestions were made, such as a relevant website or setting up "consulates" in charge of cross-border inheritance issues.

C. Cross-border inheritance tax problems faced by small and medium-sized enterprises (SMEs) and possible solutions

As regards the problems related to transfer of business in the case of the death of an SME owner, many stakeholders expressed the view that both discrimination and double taxation can create barriers to continuity.

Possible discriminatory issues in Belgium and Germany were reported in this regard, and the difference in the level of tax exemptions available in the various Member States was also highlighted.

As for tackling cross-border inheritance tax obstacles for SMEs, the suggested solutions in the majority of replies did not differentiate between the position of individual citizens and businesses.

Nevertheless, some contributors, including tax practitioners and organisations suggested particular solutions for SMEs, such as a common EU framework for business property relief which could be set out in EU-wide harmonised exemption rules; or including a provision on the transfer of business into an EU Model Convention on inheritances.