

# **STEP JOURNAL**

Downloaded on 19th September 2024 - 08:24

## **EU Commission tackles IHT cross-border obstacles**

A report on the latest measures dealing with inheritance tax.

The Commission presented a comprehensive package of measures to address cross-border inheritance tax problems on 15 December 2011. As tax practitioners dealing with estate planning will be aware, EU citizens who receive foreign inheritances or gifts may face a crippling tax burden. They may be required to pay inheritance or gift tax in two or more member states. They may also be subject to harsher tax rules than those applied to local inheritances or gifts.

Member states are free to decide on the tax rules they wish to apply to the inheritances connected to their territories, although EU law prohibits them from applying their rules in a discriminatory way. Double taxation as such is not prohibited under EU law, but may deter citizens and businesses from taking full advantage of their right to move and operate freely across borders in the internal market. Citizens could be forced to sell inherited assets just to cover the taxes, and small businesses could face transfer difficulties on the death of their owners. I believe it is our duty to find solutions to these problems.

The number of EU citizens who may be affected by cross-border inheritance tax rules is not insignificant. Even very conservative estimates point to a current figure of 290,000–360,000 potential cross-border inheritance cases per year in the EU. With more citizens than ever moving across borders for work and personal reasons, purchasing property and investing in assets abroad, it is likely that more citizens are going to receive inheritances or gifts across borders in the future.

The Commission's package consists of a Communication that analyses and summarises the possible solutions, a Recommendation comprising steps that member states could adopt to prevent double taxation, and a Commission-staff working paper that sets out principles for non-discriminatory inheritance tax systems.

Inheritance tax is, for this initiative, defined to cover all possible taxes levied on the death of an individual, irrespective of the name of the tax; the manner in which it is levied; whether it is applied at national, regional or local level in the EU; and whether it is imposed on the assets of the deceased person or on the heir. It is also defined to include taxes on gifts where these are made in anticipation of later inheritances and where they are taxed under the same or similar provisions as inheritances. This broad definition is intended to encompass the very different approaches to inheritance tax in member states.

While 18 member states levy specific taxes on death, the other nine (Austria, Cyprus, Estonia, Latvia, Malta, Portugal, Romania, Slovakia and Sweden) do not, but at least some of those nine tax inheritances under other headings such as income tax. Of those applying specific taxes on death, some apply it on the heirs (inheritance tax) while others apply tax (often called estate tax) on the basis of the assets of the deceased. Member states also differ significantly with regard to when and how they apply specific taxes upon death.

The Recommendation is designed to address double-taxation problems. Its aim is not to assign taxing rights to one or other countries in cross-border situations, because each member state has the right to tax as it chooses. Rather, it aims to eliminate the double taxation that may result from the parallel

exercise of taxing rights by two countries. The objective is to ensure that the taxpayer pays no higher tax than they would pay if they were only taxed by the country that imposes the highest tax. We believe this is a fair solution to double-taxation problems.

Inheritance taxes can, if applied by several member states simultaneously, quickly reach a very high level overall, even if no single member state involved applies a high level. This is because there are few ways to allow tax applied in one country to be set against tax due in another. Most member states allow some relief under their national rules for foreign taxes, but these relief provisions can be narrow in design; they often do not, for example, allow tax relief against specific inheritance taxes for income taxes, estate or stamp duties that other countries apply to the same inheritance.

In addition, unlike for income taxes, there are few bilateral inheritance tax treaties in place between EU member states (only 33 out of a possible 351). Nor are there any EU measures in place to prevent double or multiple taxation. Note also that some member states apply very high tax rates to inheritances, as much as 80 per cent, over certain thresholds, in cases where the deceased and the beneficiary are not related; double taxation in those cases would wipe out the value of the inheritance.

A further complication is the high number of instances where several member states can claim taxing rights over an inheritance. While income taxes are mainly applied on the basis of an individual's residence and income source, the picture is more complex for inheritance taxation. If an heir lives in one member state, the property they inherit is located in another member state and the deceased lived in a third member state, it is quite possible that all three countries will claim taxing rights over the inheritance. Other member states may also claim taxing rights if the heir and the deceased are domiciled or are nationals of different countries to their countries of residence.

## **The Recommendation**

The Recommendation therefore suggests an order of taxing rights and relief for previous taxation in cases where several member states have taxing rights over the same inheritance. The logic followed by the Recommendation is that the member state with the closest links first to the property, then to the deceased and then to the heir, should take precedence in terms of taxing rights.

In addition, the Recommendation suggests solutions to cases where the deceased or an heir has 'personal links' to more than one member state – for example if they are a resident in one of the states and domiciled in or a national of another. The Recommendation suggests that member states allow double-taxation relief for a reasonable period of time, such as ten years from the time limit by which inheritance taxes that they apply have to be paid. This is because member states vary in their rules about when assets are deemed to be transferred and when taxes are due, and a foreign inheritance tax may become due after a local inheritance tax has been levied.

*We aim to eliminate the double taxation that may result from the parallel exercise of taxing rights by two countries. We believe this*

## *is a fair solution*

The Recommendation encourages member states to deal with any disputes in the inheritance tax area, such as conflicts of closest personal links and conflicting definitions of the location of movable assets, by way of a mutual agreement procedure. This procedure could also help to resolve any cross-border issues related to the taxation of inheritances received through trusts. Member states are invited to introduce the solutions suggested in the Recommendation either in national legislation or by way of administrative measures adopting a more flexible interpretation of existing provisions.

The Recommendation does not entail a proposal for legally binding legislation, which the Commission views as unnecessary at this stage. The suggested solutions could be implemented by member states easily and quickly either by amending their current national provisions granting relief from double taxation on inheritances or by interpreting these provisions in a more flexible way.

The solutions proposed should not prejudice future bilateral or multilateral arrangements that member states may conclude to eliminate double inheritance tax.

## **Non-discriminatory systems**

The principles explain and illustrate how the operation of the fundamental freedoms under the EU Treaty and the prohibition of discrimination affect inheritance tax rules. Member states' inheritance tax rules may treat cross-border inheritances more harshly than local inheritances. They may, for example, apply a higher rate of inheritance tax where the assets or the deceased persons or the heirs are based in other countries than they would apply in purely local situations. In many cases, the problems may arise because the tax rules were designed before cross-border movement was as common as it is today.

If member states discriminate in this way, they may breach EU non-discrimination rules and can be taken to the Court of Justice of the European Union (the Court). The Court has already found aspects of member states' inheritance tax laws discriminatory in eight out of the ten cases it has examined since 2003. However, it is not always clear to the general public – and even to member states themselves – when inheritance tax laws are discriminatory. In addition, there may be many cases of discrimination that have not reached the Court, in particular because court cases may involve high costs for taxpayers.

The principles are, therefore, designed to assist member states in bringing their inheritance tax provisions into line with EU law and should also make EU citizens more aware of the rules that member states must respect when taxing cross-border inheritances. The principles are drawn from case law and demonstrate how inheritance tax rules should avoid discrimination with regard to, for example, the geographical location of the assets (different valuation methods for foreign assets), the residence of the deceased or the heir (lower personal allowances for foreign residents) and with regard to businesses (availability of tax allowances only if employees are local). The principles

complement, but do not replace, the Commission's ongoing infringement actions against those member states that apply inheritance tax rules that infringe EU law.

## **Next steps**

In conclusion, the Commission believes that it has, in its package, set out effective, efficient and proportionate solutions to the double-taxation and discrimination problems that can arise when inheritances are received across borders. Small changes in member states' rules to make them more coherent with each other could deliver real benefits for hundreds of thousands of people across Europe. This is what we aim to achieve.

The Commission will now launch discussions with member states to encourage them to change their national laws in the direction outlined. In three years, the Commission will present an evaluation report showing how the situation has evolved, and will take appropriate follow-up steps, including proposing legislation, if necessary. It will also monitor the number of inheritance tax complaints it receives from citizens.

## **Join the discussion**

What do you think? Email your opinion to [editor@step.org](mailto:editor@step.org)

## **Comment – Timothy Lyons QC**

*Timothy Lyons QC TEP is a member of the STEP EU Committee and the Cross-Border Estates Committee. He is a member of the expert group assisting the Commission in its review of the functioning of the EU Savings Tax Directive.*

For many individuals, including those responsible for small or medium-sized businesses, the internal market can be a dangerous place. As well as increased commercial risks, there are risks and difficulties in relation to indirect tax, direct tax, property law and succession law. So far as tax is concerned, Commissioner Šemeta refers to the possibility of a 'crippling' burden. He is right to do so. For some businesses survival will be at stake.

Discriminatory taxation is one risk. Even more devastating is the risk of double taxation, or worse, multiple taxation. It is good to see the Commission recognises it. In relation to business taxes, double-tax conventions can often be relied upon to minimise, although by no means eliminate, the problems. Much more difficult to deal with are issues that arise in relation to gift and inheritance taxes.

The owners and heirs to family businesses, in particular, may all face intractable difficulties in these areas. Often they are wrapped up in novel problems on questions of property or succession law.

Yet, in an internal market, there ought not to be discriminatory taxation. Neither ought there to be double or multiple taxation. Advocate General Colomer once said: 'The fact that a taxable event might be taxed twice is the most serious obstacle there can be to people and their capital crossing internal borders.'

What he would have said about multiple taxation in the context of inheritance and gift taxes can only be guessed at.

The Courts can help fight discriminatory taxation, but when it comes to double taxation they have so far proved themselves less powerful (although the extent to which the Court of Justice of the European Union accepts double taxation may be worth testing). Nevertheless, if courts' rulings on discriminatory taxation are to be effectively enforced and double taxation is to be eliminated, continuing resolute action by the EU Commission will be vital.

Many people, including many business people, will therefore be grateful to the EU Commission and to Commissioner Šemeta for pushing discriminatory and double taxation of inheritances up the agenda and for publishing proposals for measures to tackle inheritance tax problems.

Given the national sensitivities involved it is, perhaps, inevitable that the proposals do not take legislative form. But legislation of some kind may well be necessary. The issues that the Commission is now addressing have been aired for a long time. They were raised in particular at the time of the Ruding Committee report in March 1992 but have yet to be resolved.

It is good to see, therefore, that the Commission proposes to keep attention focused on these issues by publishing a report on the state of play three years after adopting the Recommendation. What will follow that? No doubt many members of STEP would be delighted to make suggestions. Their clients are unlikely to be as patient as the member states would hope.

© 2024 STEP (Society of Trust and Estate Practitioners). All rights in and relating to the STEP Journal and Trust Quarterly Review and to content online at [journal.step.org](https://journal.step.org) are expressly reserved.

<https://journal.step.org/step-journal-march-2012/eu-commission-tackles-iht-cross-border-obstacles>