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European Commission consultation on problems related to cross-border inheritance tax

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The European Commission has launched a public consultation on problems related to cross-border inheritance tax (IHT) within the EU and possible solutions to these problems. The consultation will run until 22 September 2010. Several cross-border IHT cases have been referred to the European Court of Justice (ECJ) in recent years. Among the problems that can occur in cross-border inheritance situations are double taxation and discriminatory application of IHT rules. When these problems arise, they can result in very high overall IHT rates and may, therefore, deter citizens and businesses from moving and operating freely within the internal market. The public consultation will play a valuable role in helping the Commission to establish the extent of any problems in this area and to determine what measures need to be taken with regard to cross-border IHT.

This article examines the background to the consultation, including EU competence over taxation, ECJ case law on inheritance and gift taxes, and the impact of the draft Regulation on succession law.

Background: EU competence over taxation

The full consequences of the ratification of the Maastricht Treaty were never foreseen: that the freedom of movement of people, goods, capital and services would have such increasingly far reaching effects. In a union with no internal borders, it becomes necessary to agree on issues of immigration and police powers in a common form across Europe. Taxation, however, has always been seen as an element of national sovereignty. The EU was thought to have no competence over direct taxation, only over VAT. However, when tax rules conflict with the free movement of people or capital who wins? The European

Commission Directorate General for Taxation and Customs Union (DGTCU) has recently been consulting on issues of double tax conventions and the internal market in its consultation paper, *Double Tax Conventions and the Internal Market: factual examples of double taxation cases (April 2010)*.

The days of member states being able to negotiate their own Hague Conventions are passing. Will double tax agreements be next in the firing line? The DGTCU is now consulting specifically in relation to IHT in its consultation paper, *Possible approaches to tackling cross-border inheritance tax obstacles within the EU (June 2010)*. How long can national sovereign governments protect their right to control all aspects of direct taxation? Do EU citizens value their area of freedom, security and justice above the rights of their state governments?

Double (and triple) inheritance taxation

Most states have a tax basis of residence for taxing income and capital gains. The taxation of inherited assets has a much more varied basis. It can be connected by:

- Domicile (www.practicallaw.com/8-382-5679).
- Deemed domicile.
- Residence.
- Habitual residence.
- Nationality.
- The situation of assets.

Equally the connecting factor may be that of:

- The deceased.
- The beneficiaries.
- A mixture of both.

Double or triple taxation is much more likely to arise in relation to inheritance than in any other area of taxation. Conversely, the numbers of double taxation agreements relating to inheritance are tiny. The USA has the most, but still only 18. The UK has ten. Within the EU and between member states, the number is very restricted. While France has treaties with eight other member states, Ireland only has a treaty with the UK. Although many states have forms of unilateral relief, it is often limited and with peculiar effects. In the UK some treaties override the deemed domicile rules; unilateral relief will not. Generally, unilateral relief is never given against foreign tax on assets situated in the relieving state. Definitions as to where property is situated may be different. Belgium only allows relief in relation to foreign tax on foreign immovables. Slovenia and Portugal have no system of unilateral relief at all.

Enter the ECJ

It has taken some years for the ECJ to have significant impact in relation to inheritance and gift taxes, but the number of cases increases and the body of law has become more established:

- *Barbier (Free movement of capital) (Case C-364/01) [2003] ECR I-15013*: the court found that calculation of IHT differently according to whether immoveable property was in one member state or another was in breach of the EU Treaty.
- *van Hilten-van der Heijden (Free movement of capital) (Case C-513/03) [2006] ECR I-1957*: although the court found that the right to free movement did not prevent the Netherlands from continuing to impose IHT on someone dying within ten years of leaving the Netherlands, it did make it very clear in paragraph 42 "that an inheritance is a movement of capital within the meaning of [now Article 63 of the TFEU] (see to that effect, also, *Case C-364/01 Barbier [at paragraph 58]*), except in cases where its constituent elements are confined within a single Member State".
- *Geurts and Vogten (Free movement of capital) (Case C-464/05) [2007] ECR I-9325*: provisions giving IHT exemption for a business employing workers in Belgium, but not outside Belgium, were in breach of the EU Treaty.
- *Jäger (Free movement of capital) (Case C-256/06) [2008] ECR I-123*: provisions governing the different valuation of agricultural property if inside or outside Germany were in breach of the EU Treaty.
- *Eckelkamp (Free movement of capital) (Case C-11/07) [2008] ECR I-6845*: provisions giving IHT and transfer tax relief for debts secured against immovable property in Belgium for persons dying resident in Belgium, but not for persons dying outside Belgium, were in breach of the EU Treaty.
- *Arens-Sikken (Free movement of capital) (Case C-43/07) [2008] ECR I-6887*: provisions accepting for IHT an *inter vivos* agreement as to partition with equality money in relation to immovable property in the Netherlands for persons dying resident

in the Netherlands, but not for persons dying outside the Netherlands, were in breach of the EU Treaty.

- *Block (Free movement of capital) (Case C-67/08) [2009] 2 CMLR 39*: an example of the court deciding that member states could tax the same capital twice and that this did not conflict with free movement of capital. Germany did not give unilateral credit for foreign tax paid on German assets. Spain regarded the Spanish bank account as situated in Spain and taxed it. Germany regarded it as situated in Germany since it belonged to a German taxpayer. The lack of unilateral relief was not in breach of the EU Treaty.
- *Mattner (Free movement of capital) (Case C-510/08) [2010] All ER (D) 167 (Apr)*: by contrast, this decision was that German gift tax rules that only gave an exemption to a German resident did conflict with the free movement of capital by reducing the value of a gift that included German property. (The case is also worth looking at to consider the distinctions between liability for tax in a particular state limited to assets in that state or worldwide and unlimited liability.)

The Treaty of Lisbon and other politics

The EU was thought to have no competence over direct taxation, only over indirect taxation and then only after unanimous approval of all member states.

The ***Lisbon Treaty (www.practicallaw.com/1-500-8458)*** came into force on 1 December 2009, although the timing of the introduction of some of its provisions is phased.

The Lisbon Treaty now sets out the basis for EU law making. A working knowledge of the structure of the new consolidated versions of the EU treaties is helpful when trying to understand the EU law making process. The Rome Treaty Establishing the European Community and the Maastricht Treaty on the European Union have now been replaced by the Treaty on the European Union (TEU) and the Treaty on the Functioning of the European Union (TFEU).

A detailed analysis of the changes made by the Lisbon Treaty and their likely effects will occupy scholars for some time to come. The Lisbon Treaty and the continued membership of the UK in the EU produces political fault lines. It is very difficult for any analysis not to slip onto one side of the fence or the other. The effects of the Lisbon Treaty are to change the political balance between the European Commission, the Council of Ministers and the European Parliament. No-one knows where it will end and what the result will be. All commentary has some innate political basis. The analysis of Professor Peers of the University of Essex prepared for Statewatch may be regarded as having somewhat less hidden influences at work than some others.

For a useful resource leading to the various EU texts and these analyses, see *Statewatch Observatory on the EU Constitution: Lisbon Treaty*. For more information about the Lisbon Treaty generally, see *Practice note, The European Union after the Treaty of Lisbon (www.practicallaw.com/2-381-1190)*.

Title IV of the TFEU deals with the free movement of persons, services and capital. Chapter 4 deals with capital and payments. An inheritance is a movement of capital for the purposes of the TFEU. Article 63 of the TFEU prohibits the restriction on the free movement of capital, but Article 65.1(a) of the TFEU limits such prohibition so that it is without prejudice to the right of member states to apply the relevant provisions of their tax law that distinguish between taxpayers who are not in the same situation with regard to their place of residence or with regard to the place where their capital is invested.

Title VII of the TFEU deals with common rules on competition, taxation and approximation of laws. Chapter 2 covers taxation and Article 113 of the TFEU deals with harmonisation of indirect taxation.

The Lisbon Treaty added the words "and to avoid distortion of competition" at the end of what is now Article 113. It will be interesting to see whether this has any material broadening of its effect.

Protocol No 27 of the TFEU on the internal market and competition gives the EU power to take action under the TEU and TFEU and specifically under Article 352 of the TFEU to ensure that competition is not distorted. Some argue that this may give added weight in applying the internal market rules to remove such distortions.

The tax harmonisation provisions of Article 113 require unanimity and only apply to indirect taxation although that term is not defined. It is possible that harmonisation of direct taxes is possible under Article 352.

Draft Regulation on succession

The draft Regulation 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 (known as Brussels IV) was published on 14 October 2009 and is currently subject to negotiation within the Council of Ministers and within the EU Parliament. Although the UK and Ireland have not chosen to opt in at this stage, it is open to either state to opt in later. The Regulation is unlikely to be finalised until the end of 2011 and will probably not come into force for a further three years.

It is recognised that each member state's system of IHT is geared to that state's system of succession. In England and Wales it is generally possible for the deceased's estate to pass to the surviving spouse and in those circumstances is usually exempt from IHT (see *Practice note, Inheritance tax: overview: Gifts to a spouse or civil partner (www.practicallaw.com/3-383-5652)*). In other states, minimum IHT usually coincides with succession in equal shares to a surviving spouse and children.

Cross-border enforcement of succession law is therefore likely to lead to distortions in IHT and in the consequent movement of capital.

In the longer term therefore, whether or not the UK or Ireland opt in to Brussels IV, its effects on cross-border inheritance and thus on the EU acting to harmonise IHT, are likely to be felt throughout the EU.

In the light of the *Jäger* case, the UK has been forced to amend its IHT *relief for agricultural property (www.practicallaw.com/0-383-5823)* (APR) and extend APR to property anywhere in the EU and the European Economic Area (see *2008 Pre-Budget Report to Finance Act 2009: legislation tracker: APR and woodlands (section 122) (www.practicallaw.com/9-384-6940)*).

Would the UK limited spouse exemption of £55,000 withstand the scrutiny of the ECJ? This is less clear, since the UK distinguishes between spouses of different domiciles rather than of different nationalities or residencies. However, Article 65.1(a) of the TFEU does not seem to give the UK protection.

Political pressures from the EU are likely to continue and a provision which has the effect of taxing spouses originating from outside the UK, but not taxing spouses originating from within the UK, looks in danger.

If HMRC claims IHT on the basis of the limited spouse exemption for a spouse who is a national of another EU member state, it may be worth reserving a client's position.

Conclusion

The balance of power between EU institutions and member states, and between the European Commission, the Council of Ministers and the European Parliament continues to shift. In what direction and with what effect is unknown by all. All are encouraged to respond to the existing consultation.

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