TRUST & ESTATE PLANNING

Cross-border inheritance tax problems within the European Union

By Henry Charles

The European Commission is consulting in order to collect information on the progress made in European Union (EU) countries in tackling cross-border inheritance tax (IHT) problems.

What is the problem?

In the EU some people can effectively pay IHT twice or more in different countries.

Why is that?

EU countries have to respect EU treaties and in particular are not allowed to discriminate against EU citizens when imposing IHT. However, they are not obliged to harmonise or coordinate their policies on IHT and two or more countries can impose their taxes in parallel.

As a result there are a number of mismatches including:

- Some countries apply a tax on the heirs, whilst others levy IHT on the basis of the estate.
- There can be a variety of relevant factors including the residence, domicile or nationality of the deceased or heir, despite the EU requirement not to discriminate; and/or the location of the property.
- Different valuation methods.
- The different characterisation of assets depending on different ways of holding property e.g. there is no clear English authority on whether a partner's interest in partnership land is an interest in moveable or immovable property.
- Different exemptions and reliefs.
- Different tax rates for certain groups of beneficiaries.
- Lack of double taxation agreements covering IHT.
- Unilateral relief not available or incomplete

What has been done?

In 2010 the Commission consulted the public on possible approaches to tackling cross border IHT obstacles for citizens and SMEs within the EU. It received contributions which it summarised in a report. Around half of the opinions concerned solutions at EU level ranging from an EU model double taxation relief provision, to the establishment of common rules to determine the basis of taxation. One third suggested the extension of the treaty network within the EU while a quarter expressed a preference for the application of unilateral relief mechanisms.

In 2011 the Commission asked EU countries to consider modifying their existing domestic rules for relieving double IHT such as by introducing a credit for tax paid in another EU country or exempting certain items of foreign property from the domestic tax base. The commission also recommended an order of taxing rights (i.e. which state has the primary right to tax the inheritance) based on the standards commonly accepted in international tax practice. Separately, the EU Court of Justice has heard an increasing number of cases in relation to inheritance and gift taxes.

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What is happening now?

The Commission has launched a public consultation to receive contributions regarding the way its 2011 recommendations have been implemented in the legislative and administrative practice of EU countries together with any information on current problems, views on the principles proposed and feasible solutions.

It reiterates its 2011 recommendations which include the following proposals:

"... that EU countries in which immovable property and business property of a permanent establishment is situated should, as the country with the closest link, have the primary right to apply inheritance tax to such property. In respect of movable property the Commission has proposed to favour the personal links that the deceased or the heir may have with its EU country over the link that the movable property has with the EU country where it is located. The EU country where such movable property is situated should, therefore, exempt the property from its inheritance taxation if such taxation is applied by the EU country with which the deceased and/or the heir has a personal link. In respect of the personal link the Commission has proposed to favour that which the deceased person had with its state rather than the link of the heir.

... proposed to solve potential conflicts of many personal links to several EU countries on the basis of a mutual agreement procedure involving tie-breaker rules to determine the closest personal link. The tie breaker rule is to some extent based on Article 4.2 of the OECD Model Tax Convention on Income and Capital. The tie breaker rule assumes that the person has closer links with one of two or more states, if that person has a permanent home available in one of those states. If that person has such homes available in more than one states, then the priority is given to a country with which his/her personal and economic relations are closer. If the above cannot help then the decisive factors would be the habitual abode (where the person usually lives) and, finally, the nationality.

... proposed a period of 10 years to use the tax relief since the timing for the application of inheritance tax may differ in the EU countries involved and cases with cross-border elements may take significantly longer to be resolved compared to domestic inheritance tax cases. The Commission has considered that in cross-border inheritance tax cases citizens deal with more than one legal and/or tax system and therefore EU countries should allow claims for tax relief for a reasonable period of time."

Looking forward

This article has gone to press just after the period of consultation ended. In a future edition of the Insider I will report on the Commission's findings. Increasing globalisation and in particular the free movement of people within the EU means that cross-border IHT is an increasingly important issue to consider. The fact that the EU is making recommendations to avoid double taxation serves to highlight the problem and is an area where GGI practitioners can liaise to help our clients.

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