Taxation of cross-border inheritances and donations: suggestions for improvement

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CHAPTER 7

Separate solutions at the EU level

This chapter deals with separate solutions to the problems of cross-border death and gift taxation at the EU level. Before suggesting solutions to these problems, however, I review the progress made in the EU regarding each problem to assess whether the current mechanisms employed at the EU level are effective.

In the course of my research, I observed that very little progress had been made at the EU level in addressing the problem of double or multiple taxation of inheritances. The same is true with regard to the double or multiple non-taxation of inheritances. On the contrary, by declaring several discriminatory inheritance and gift tax provisions of the EU Member States contrary to EU law, the Court has contributed the most to the so-called "negative harmonisation" of inheritance and gift taxes. Finally, administrative difficulties of the cross-border inheritances and donations are dealt with – up to a certain extent – by two EU Directives, which apply to any type of death and gift taxes.

7.1 Double or multiple taxation

The 2015 inheritance tax report extensively discussed the double or multiple taxation problem of cross-border inheritances and donations within the EU. According to the report, "[t]he number of people leaving property situated in two or more Member States when they die is growing rapidly. Many of their families will soon discover that tax on inheritance can often be claimed by each of the Member State concerned. It does not take long for multiple taxation, even at low rates, to amount to expropriation."[1] In the same line, the report of the Copenhagen Economic Institute "Study on inheritance taxes in the EU Member States and possible mechanisms to resolve problems of double inheritance taxation in the EU"[2], issued in 2010, stated that "from a macro perspective, the existing evidence shows that the scale of double taxation problem in the field of inheritance is relatively small […]. However, for the individual EU citizens who are exposed to double taxation, the conclusion may be far different. To these EU Citizens, it may have a major negative impact on their personal financial situation that their inheritance is taxed in more than one Member State."[3]

1 EU, *"Ways to Tackle Inheritance Cross-Border Tax Obstacles Facing Individuals within the EU"*, report prepared by the European Commission Expert Group, para. 5, p. 5.

2 Copenhagen Economics Institute, *Study on inheritance taxes in the EU Member States and possible mechanisms to resolve problems of double inheritance taxation in the EU* (2010), 13. This respectable report has been commissioned by the EC.

3 Copenhagen Economics Institute, *Study on inheritance taxes in the EU Member States and possible mechanisms to resolve problems of double inheritance taxation in the EU* (2010), 11.

While considering that in January 2014, the number of individuals living in an EU Member State other than their home state was estimated at 14 million[4] and that an individual's wealth can be located in several EU Member States, double or multiple taxation can become a serious obstacle to the smooth functioning of the internal market defined in Article 26(2) TFEU as "an area without internal frontiers in which the free movement of goods, persons, services, and capital is ensured in accordance with the provisions of the Treaties."

Nevertheless, the progress made within the EU towards addressing double or multiple taxation of inheritances and donations is admittedly not commensurate with the effects of the problem on the internal market and the EU taxpayers. This is true given that the EU fundamental freedoms do not deal with the juridical double or multiple taxation (section 7.1.1) and the EC's recommendation has failed to achieve its objective nine years after its issuance (section 7.1.2).

7.1.1 EU fundamental freedoms and juridical double taxation of inheritances

Despite the adverse effect of double or multiple taxation on the smooth functioning of the internal market, it is settled case law of the Court that the EU fundamental freedoms do not protect against juridical double taxation.[5] Although in the inheritance tax case *Van Hilten* (C-513/03) the Court raised the importance of the unilateral credit by the state of the deceased's extended residence, it became clear from *Block* (C-67/08) that the EU Member States are not obliged "to adapt their own tax systems to the different systems of tax of the other Member States."[6]

Ms Block, a German resident, was the sole beneficiary of a person who died in Germany. The inheritance of that person consisted of, *inter alia*, capital claims against financial institutions in Spain. Germany taxed these claims in its capacity as the state of the personal nexus (as both the deceased and the beneficiary were resident in Germany). On the other hand, Spain taxed the claims in its capacity as the state of the objective nexus (because the capital claims were sited in its territory under Spanish law). Ms Block, therefore, paid inheritance tax in both EU Member States and subsequently, requested a credit for the Spanish inheritance tax against the German inheritance tax. The German tax authorities rejected her application because the claims against financial institutions in Spain were not considered "foreign assets", for which a foreign tax credit would be available.[7] She was only allowed to deduct the Spanish tax from the German inheritance tax base as a debt of the estate.

Under German law, a foreign tax credit is available if the asset, which was subject to tax abroad, was considered a foreign asset under German situs rules. This was not the case of the capital claims at hand because Germany would not have taxed them if it were only the state of the objective nexus.[8] On the other hand, Spain was subjecting those claims

4 EU, *"Ways to Tackle Inheritance Cross-Border Tax Obstacles Facing Individuals within the EU"*, report prepared by the European Commission Expert Group, para. 5, p. 5.

5 ECJ, *Kerckhaert and Morres* (C-513/04), ECJ, *Jacques Damseaux v Belgian State* (C-128/08).

6 ECJ, *Block* (C-67/08), para. 31.

7 This is because, as noted in section 3.1.1.10, some states provide for a unilateral double taxation relief only for assets that they would have taxed if they were taxing them in their capacity as states of the objective nexus.

8 Germany was taxing the claims tax if the creditor (i.e. the deceased) was a resident of Germany.

to inheritance tax if the debtor (i.e. the financial institution) was a resident in Spain. As a result, the capital claims at hand were taxed in both Germany (personal nexus rule) and Spain (objective nexus rule). This gave rise to juridical double taxation due to a residence vs source conflict. Nevertheless, the Court held that:

"30. Community law, in the current stage of its development and in a situation such as that in the main proceedings, does not lay down any general criteria for the attribution of areas of competence between the Member States in relation to the elimination of double taxation within the European Community. Consequently, […] no uniform or harmonisation measure designed to eliminate double taxation has as yet been adopted at Community law level (see Kerckhaert and Morres, paragraph 22, and Columbus Container Services, paragraph 45).

31. It follows from this that, in the current stage of the development of Community law, the Member States enjoy a certain autonomy in this area provided they comply with Community law, and are not obliged therefore to adapt their own tax systems to the different systems of tax of the other Member States in order, inter alia, to eliminate the double taxation arising from the exercise in parallel by those Member States of their fiscal sovereignty and, in consequence thereof, to allow the inheritance tax paid in a Member State other than that in which the heir is resident to be deducted in a case such as that of the main proceedings (see, to that effect, Columbus Container Services, paragraph 51)."[9]

It follows from the *Block* case – which is in line with the Court's previous case law on juridical double taxation[10] – that the Court views juridical double taxation as the outcome of disparities in tax systems of two EU Member States.[11] As a result, it falls outside the scope of the EU fundamental freedoms that protect against discrimination arising within a *single* EU Member State. On the contrary, juridical double taxation is the outcome of the parallel application of *two or more* EU Member States' inheritances tax legislations. In the Court's view, double taxation of inheritances and donations can only be addressed through a "uniform or harmonisation measure designed to eliminate double or multiple taxation" at the EU level. I observe, however, that to date, such a measure has not been proposed in the EU. On the contrary, the double or multiple taxation problem of cross-border inheritances and donations is currently dealt with by a coordination measure, the EC's recommendation 2011/856 regarding relief for double taxation of inheritances.

7.1.2 The EC's recommendation 2011/856 regarding relief for double taxation of inheritances

7.1.2.1 Introduction

On 15 December 2011, the EC released a package dealing with issues related to double taxation and discriminatory tax treatment in the area of inheritance and gift taxation. Among other documents, this package included a recommendation regarding relief for the

9 *Id.*, paras. 30, 31.

10 ECJ, *Kerckhaert and Morres* (C-513/04), ECJ, *Jacques Damseaux v Belgian State* (C-128/08).

11 On the concept of disparities, see also ECJ, *Egon Schempp v Finanzamt München V* (C-403/03) and Sjoerd Douma, "*Optimization of tax sovereignty and free movement*" (Amsterdam, IBFD, 2011), 135-142.

double taxation of inheritances (the EC's recommendation 2011/856/EU).[12] Preceding the issuance of the EC's recommendation, the EC's Communication on "Double taxation in the Single Market"[13] recognised that existing and planned legislation for relieving the double taxation of income and the capital could not efficiently handle cross-border inheritance and gift tax issues. Therefore, distinct solutions would be necessary for this area. The EC's recommendation serves in that regard as the one and only "separate solution" to the double or multiple taxation problem of cross-border inheritances and donations in the EU.

While being aware of the fact that a full harmonisation of national inheritance and gift tax systems would be disproportionate to the objective of addressing this problem, the EC, by proposing the recommendation, followed a soft law approach aiming at the *coordination* of the EU Member States' national legislations instead of their harmonisation.[14] In its view, if the EU Member States follow the recommendation and integrate its provisions into their national inheritance and gift tax systems, the juridical double and multiple taxation problem of inheritances can be resolved.[15]

The general objective of the EC's recommendation is mentioned its Article 3. The recommendation aims at "resolving cases of double taxation so that the overall level of tax on a given inheritance is no higher than the level that would apply if only the Member State with the highest tax level among the Member States involved had tax jurisdiction over the inheritance in all its parts."

The recommendation contains in Article 2(a) a broad definition of the term "inheritance tax". More specifically, "inheritance tax means any tax levied at national, federal, regional, or local level upon death, irrespective of the name of the tax, of the manner in which the tax is levied and of the person to whom the tax is applied, including in particular estate tax, inheritance tax, transfer tax, transfer duty, stamp duty, income and capital gains tax."[16] Therefore, the recommendation applies to any death taxes levied by the EU Member States. Of note is that it applies by analogy to gift taxes where gift taxes are levied under the same or similar rules as inheritance taxes (Article 1.2). The recommendation further defines the terms "tax relief,"[17] "assets" and "personal link".

However, it leaves the following terms undefined: "permanent establishment", "immovable property", "movable property", "resident", "domicile", "nationality", "habitual

12 See also Rik Deblauwe, Anouck Biesmans, Bianca de Kroon and Frans Sonneveldt, "Gift and Inheritance Tax with Regard to Charities," in *Taxation of Charities*, ed. Frans Vanistendael (Amsterdam: IBFD, 2015), 88.

13 European Commission Communication, Double Taxation in the Single Market, COM (2011) 712 final.

14 European Commission Staff Working Paper, Impact Assessment accompanying the document Commission Recommendation regarding relief for double taxation of inheritances, SEC (2011) 1489,37.

15 Edouard-Jean Navez, "The Influence of EU Law on Inheritance Taxation: Is the Intensification of Negative Integration Enough to Eliminate Obstacles Preventing EU Citizens from Crossing Borders within the Single Market?," *EC Tax Review* 21, no.2 (2012): 93.

16 Furthermore, for the purposes of point (a), previously paid gift tax on the same asset is considered as inheritance tax for the purposes of granting tax credit.

17 Article 2(b) of the recommendation defines the term "tax relief" as follows: "'tax relief' means a provision contained in legislation and/or general administrative instructions or guidance whereby a Member State grants relief for inheritance tax paid in another Member State, by crediting the foreign tax against tax due in that Member State, by exempting the inheritance or parts of it from taxation in that Member State in recognition of the foreign tax paid or by otherwise refraining from the imposition of inheritance tax".

abode" and "permanent home". These terms are defined either by the domestic law of the EU Member State applying them or by a mutual agreement procedure (Article 6).

The recommendation contains three main rules regarding the provision of tax relief. Under Article 4.1, an EU Member State should allow tax relief for inheritance tax applied by another EU Member State on immovable property situated in that other EU Member State (Article 4.1 (a)) and on movable property that is the business property of a PE situated in that other EU Member State (Article 4.1 (b)). It follows that the recommendation respects the allocation of taxing rights suggested by the OECD IHTMTC. Articles 4.1(a) and 4.1(b) are, therefore, in line with Articles 5 and 6 of the OECD IHTMTC respectively.

Furthermore, under Article 4.2, "[i]n respect of movable property other than business property as referred to in Article 4.1(b), a Member State with which neither the deceased nor the heir has a personal link should refrain from applying inheritance tax provided that such tax is applied by another Member State by reason of the personal link of the deceased and/or the heir to that other Member State." Article 4.2 thus precludes the EU Member State of the objective nexus to tax the movable property (not connected to the business property of a PE) as long as another EU Member State taxes this property based on the personal nexus of the deceased and/or the beneficiary with it. It follows that this Article aims at limiting the broad situs rules of several EU Member States,[18] which may otherwise claim to tax the movable property concerned.

Article 4.2 is similar to Article 7 of the OECD IHTMTC as it precludes the EU Member State of the objective nexus to tax.[19] It has, however, a broader scope: Article 4.2 of the recommendation suggests that *any* EU Member State with which the deceased and/or the beneficiaries have no personal nexus is not allowed to tax the movable property that is situated there and is not connected to the business property of a PE. As a result, it addresses cases of double or multiple taxation. Moreover, I observe that the rule applies only if another EU Member State taxes the movable property based on the personal nexus of the deceased and/or the beneficiary with it, a condition which is not included in Article 7 of the OECD IHTMTC.

Moreover, under Article 4.3 "[s]ubject to paragraph 4.1, in cases where more than one Member State can apply taxation to an inheritance on the basis that a deceased had personal links with one Member State and the heir has personal links with another Member State, then the second Member State should give tax relief for the tax paid on the inheritance in the Member State with which the deceased had personal links." It follows from Article 4.3 that the taxing rights of the EU Member State of the deceased's personal nexus take precedence over those of the EU Member State of the beneficiaries' personal nexus. The underlying principle of this Article is that inheritances have often been accumulated over the lifetime of the deceased. Moreover, the assets contained in an inheritance are more likely to be located in the EU Member State to which the deceased had personal links than in the EU Member State to which the beneficiary has personal links. Finally, a majority

18 See also, Frans Sonneveldt, "Voldoet Nederland aan de aanbeveling van de Europese Commissie op het gebied van grensoverschrijdende erfbelasting?," *WPNR Weekblad voor Privaatrecht Notariaat en Registratie* 6334 (2012): 444.

19 *Id.*

of EU Member States impose death and gift taxes on a worldwide basis according to the personal nexus of the deceased with their territory.[20]

The recommendation contains a tiebreaker rule in Article 4.4 in cases of multiple personal links of an individual (Article 4.4.1) or a person other than an individual (Article 4.4.2). It is suggested that the attachment of an individual or a legal entity to an EU Member State be determined through a mutual agreement procedure "set out" in Article 6, or otherwise. The connective criteria used in Article 4.4.1 (for individuals) and Article 4.4.2 (for persons other than individuals) are similar to those of the OECD ICTMTC's and OECD IHTMTC's tiebreaker rule.

Finally, under Article 5 of the recommendation, EU Member States should allow tax relief for a reasonable period, e.g. ten years from the time limit by which inheritance taxes that they apply have to be paid.

As noted in the 2015 inheritance tax report, several years have passed since the adoption of the recommendation and it seems that it has failed to generate sufficient action and is not going to lead to any fundamental change in the approach of Member States to the problem of double taxation of inheritances.[21] However, it has not been entirely ignored. For example, as per the report, it was debated in 2011 in the Polish legislature and the Netherlands' finance minister has stated that the Netherlands' unilateral relief will be applied more liberally.[22] Academic literature has already noted that the Netherlands broadly complies with the suggestions of the recommendation.[23]

In the course of my research, I observed that the recommendation has some innovative aspects (section 7.1.2.2) and problematic aspects (section 7.1.2.3).

7.1.2.2 The innovative aspects of the recommendation

By issuing the recommendation, the EC attempted to *coordinate* the EU Member States' provisions concerning relief for the double taxation of inheritances and donations by means of a non-binding legal instrument. The non-binding force of the recommendation derives from Articles 288 section 5 TFEU and 292 TFEU. Under Article 288 section 5 TFEU, "[r]ecommendations and opinions shall have no binding force." Furthermore, under Article 292 TFEU, "[t]he Council shall adopt recommendations. It shall act on a proposal from the Commission in all cases where the Treaties provide that it shall adopt acts on a proposal from the Commission. […]."

It follows from the above that recommendations do not have binding force. The EU Member States, thus, are not obliged to follow the recommendations and are not sanctioned if they ignore them. However, in *Grimaldi*, the Court ruled that:

"it must be stressed that the measures in question [author: two EC's recommendations] cannot, therefore, be regarded as having no legal effect. *The national courts are bound to*

20 Preamble p. 17 of the recommendation and Frans Sonneveldt, "Voldoet Nederland aan de aanbeveling van de Europese Commissie op het gebied van grensoverschrijdende erfbelasting?," *WPNR Weekblad voor Privaatrecht Notariaat en Registratie* 6334 (2012), 444.

21 EU, *"Ways to Tackle Inheritance Cross-Border Tax Obstacles Facing Individuals within the EU"*, report prepared by the European Commission Expert Group, para. 10, p. 18.

22 *Id.*, p.18.

23 Frans Sonneveldt, "Voldoet Nederland aan de aanbeveling van de Europese Commissie op het gebied van grensoverschrijdende erfbelasting?," *WPNR Weekblad voor Privaatrecht Notariaat en Registratie* 6334 (2012), 445-450.

take recommendations into consideration in order to decide disputes submitted to them, in particular where they cast light on the interpretation of national measures adopted in order to implement them or where they are designed to supplement binding Community provisions (Italics, VD)."[24]

Despite its non-binding force, the EC's recommendation has some innovative aspects that should be considered when dealing with the double and multiple taxation problem of cross-border inheritances and donations.

7.1.2.2.1 Broad scope

First, the definition of the term "inheritance tax" in Article 2(a) of the recommendation is remarkably broad. The term shall mean *any* death tax levied in the event of death, thus, also *mortis causa* income and capital gains taxes. Furthermore, the recommendation applies by analogy to gift taxes (Article 1.2). The broad definition of the term "inheritance tax" and the application of the recommendation to gift taxes by analogy admittedly widen its scope as the EU Member States are suggested to grant double taxation relief also for foreign death and gift taxes that are different from those levied in their territory. Therefore, I am of the view that in relation to this point, the recommendation is in line with its objective, i.e. addressing double and multiple taxation cases, as mentioned in its Articles 1.1. and 3.

As a matter of example, the recommendation suggests that a *mortis causa* capital gains tax levied in the EU Member State B be credited against the inheritance tax levied in the EU Member State A, as both taxes shall be considered inheritance taxes.

7.1.2.2.2 Double or multiple taxation

Moreover, I note that Article 4.1 of the recommendation broadly follows the division of taxing rights of the OECD IHTMTC. Therefore, the primary taxing rights regarding immovable property and movable property connected to a PE are assigned to the EU Member State of the objective nexus. Nevertheless, I observe that the EC went one step further by suggesting in Article 4.2 of the recommendation the restriction of the EU Member States' situs rules with regard to *other* kinds of movable property. Therefore, under Article 4.2 of the recommendation, an EU Member State is precluded from taxing the movable property, which is located in its territory *and* is taxed under its domestic situs rules, if another EU Member State taxes this property by reason of the deceased's and/or the beneficiaries' personal nexus.

Article 4.2, in my view, is particularly effective in situations involving more than two EU Member States. More specifically, if the deceased died in EU Member State A and his beneficiaries are residing in EU Member State B while his movable property (not connected to a PE) is located in EU Member State C, the latter state is suggested to refrain from taxing this property if EU Member State A or B tax this property on the basis of the deceased's and/or the beneficiaries' personal nexus. Therefore, I am of the view that in relation to this point, the recommendation is in line with its objective, i.e., addressing cases of double and multiple taxation, as mentioned in its Articles 1.1. and 3.

24 *Grimaldi* (C-322/88), para. 18 and Jan Szczepański, "Personal Genuine Links under Domestic Inheritance Tax Rules in the light of International and European Standards," *Intertax* 43, no. 10 (2015): 607.

Article 4.2 admittedly contains a very practical rule, which, if followed by the EU Member States, addresses cases of multiple taxation. If the EU Member State of the objective nexus is precluded from taxing the movable property not connected to a PE, double taxation may only arise between the EU Member State of the deceased's personal nexus and the EU Member State of the beneficiaries' personal nexus.[25], [26] Of note is that Article 4.2 suggests that the EU Member State of the objective nexus shall not tax, thus the EU Member State of the deceased's or beneficiaries' personal nexus does not have to provide relief in the first place.

In cases where both the EU Member State of the deceased's personal nexus and the EU Member State of the beneficiaries' personal nexus seek to tax the cross-border inheritance and/or donation, Article 4.3 suggests that the latter state provide relief for the tax paid in the former state. As a result, the primary taxing rights belong to the EU Member State of the deceased's personal nexus. Finally, I note that, contrary to Article 4.2, Article 4.3 does *not* preclude the EU Member State of the beneficiaries' personal nexus from taxing the cross-border inheritance or donation.

7.1.2.3 The aspects of the recommendation that could be improved

In my view, the recommendation has certain problematic aspects, which are all connected to the lack of definition of critical terms of its rules. More specifically, under Article 2, last section, "[t]he terms 'permanent establishment', 'immovable property', 'movable property', 'resident', 'domicile/ domiciled', 'national/nationality', 'habitual abode', and 'permanent home' have the meaning applicable under the domestic law of the Member State applying the term."

The problematic aspects that are connected to the lack of definition of critical terms, are as follows: the unrelieved double taxation, the tiebreaker rule and the mutual agreement procedure.

7.1.2.3.1 Unrelieved double or multiple taxation

I observe that the lack of definition of the terms mentioned above may lead to cases of *unrelieved* double or multiple taxation, thereby making the rules of the recommendation practically ineffective. For example, the term "immovable property" is not defined. As a result, it has the meaning under the domestic law of the EU Member State applying this term. If, for example, the inheritance of a person resident in EU Member State A, includes a company holding immovable property in EU Member State B, both states may seek to tax. More specifically, EU Member State B may apply a look-through approach and seek to tax the immovable property in line with Article 4.1 (a) of the recommendation. On the other hand, EU Member State A may regard the company shares as movable property and

25 In such a case, Article 4.3 of the recommendation would be applicable.

26 On the contrary, if the assets of a cross-border inheritance/donation are located also in a third state which has not concluded a double tax treaty with the state of the deceased's fiscal domicile, the third state can still tax these assets even in the absence of any personal links with the deceased or the beneficiaries.

seek to tax them in line with Article 4.2 of the recommendation.[27] Both EU Member States, therefore, may consider that they have the primary right to tax. They will also not grant double taxation relief for the tax paid in the other EU Member State.[28] It follows that this situation gives rise to double taxation that is attributable to differences in domestic law classifications. This outcome, however, seems to counter the objective of the recommendation, as mentioned in its Articles 1.1. and 3.

The risk of double taxation due to differences in domestic law classifications has already been dealt with by the "new approach" within the framework of the income and capital tax model. In that regard, I suggested that this approach should also apply to the OECD IHTMTC due to the insufficient alternative wording of the Commentary of the model (section 6.1.7). In the same vein, it would have been better if the EC's recommendation had contained a provision that could safeguard that differences in domestic law classifications would not result in double or multiple taxation. In line with this provision, the EU Member State of the personal nexus must follow the classification that the EU Member State of the objective nexus grants to the property at hand. It is understood that this approach applies only if the EU Member State of the objective nexus seeks to tax the property mentioned in Article 4.1.(a) or (b) of the EC's recommendation because only in such a case, is this state, in principle, allowed to exercise its taxing rights.

7.1.2.3.2 The tiebreaker rule

As I mentioned in section 7.1.2.1, the tiebreaker rule of Article 4.4.1 of the recommendation is similar to that of the OECD IHTMTC (Article 4(2) of the model). As a result, preference is given, in descending order, to the individual's permanent home, centre of vital interests, habitual abode, and nationality. In the case of a person other than an individual, its closer personal link could be deemed to be with the EU Member State in which its place of effective management is situated. It is noteworthy that the tiebreaker rule of the recommendation equally applies to both the deceased and the beneficiaries in comparison with the OECD IHTMTC's tiebreaker rule, which applies only at the level of the deceased or the donor. Furthermore, like the OECD IHTMTC's tie-breaker rule, the rule seems to disregard two important elements for the determination of the individual's lifelong attachment with an EU Member State, namely the intention to reside and a minimum period of presence in a particular EU Member State. As a result, a minimum period of presence in an EU Member State preceding the death or the donation as well as a reference to individual's clear intention to retain his permanent home in the EU Member State could have been inserted in Article 4.4.1 (a). In addition, the term "permanent home" should not have been left undefined.

Finally, I observe that the application of the connective criteria of the tiebreaker rule of Articles 4.4.1 and 4.4.2 seems to be optional to the EU Member States. This is based on the wording of Articles 4.4.1. and 4.4.2: "a closer personal link of an individual *could be*

27 To be accurate, Article 4.2. of the recommendation precludes EU Member State B to tax provided that EU Member State A taxes the deceased's movable property (other than movable property of a permanent establishment).

28 See also Inge van Vijfeijken and Hedwig van der Weerd-van Jolingen, "Double Taxation of Inheritances and the Recommendation of the European Commission," *EC Tax Review* 21, no. 6 (2012): 311, 314.

determined as follows:" (Italics, VD) and "in the case of a person other than an individual, such as a charity, its closer personal link *could be* deemed to be […]" (Italics, VD), respectively. Nevertheless, this does not guarantee, in my view, a common and coordinating approach in case of multiple personal links of an individual and an entity.

7.1.2.3.3 The mutual agreement procedure

Under Article 6 of the recommendation, "[w]here necessary in order for the general objective set out in point 3 to be attained, Member States should operate a mutual agreement procedure to deal with any disputes connected with double taxation, including conflicting definitions of movable and immovable property or of the location of assets or the determination of the Member State which should provide tax relief in a given case."

The question arises, however, whether the mutual agreement procedure of Article 6 can also be initiated in the absence of a tax treaty concluded between the EU Member States involved. At a second level, it is unclear whether the recommendation suggests the initiation of the mutual agreement procedure under an inheritance and gift tax treaty or also that of an income and capital tax treaty.[29]

In my view, it would have been better if the recommendation had provided detailed rules for a mutual agreement procedure with clearly defined steps for settling disputes connected with the double and multiple taxation of inheritances and donations. As a result, the mutual agreement procedure can be improved considering the objectives of the recommendation, as mentioned in its Articles 1.1. and 3. As the EC decided to leave important terms undefined, the EU Member States should at least have been able to operate an effective mutual agreement procedure to deal with disputes, including those arising from the divergent definition of critical terms. Finally, the detailed rules should have taken into account that the dispute must be settled as soon as possible. According to the 2015 inheritance tax report, "[the mutual agreement procedure] is unlikely to be a speedy procedure and cannot be attractive in situations where free movement of individuals is fast increasing."[30]

7.1.3 Conversion of the EC's recommendation to an EU Directive

The issuance of the recommendation was not incidental as explained in the 2011 EC's Working Paper – Impact Assessment. This document accompanied the recommendation and explained why the EC decided to take specific actions to address, among others, the double and multiple taxation of cross-border inheritances and donations. In this document, the EC discussed the various policy options to address those problems and assessed the available

29 Notwithstanding the fact that "The mutual agreement procedures established under double tax treaties on IHT suffer from the well-known practical deficiencies, which are also present in the procedures established in treaties on income tax", EU, "Ways to Tackle Inheritance Cross-Border Tax Obstacles Facing Individuals within the EU", report prepared by the European Commission Expert Group, para. 10, p. 14.

30 *Id.*, para. 25, p. 20.

options based on their effectiveness, proportionality, efficiency/ease implementation and flexibility.[31] The policy options are as follows:

- Continuation of the current situation (policy option B1),
- EC's recommendation regarding (unilateral) national provisions designed to relieve double taxation of inheritances (policy option B2),
- EC's recommendation regarding relief for double taxation through bilateral agreements between EU Member States designed to relieve double taxation of inheritances (policy option B3),[32]
- Binding rules governing bilateral agreements: adoption into EU law of a) a single basis for determining the tax liability, such as the location of assets or the residence of the deceased, etc. in bilateral relations, or b) minimum standard common rules for bilateral conventions (policy option B4),
- An EU-wide multilateral double tax convention (policy option B5),
- Binding EU legislation taking the form of an EU Directive for i) a single harmonised basis for taxation (policy option B6.a), ii) a combination of common definitions plus a single harmonised basis (policy option B6.b), iii) the relief of double taxation alone, by way of a binding unilateral relief provision coupled with a binding dispute resolution mechanism without making any changes in Member States' inheritance tax rules (policy option B6.c); and (iv) a combination of features of policy options B6.a, b and c, i.e. single harmonised basis, common definitions and a binding dispute settlement mechanism (policy option B6.d).

The issuance of a recommendation regarding (unilateral) national provisions designed to relieve double and multiple taxation of inheritances (policy option B2) scored the highest regarding its effectiveness, proportionality, efficiency and flexibility. On the contrary, the EC regarded the issuance of binding tax legislation taking one of the forms of the policy option B6 as a less effective, proportionate and flexible solution to the double and multiple taxation problem of cross-border inheritances and donations. With particular reference to the proportionality criterion, I note that the EC considered an option that results in harmonisation of EU Member States' laws disproportionate to the objective to be achieved, i.e. addressing double or multiple taxation of a single inheritance by several EU Member States. In that regard, a proportionate solution, in the view of the EC, is a solution that

31 European Commission Staff Working Paper, Impact Assessment accompanying the document Commission Recommendation regarding relief for double taxation of inheritances, SEC (2011) 1489,27.

32 The policy option B3 takes the following forms: Recommendation that EU Member States complete a full network of bilateral double taxation treaties on inheritances, based either on the OECD model convention on inheritance taxes of 1982 (Policy Option B3.a) or an alternative model such as an EU model treaty (Policy Option B3.b), or else include inheritance tax provisions within the scope of existing bilateral income tax treaties (Policy Option B3.c).

"[goes] no further in terms of EU measures/EU harmonisation than is necessary to achieve the objective".[33, 34]

Nevertheless, given the disappointing effect of the recommendation on EU Member States' unilateral relief provisions, it would be arguable that a binding solution, in the form of an EU Directive, could address the problem of double and multiple taxation of inheritances and donations. This is conceivable, in principle, under Article 115 TFEU.[35] This Article provides the legal basis for the issuance of EU Directives for the approximation of the EU Member States' laws that directly affect the establishment or functioning of the internal market. Under this Article "[w]ithout prejudice to Article 114, the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue *directives* for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market." I note that only EU Directives can be issued based on Article 115 TFEU. On the contrary, the issuance of an EU Regulation is not possible under this Article that explicitly refers to "directives for the approximation of such laws, regulations or administrative provisions of the Member States".[36]

In that regard, the EC's expert group noted that "[a] regulation which contained the terms of the recommendation would go some way to resolving the problem of very high double taxation of inheritances". The group notes, however, that "[a]lthough it would be reasonable for the Commission to propose that the terms of the recommendation be contained in EU legislation, it will be apparent that the need to accommodate the taxing rights of more than one Member State and the need to determine the existence of 'personal links' and 'closer personal links' requires a complex set of provisions […]."[37] I agree with this observation of the group. The application of an EU Directive regulating the granting of the relief for double taxation of inheritances (and donations) prerequisites harmonised rules for the determination of inheritance and gift tax liability and definition of critical terms used in its Articles. Defining, however, these terms and, most importantly, determining a new set of harmonised rules for the EU Member States on how to levy inheritance and gift taxes was already considered a disproportionate solution (see policy option B6) to the objective of addressing the double and multiple taxation of inheritances and donations,

33 European Commission Staff Working Paper, Impact Assessment accompanying the document Commission Recommendation regarding relief for double taxation of inheritances, SEC (2011) 1489, 32.

34 Jan Szczepański, however, is of the view that a coordinated system of taxation applicable to cross-border inheritances and gifts is proportionate to the objective of avoiding double or multiple taxation. See Jan Szczepański, "Proposal for the Coordinated System of Taxation Applicable to Cross-Border Inheritances and Gifts in the Internal Market," *Intertax 47*, no.3 (2019): 252.

35 *Cf.* See Inge van Vijfeijken, "One Inheritance, One Tax," *EC Tax Review* 26, no. 4 (2017): 219: "In the [2015 inheritance tax] Report, the expert group presents two alternatives. The first alternative solution is to turn the recommendation of 2011 into a Regulation." Also, Frans Sonneveldt, "Na de Erfrechtverordening nu de Erfbelastingverordening?, *NTFR Nederlands Tijdschrift voor Fiscaal Recht* 1732 (2015): "After the Succession Regulation, an Inheritance Tax Regulation could be considered. This Regulation could include the suggestions of the EC's recommendation but it would have binding force" (translation, VD).

36 In the same vein, even if Articles 116 and 117 TFEU could be used as a legal basis for the issuance of EU measures in direct taxation (which that has not happened to date), I note that both Articles refer to the issuance of EU "directives".

37 EU, "Ways to Tackle Inheritance Cross-Border Tax Obstacles Facing Individuals within the EU", report prepared by the European Commission Expert Group, para. 25, p. 20.

apart from the difficulty of achieving unanimity in the Council of Ministers (ECOFIN), that is one of the conditions for the adoption of an EU Directive under Article 115 TFEU.

7.1.4 A combination of a treaty-based and an EU law solution

7.1.4.1 Multilateral convention for the avoidance of double taxation of estates, inheritances and donations (treaty-based solution) in the form of an EU Directive

It has been previously mentioned that the conclusion of a multilateral inheritance tax convention within the EU had already been voiced by the EC in its 1994 Communication. As per the 2015 inheritance tax report "[t]he need to find a general solution which the European Commission correctly identified in 1994 is, even more, pressing in 2015. The possibility that a multilateral European convention may be concluded in respect of taxes on inheritance was raised as long ago as 1993 at a Symposium in Brussels organised by the Commission. Its proposals are published as an annex to the communication of 1994. In the past, the suggestion that a multilateral convention may be the solution to the problem of [inheritance tax] double taxation may have appeared somewhat optimistic. Some may think it less so now."[38]

Worthy of note is that the Nordic inheritance and gift tax treaty serves as an example of a multilateral convention in the area of inheritance and gift taxation within the European Economic Area (EAA). The convention has been concluded between Denmark, Finland, Iceland, Norway and Sweden. Denmark, Finland and Sweden are EU Member States and Norway and Iceland EEA countries.

The conclusion of a multilateral convention inspired by the OECD IHTMTC[39] and the EC's recommendation seems, in my view, the most proportionate solution to the problem of double and multiple taxation of inheritances and donations in the EU. It does not involve substantial changes to EU Member States' death tax laws, as it would deal only with the interaction of these diverse laws. As a result, such a solution would be proportionate to both the objective to be achieved and the EU Member States' fiscal sovereignty.[40] Furthermore, such a convention can also amend the existing tax treaties, as was the aim of the MLI

38 EU, "Ways to Tackle Inheritance Cross-Border Tax Obstacles Facing Individuals within the EU", report prepared by the European Commission Expert Group, para. 27, 28, p. 21.

39 In that regard, I note that the EC's expert group also considered the issuance of a multilateral convention a possible option for addressing the problem of double or multiple taxation of inheritances. More specifically, the group stated that "[w]ere a multilateral treaty to be considered as a solution to [inheritance tax] multiple taxation it could, perhaps, adopt an approach similar to that advanced in the [EC's] recommendation". See EU, "Ways to Tackle Inheritance Cross-Border Tax Obstacles Facing Individuals within the EU", report prepared by the European Commission Expert Group, 21, point 30. On the other hand, the suggestion put forward in this section – albeit taking the form of a multilateral convention – is based on an approach that combines the OECD IHTMTC and the EC's recommendation.

40 It should be noted that the EC in its 2011 Working Paper – Impact Assessment recognised that a multilateral convention "[c]ould address triangular situations, where more than two Member States have taxing rights. However, in the EC's view, "[i]t is very unlikely that Member States would agree on such a convention given a previous failed attempt at such a solution for income tax. Moreover, such a convention if proposed by the Commission could only be proposed in the form of a Directive […]". See European Commission Staff Working Paper, Impact Assessment accompanying the document Commission Recommendation regarding relief for double taxation of inheritances, SEC (2011) 1489, 29.

regarding the covered tax agreements in the area of income and capital taxes. It would, thus, reduce the time needed to renegotiate previous tax treaties and make it possible to interpret identical notions in an EU autonomous way. This would be possible, given that the convention could take the form of an EU Directive, thereby allowing the Court to interpret it.

Furthermore, I submit that the multilateral convention could have a broad scope (inspired by Article 2 of the EC's recommendation) and, therefore, apply to any death and gift tax levied by the EU Member States. In addition, it could include the amendments, which I suggested in chapter 6 as an improvement to the tie-breaker provision of the OECD IHTMTC. Therefore, it would be more in line with the nature of the taxes to which it would apply. It could also include an Article similar to Article 4.2 of the EC's recommendation (which, as noted, is very effective especially in situations involving more than two EU Member States) and possibly an Article similar to Article 4.3. Finally, it should contain an Article on a binding dispute resolution mechanism (mutual agreement procedure). The design of such a mechanism can be inspired by the Council Directive 2017/1852/EU which, however, does not apply to death and gift taxes.

A proposal for Council Directive on a multilateral convention for the avoidance of double or multiple taxation of cross-border inheritances and gifts is included in appendix II of this study.

7.1.4.2 Extension of the scope of the Council Directive 2017/1852/EU (EU law solution)

On 10 October 2017, the Council of EU Ministers adopted the EU Directive 2017/1852/EU on tax dispute resolution mechanisms in the European Union. The Directive aims at introducing mechanisms in the EU that ensure the effective resolution of disputes concerning the interpretation and application of such bilateral tax treaties and the Union Arbitration Convention, in particular, disputes leading to double taxation. The Directive introduces an enforceable obligation on the EU Member States to arrive at a resolution of all disputes that originate in tax treaties and affect the tax position of businesses and individuals. Most importantly, it introduces clearly defined and enforceable timelines with a standard period of 18 months for the arbitration phase.

The scope of the Directive is determined in Article 1: "This Directive lays down rules on a mechanism to resolve disputes between Member States when those disputes arise from the interpretation and application of agreements and conventions that provide for the elimination of double taxation of *income* and, where applicable, *capital*. It also lays down the rights and obligations of the affected persons when such disputes arise. For the purposes of this Directive, the matter giving rise to such disputes is referred to as a 'question in dispute'." (Italics, VD). The term double taxation is further defined in Article 2(1) (c) of the Directive: "'double taxation' means the imposition by two or more Member States of taxes covered by an agreement or convention referred to in Article 1 in respect of the same taxable *income* or *capital* when it gives rise to either: (i) an additional tax charge; (ii) an increase in tax liabilities; or (iii) the cancellation or reduction of losses that could be used to offset taxable profits;" (Italics, VD). It follows that the Directive does not apply to disputes arising from the application of inheritance and gift tax treaties as evidenced from the definition of the term "double taxation" and the scope of the EU Directive.

I do not understand why the scope of the Directive has been limited to disputes relating to taxes on income and capital. An EU Member State which has already concluded both

an income and capital tax treaty and an inheritance and gift tax treaty with another EU Member State is expected to apply the same national law provisions for the application of the mutual agreement procedure regardless of the type of taxes to which this dispute relates. I suggest therefore that the Directive 2017/1852/EU be amended to also apply to disputes arising from the application of inheritance and gift tax treaties concluded between EU Member States.

A proposal for an amendment to the Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union is included in appendix III of this study.

7.2 Double or multiple non-taxation

As previously noted, the EC's recommendation aims at "resolving cases of double taxation so that the overall level of tax on a given inheritance is no higher than the level that would apply if only the Member State with the highest tax level among the Member States involved had tax jurisdiction over the inheritance in all its parts." (Article 3). Nevertheless, I observe that Article 4.2. of the recommendation also deals with possible double or multiple non-taxation issues. Therefore, one could take the view that the recommendation aims (up to a certain extent) also at the avoidance of double or multiple non-taxation.

As previously mentioned, Article 4.2. precludes the EU Member State of the objective nexus to tax the movable property (other than movable property connected to a PE) "[p]rovided that such tax is applied by another Member State by reason of the personal link of the deceased and/or the heir to that other Member State". In that regard, I noted that this Article is particularly effective in situations involving more than two EU Member States. This is because the EU Member State of the objective nexus is precluded from exercising its taxing rights if the EU Member State of the deceased's or beneficiaries' personal nexus does so. On the contrary, the EU Member State of the objective nexus may still exercise its taxing rights if no tax is levied by either the EU Member State of the deceased's personal nexus or the EU Member State of the beneficiaries' personal nexus. Therefore, I observe that this Article deals with double or multiple non-taxation issues as well. This is undoubtedly an innovative aspect of the EC's recommendation.

Nevertheless, as in the case of double or multiple taxation, even if EU Member States apply the EC's recommendation, differences in domestic law classifications can result in double or multiple non-taxation due to the lack of definitions of the terms used in the recommendation in conjunction with the application of the exemption method for the avoidance of double taxation. For example, the non-definition of the term "immovable property" may lead to double non-taxation. Reversing the legal systems of the EU Member States of the example mentioned in section 7.1.2.3.1, EU Member State B may apply Article 4.2 of the recommendation and abstain from taxing the company shares of the company. On the other hand, EU Member State A may apply Article 4.1 and exempt the immovable property located in the EU Member State B. However, this result seems to counter the objective of avoiding double or multiple non-taxation (that seems to be reflected in the wording of Article 4.2. of the recommendation).

The risk of double non-taxation due to differences in domestic law classifications has already been dealt with by the "new approach" within the framework of the income and capital tax model. In that regard, I suggested that this approach should also apply to the OECD

IHTMTC due to the insufficient alternative wording of the Commentary of the OECD IHTMTC (section 6.1.7). In the same vein, it would have been better if the EC's recommendation had contained a provision that could safeguard that differences in domestic law classifications would not result in double or multiple non-taxation. In line with this provision, the EU Member State, which provides tax relief (in the form of an exemption), shall not exempt property that has not been *actually* taxed by the other EU Member State due to differences in domestic law classifications between the EU Member States concerned.

Despite the above, I note that a possible conversion of the EC's recommendation to an EU Directive providing common definitions of the undefined terms would be a disproportionate solution to the objective of addressing the double or multiple non-taxation problem of inheritances and donations, as in the case of double or multiple taxation. Therefore, I refer to section 7.1.3 of this study. However, the conclusion of a multilateral convention, in my view, would be a step in the right direction when dealing with double or multiple non-taxation issues (and thus, not only with double or multiple non-taxation issues). In that regard, I refer to section 7.1.4.1 of this study.

7.3 Discriminatory treatment of cross-border inheritances and donations

7.3.1 The "EU compliant inheritance and gift tax"

The application of the EU fundamental freedoms to cross-border inheritances and donations within the EU dates back to 2003 when the Court delivered its first judgment[41] on the compatibility of a provision of the Netherlands inheritance tax legislation with the free movement of capital (Article 63 TFEU). Since then, the Court has delivered more than 19 judgments, examining several aspects of the EU Member States' inheritance and gift tax laws, amongst others:

- special tax deductions for certain liabilities and debts [e.g. obligation to transfer title – *Barbier* (C-364/01),[42] mortgage debt – *Eckelkamp* (C-11/07), overendowment debt – *Arens-Sikken* (C-43/07)],
- subjective tax exemptions [*Geurts* (C-464/05), *Mattner* (C-510/08), *Welte* (C-181/12), *Hunnebeck* (C-479/14), *Commission v Germany* (C-211/13)],
- objective tax exemptions [*Commission v Greece* (C-244/15), *Commission v Spain* (C-127/12), *Q* (C-133/12), *Huijbrechts* (C-679/17)],
- valuation rules [*Jäger* (C-256/06), *Halley* (C-132/10), *Scheunemann* (C-31/11)],
- extended domicile rules [*Van Hilten* (C-513/03)],
- reduced rates for domestic non-profit organisations [*Missionwerk Werner* (C-25/10), *Commission v Greece* (C-98/16)[43]], and
- credit for the previously paid inheritance tax [*Feilen* (C-123/15)].

41 ECJ, *Barbier* (C-364/01).

42 I note that issues on the incompatibility of EU Member States' inheritance and gift tax legislations have already been discussed in the literature, even after delivery of the ECJ's judgment in *Barbier*. See, for instance, Frans Sonneveldt, "The Barbier case," *European Taxation* 44, no. 6 (2004): 286-287.

43 See also Vasileios Dafnomilis, "European Commission v. Hellenic Republic (Case C-98/16): The Third Act of the Greek Tax Tragedy in Europe," *European Taxation* 57, no. 9 (2017): 408-417.

I am of the opinion that these judgments have contributed the most to the so-called "negative harmonisation" of the EU Member States' inheritance and gift tax systems, thereby setting the framework of what I call the "EU compliant inheritance and gift tax". As is the "proposed inheritance and gift tax", the "EU compliant inheritance and gift tax" is a concept, which provides guidance to the EU Member States on how to apply their inheritance and gift tax laws in an EU compliant manner.

Under the EU compliant inheritance and gift tax, the EU Member States are required to apply the same valuation rules to both domestic and foreign-located assets.[44] Second, they shall allow the deduction of debts and liabilities pertaining to assets, which they tax in their capacity as states of the objective nexus.[45] Third, they shall grant the same objective and subjective tax exemptions to resident and non-resident beneficiaries when they tax in their capacity as the states of the objective nexus.[46] Moreover, the granting of these exemptions shall not depend on the exercise of an option by the non-resident beneficiary to be treated as resident beneficiary. Fourth, the EU Member States shall extend the application of the reduced rate applicable to transfers of assets to domestic non-profit organisations also to EU ones under certain conditions.[47]

On the other hand, the application of extended residence or domicile rules by an EU Member State does not entail discrimination if these rules apply only to nationals of the EU Member State applying these rules.[48] Besides, reverse discrimination is allowed under EU law. In addition, the EU Member States of the personal nexus are allowed to grant an objective tax exemption pertaining to assets situated in their territory if they form part of its cultural and historical heritage.[49] Finally, the EU Member States do not have to provide for a reduction in the inheritance corresponding to the inheritance tax that another EU Member State has levied in respect of an earlier acquisition taxed in the latter EU Member State.[50]

7.3.2 The OECD IHTMTC and the EU fundamental freedoms

I observe that EU law constellations can influence the application of an inheritance and gift tax treaty.[51] This applies, in principle, to tax treaties concluded by the EU Member States and is based on the principle of sincere cooperation under Article 4(3) of the Treaty on European Union (TEU). For example, I submit that Article 8 of an inheritance and gift tax treaty shall apply in conformity with EU law. Under Article 8(1) to (3) of the OECD IHTMTC,

"1. Debts especially secured on any property referred to in Article 5 shall be deducted from the value of that property. Debts, not being especially secured on any property referred

44 ECJ, *Jäger* (C-256/06); CJ, *Halley* (C-132/10).
45 ECJ, *Barbier* (C-364/01); ECJ, *Eckelkamp* (C-11/07); ECJ, *D. M. M. A. Arens-Sikken v. Staatssecretaris van Financiën* (C-43/07).
46 CJ, *Mattner* (C-510/08); CJ, *Welte* (C-181/12); CJ, *Commission v Germany* (C-211/13); CJ, *Hunnebeck* (C-479/14), CJ, *Commission v Spain* (C-127/12); CJ, *Commission v Greece* (C-244/15); CJ, *Huijbrechts* (C-679/17).
47 CJ, *Werner* (C-25/10), *Commission v Greece* (C-98/16).
48 ECJ, *Van Hilten* (C-513/03).
49 CJ, *Q* (C-133/13).
50 CJ, *Feilen* (C-123/15).
51 See also, Alexander Rust, "Article 24. Non-discrimination," in *Klaus Vogel on Double Taxation Conventions*, eds. Reimer Ekkehart and Alexander Rust (Alphen aan den Rijn: Kluwer Law International, 2015), 1696.

to in Article 5, which are represented by the acquisition, conversion, repair or upkeep of any such property, shall be deducted from the value of that property.

2. Subject to the provisions of paragraph 1, debts pertaining to a permanent establishment referred to in paragraph 1 of Article 6, or to a fixed base referred to in paragraph 6 of Article 6, shall be deducted from the value of the permanent establishment or the fixed base as the case may be.

3. Other debts shall be deducted from the value of property to which the provisions of Article 7 apply."

It follows that the allocation of debts follows the division of taxing rights of the inheritance and gift tax treaty. Debts economically linked to property that may be taxed by the other Contracting State, shall be deducted only in this state. All other debts shall be deducted in the Contracting State of the fiscal domicile. Regardless, however, of the above debt allocation rules, I submit that debts are required to be deducted in each EU Member State in an EU compliant manner.

The same applies to the granting of the so-called "special deductions". Paragraph 26 of the Commentary on Article 9A of the OECD IHTMTC merely states that "[d]ifficulties may arise because the laws of most States provide for special deductions from the net amount of the estate or gift, or from specific items of the estate or gift, on the relationship between the deceased or the donor and the heir, legatee, or donee." Nevertheless, under paragraph 28, "[i]n view of the wide variety of fiscal law and practice in the different States regarding the determination of tax, especially in relation to deductions, allowances and similar benefits, it is preferable not to propose an express and uniform solution in the Convention, but to leave each State free to apply its domestic law and practice. States which prefer to have a special problem solved in their conventions are free to do so in bilateral negotiations […]."

It follows that those who drafted the OECD IHTMTC did not propose an express and uniform tax treatment of the special deductions granted by many states. On the contrary, this issue was left to bilateral negotiations. I note, however, that EU law sometimes obliges the EU Member States to grant the special deductions of their domestic law in an EU-conform manner.[52] For example, the Court has already ruled, amongst others, in *Welte* that the EU Member State of the objective nexus shall provide the same tax-free allowances to domestic and cross-border inheritances and donations if both inheritances are comparable in light of the object and purpose of the inheritance and gift tax system at hand.

7.3.3 Two important issues arising from the Court's case law

In my view, two important issues, which require further research, arise from the Court's case law on EU inheritance and gift taxation. The first issue is the non-application of the *Schumacker* doctrine to EU inheritance and gift taxation (section 7.3.3.1). The second is the application of the neutrality argument in EU inheritance and gift taxation (section 7.3.3.2).

52 ECJ, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v Finanzamt Aachen-Innenstadt* (C-307/97); ECJ, *Elide Gottardo v Istituto nazionale della previdenza sociale (INPS)* (C-55/00).

7.3.3.1 The non-application of the Schumacker doctrine

Back in 1995, the ECJ held in *Schumacker* (C-279/93) that, although resident and non-residents are not in a comparable situation with respect to direct taxes,[53] the EU Member State of source shall grant national treatment to those non-residents who earn all or most of their income in its territory (the so-called "the *Schumacker* doctrine"). It must, therefore, grant them the person-related tax deductions, which it normally grants to its residents. On the other hand, if the non-residents do not earn most of their income in the EU Member State of source, the EU Member State of their residence remains competent to assess their ability-to-pay-taxes, and thus grant them the person-related tax deductions of its national law. Since 1995, the Court has delivered several judgments on personal income taxation in which it repeatedly applied or clarified the *Schumacker* doctrine.[54] It is important to note that the *Schumacker* doctrine applies only to person-related deductions, i.e. tax advantages, which are granted due to taxpayers' personal and family circumstances. On the other hand, it does not apply to income-related deductions, i.e. deductions connected with the activity in the EU Member State of source.

I observe that the Court took another direction in EU inheritance and gift taxation, and in *Mattner* and *Welte* it rejected the application of the *Schumacker* doctrine. The Court considered in *Mattner* the German gift tax legislation, which provided for a smaller tax-free allowance if both the donor and the donee were not resident in Germany than in a situation when at least one of them was resident in Germany. It ruled that the free movement of capital precludes such different treatment because resident and non-resident donees were comparable in light of the German tax legislation. More specifically, the gift tax on immovable property situated in Germany was assessed based on the value of the property and the kinship between the donor and the donee. As neither criteria depended on the place of residence of the donor or the donee, there was no objective difference between the situation wherein neither person resided in Germany and what wherein at least one of them resided in Germany.[55]

A few years later, the ECJ delivered a second "*Mattner* judgment" to confirm the non-application of the *Schumacker* doctrine to EU inheritance and gift taxation in the *Welte* case. This case concerned the German inheritance tax legislation, which provided for a higher tax-free allowance if at least one of the parties were resident in Germany in comparison with the tax-free allowance granted in case both parties were non-residents. The Court first observed that the amount of the tax-free allowance did not vary in relation to the amount of the taxable value of the inheritance and the allowance was granted to the beneficiaries in their capacity as taxable persons. The fact, therefore, that the non-resident

53 ECJ, *Schumacker* (C-279/93), para. 31.

54 See Sjoerd Douma, "*Optimization of tax sovereignty and free movement*" (Amsterdam, IBFD, 2011), 144-145, 174-175; Sjoerd Douma, "The Three Ds of Direct Tax Jurisdiction: Disparity, Discrimination and Double Taxation," *European Taxation* 46, no. 11 (2006): 526-527; Isabella de Groot, "Case X (C-283/15) and the Myth of 'Schumacker's 90% Rule," *Intertax* 45, no. 8 (2017): 567-576. It should be noted that the Schumacker doctrine has been criticised in the literature. See Peter Wattel, "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances: Why *Schumacker, Asscher, Gilly* and Gschwind Do Not Suffice," *European Taxation* 40, no. 6 (2000): 210-223; Nils Mattsson, "Does the European Court of Justice Understand the Policy behind Tax Benefits Based on Personal and Family Circumstances?," *European Taxation* 43, no. 8 (2003).

55 CJ, *Mattner* (C-510/08), para. 38.

beneficiary of a non-resident deceased had limited tax liability did not make his situation objectively different from that of a non-resident beneficiary of a resident deceased or from that of the resident beneficiary of a non-resident deceased. By arriving at this conclusion, the Court rejected the arguments of the Belgian and German governments, which were formulated in light of the *Schumacker* doctrine[56] and held that non-resident and resident beneficiaries were always comparable in the EU Member State of the objective nexus.[57] This finding clearly contradicted paragraph 31 of the Court's judgment in *Schumacker* in which it ruled that residents and non-residents are not, in principle, comparable with regard to direct taxes in the EU Member State of source. As inheritance and gift taxes are *direct* taxes, one would expect that the Court would have endorsed the application of the *Schumacker* doctrine also to them.

7.3.3.1.1 Subjective tax exemptions by the EU Member State of the objective nexus

In order to explain why the ECJ rejected the application of the *Schumacker* doctrine to the subjective tax exemptions of the inheritance and gift tax systems, one needs to distinguish between subjective tax exemptions of the inheritance and gift tax systems and subjective tax exemptions of the income tax systems.

As mentioned in section 2.1.1, the subjective tax exemptions of inheritance and gift tax systems are tax-free allowances or deductions granted to certain beneficiaries or donees due to their kinship with the deceased or the donor. I consider the kinship between the beneficiary or the donee and the deceased or the donor a personal and family circumstance. It entails several rights and obligations determined under the applicable family law, for example, care and protection. Moreover, the granting of the subjective tax exemptions is primarily based on the windfall justification: a subjective tax exemption is granted as a recognition of the fact that the beneficiaries or the donees have contributed to the creation of the deceased's or donor's wealth. Furthermore, the amount of subjective tax exemptions often depends on the proximity of the kinship between the parties involved. This is the reason why the granting of the subjective tax exemptions cannot be primarily explained, in my view, by the ability-to-pay-taxes justification as discussed in section 2.4.1. If this were the case, every beneficiary or donee would have been entitled to the same amount of a subjective tax exemption regardless of the proximity of the kinship with the deceased or the donee. To sum up, the subjective tax exemptions of the inheritance and gift tax systems are often granted due to taxpayers' personal and family circumstances and it could be argued that they are primarily explained by the windfall justification as discussed in section 2.4.2.

On the other hand, the granting of subjective tax exemptions of the income tax systems is explained by the ability-to-pay-taxes justification. These exemptions are granted in light of the taxpayers' personal and family circumstances and are based on the premise that a minimum level of substance should be left free of tax to the income recipient. An income tax exemption thus, is based on the presumption that below a certain level no tax is due. To sum up, the subjective tax exemptions of the income tax systems are often granted

56 CJ, *Welte* (C-181/12), para. 53.
57 CJ, *Welte* (C-181/12), paras. 53 – 56.

due to taxpayers' personal and family circumstances and it could be argued that they are primarily explained by the ability-to-pay taxes justification.

As previously mentioned, in 1995, the Court introduced the *Schumacker* doctrine that entailed the national treatment of non-resident taxpayers in the EU Member State of source on the condition that they earn most of their income there. The *Schumacker* doctrine – although heavily criticised in the literature[58] – was introduced to better implement the ability-to-pay-taxes justification for person-related tax exemptions of the income tax sphere. Besides, the *Schumacker* doctrine is merely an exception to the general rule that the EU Member State of the taxpayers' residence is in the best position to take into account the taxpayer's personal and family circumstances as it has available all the information needed to assess their overall ability to pay.[59] It follows that the ability-to-pay-taxes justification is assessed differently for resident and non-resident taxpayers. This does not apply, however, to the subjective tax exemptions of the inheritance and gift tax systems, which, as noted above, are primarily granted due to the windfall justification that is understood irrespective of the residence of the parties involved.

In my view, the Court unsuccessfully explained the fundamental differences between income and inheritance tax subjective tax exemptions to conclude that the *Schumacker* doctrine applies only to the former exemptions. It stated in *Welte,* paragraph 53 "[t]hat allowance [i.e. the tax-free allowance for inheritance tax purposes, a subjective tax exemption] is automatically granted to each heir simply because they are subject to inheritance tax in Germany, so as to ensure that part of the estate is exempted through the reduction of the total amount of the inheritance" and "[…] *that exemption aims to reduce the total amount of inheritance*" (Italics, VD). However, I submit that the reduction of the total amount of inheritance does not seem to be the objective of a subjective tax exemption but merely the outcome of its granting. Instead, a subjective tax exemption of the inheritance and gift tax system seems to be primarily granted as a recognition of the beneficiary's contribution to the creation of the deceased's or donor's wealth. This was the case in *Welte* concerning the allowance that was granted to the spouse and sole heir of Mrs Welte-Schenkel.

Even though the Court did not sufficiently explain the objective of the subjective tax exemptions (which, in my view, is primarily connected with the windfall justification), it correctly considered that these exemptions are automatically granted to each beneficiary because he is subject to tax in the EU Member State of the objective nexus. On the contrary, the subjective tax exemptions of the income tax sphere are *not* automatically granted to each income recipient simply because he is subject to income tax in the EU Member State of source. Instead, they are only granted if the income recipient is either a resident or a

58 Hein Vermeulen, "Individual Income Taxation," in *European Tax law, Ben Terra and Peter Wattel,* eds. Peter Wattel, Otto Marres and Hein Vermeulen (Deventer: Wolters Kluwer, 2018), 859; Peter Wattel, "Progressive Taxation of Non-Residents and Intra-EC Allocation of Personal Tax Allowances; Why Schumacker, Asscher, Gilly and Gschwind Do Not Suffice," *European Taxation* 40, no. 6 (2000): 210; Peter Wattel, "Non-Discrimination à la Cour: The ECJ's (Lack of) Comparability Analysis in Direct Tax Cases," *European Taxation* 55, no 12 (2015); Peter Wattel, "The Schumacker Legacy - Introduction - Taxing Non-Resident Employees: Coping with Schumacker," *European Taxation* 35, no. 11/12 (1995): 347-423. Niels Mattsson, "Does the European Court of Justice Understand the Policy behind Tax Benefits Based on Personal and Family Circumstances?," *European Taxation* 43, no. 6 (2003): 188.

59 ECJ, *Schumacker*, para. 33.

non-resident taxpayer who meets the *Schumacker* test in the EU Member State concerned. On the basis of the above, the Court concluded that the *Schumacker* test should not apply to EU inheritance and gift taxation.

Finally, there is one more reason why, in my view, the *Schumacker* doctrine should not apply to EU inheritance and gift taxation and it relates to abuse. If the *Schumacker* test was applicable, the deceased would be able to *choose* the EU Member State in which his beneficiaries would receive a subjective tax exemption. Therefore, a beneficiary inheriting 90% of the deceased's property would be entitled to such an exemption whereas the other beneficiary would not. I submit that the fact that the first beneficiary would have received the exemption would be in fact attributed to the deceased's decision to transfer all or most of his wealth to him.

7.3.3.1.2 Subjective tax exemptions by the EU Member State of the personal nexus

I observe that there is no Court case law referring to a subjective tax exemption the granting of which was denied by the EU Member State of the personal nexus. If, however, this EU Member State enjoys worldwide inheritance and gift tax jurisdiction, it may not have a compelling reason to deny the granting of a subjective tax exemption to the cross-border inheritance and donation. This is because the situation of a resident and a non-resident beneficiary would be comparable in light of the subjective tax exemption, as the EU Member State of the personal nexus is expected to apply the same rules to both a domestic and a cross-border inheritance and donation.

It could be argued, however, that by granting a lower subjective tax exemption to a cross-border inheritance and donation, the EU Member State of the personal nexus aims to avoid a situation in which the beneficiaries move certain assets of the deceased abroad. I do not believe that this argument is sufficiently convincing. The EU Member State of the personal nexus most often will retain its right to tax these assets, even following an abusive transfer of the beneficiaries' residence before the deceased's death (see also Article 7 of the OECD IHTMTC). Besides, it can request information from the EU Member State of the objective nexus on the basis of the Mutual Assistance Directive (2011/16/EU) or Article 12 of the applicable inheritance and gift tax treaty to safeguard its taxing rights.

7.3.3.1.3 Proportionate subjective tax exemptions: a fair solution?

It was argued that if both the EU Member State of the personal nexus and the EU Member State of the objective nexus must provide under EU law the full amount of their subjective tax exemptions to a cross-border inheritance and donation, the cross-border inheritance and donation may, in some instances, receive better treatment than a domestic one. This may give rise to unfair results.

In that regard, I note that Paternotte[60] and the Netherlands Advocate General ("AG") Wattel[61] have already suggested that the EU Member State of the objective nexus provide a proportionate tax-free allowance/exemption when taxing a cross-border inheritance and

60 Rens Paternotte, "Welte, German inheritance tax. Different treatment of residents and non-residents violates free movement of capital," *Highlights & Insights on European Taxation* no 1 (2014): 33-34.

61 Opinion of the Netherlands AG, Wattel, in BNB 2015/87 (Netherlands Supreme Court).

donation.[62] The percentage of the situs property to the whole inherited or donated property has been presented as a fair criterion which determines how much of the exemption each EU Member State may provide, thereby safeguarding that the taxpayer will not receive the tax-free allowances of two or more EU Member States in full. Therefore, in line with the concept of Van Raad's "fractional taxation",[63] Paternotte argued that the granting of the full tax-free allowance in *Welte* "goes too far": "From the facts, Mr Welte inherited a total value of EUR 532,197, of which EUR 329,000 (62%) is taxed in Germany. Would not the restriction of the free movement of capital be taken away if Germany allowed a tax allowance of 62% of EUR 500,000?" In the same vein, AG Wattel considered that a tax advantage proportionate to the amount of the situs property to the whole deceased's property should be granted to the non-resident beneficiary. The AG argued that the ECJ did not adequately explain why the tax-free allowances in *Welte* were not comparable to the income tax free-allowances to which the *Schumacker* doctrine applies.[64] However, he was of the opinion that the non-application of the *Schumacker* doctrine to EU inheritance and gift taxation created a good momentum for the non-application of the doctrine to direct taxes in general.[65]

First, I believe that the above discussion will be limited to the *subjective* tax exemptions of the inheritance and gift tax sphere as only these exemptions are granted due to beneficiaries' personal and family circumstances. Furthermore, I observe that a proportionate subjective tax exemption would indeed address the granting of a tax exemption by more than one EU Member State with respect to the same cross-border inheritance and donation. If the EU Member State of the personal nexus grants 38% of its subjective exemptions and the EU Member State of the objective nexus 62% of its exemptions, the beneficiaries cannot receive two *full* tax exemptions in two different EU Member States. In addition, a proportionate subjective tax exemption would address the issue of abusive property transfers to EU Member States granting generous exemptions and tax-free allowances.

Nevertheless, I am of the opinion that the suggestion for a proportionate subjective tax exemption cannot apply to EU inheritance and gift taxation due to the lack of common valuation rules among the EU Member States. The valuation of the property is admittedly an essential element for the assessment of inheritance and gift taxes. Although the valuation rules of each EU Member State shall apply in an EU-conform manner, each EU Member

62 Furthermore, the Court has already accepted the granting of pro-rata personal deduction in multi-state situations. See CJ, *X v Staatssecretaris van Financiën* (C-283/15). See also CFE ECJ Task Force, "Opinion Statement ECJ-TF 4/2017 on the Decision of the Court of Justice of the European Union of 9 February 2017 in *X* (Case C-283/15) ("Pro-Rata Personal Deductions"), Concerning Personal and Family Tax Benefits in Multi-State Situations," *European Taxation* 58, no. 4 (2018); Hannelore Niesten, "Pro Rata Deduction of Negative Income from Income Received in Each Member State," *European Taxation* 58, no. 2/3 (2018).

63 Kees van Raad, "Non-Residents – Personal Allowances, Deduction of Personal Expenses and Tax Rates," *World Tax Journal* 2, no. 2 (2010). See also Frans Vanistendael, "Ability to Pay in European Community Law," *EC Tax Review* 23, no. 3 (2014): 134.

64 Opinion of the Netherlands AG Wattel in BNB 2015/87 (Netherlands Supreme Court), para. 8.5.

65 Opinion of the Netherlands AG Wattel in BNB 2015/87 (Netherlands Supreme Court), para. 8.17 (author's translation) "Hopefully, this inheritance tax case (the *Welte* case: VD) means that in time the incorrect *Schumacker* doctrine will also be buried for income tax purposes and non-residents will also be eligible for national tax treatment (which means: no worse treatment than fractional taxation: no worse treatment than when granting exemptions and allowances in proportion to the part of the total base taxed by the situs / source state)."

State determines the value of this property under its domestic valuation rules. It therefore, is conceivable that the EU Member State of the personal nexus and the EU Member State of the objective nexus may attach a different value to the same property. In the absence of common valuation rules (which only an EU harmonisation measure can introduce), the EU Member State of the personal nexus may consider that the property situated in its territory represents only 10% of the total inherited wealth. On the contrary, the EU Member State of the objective nexus may consider that the property located in its territory represents 70% of the total inherited wealth. Thus, if, under Paternotte's and Wattel's suggestions, each EU Member State would grant a proportionate tax exemption, the taxpayer would be entitled only to 10% of the inheritance tax exemptions in the EU Member State of the personal nexus and 70% of the exemptions in the EU Member State of the objective nexus. This, however, may lead to a cross-border inheritance being taxed more heavily than a domestic one that would also be an unfair outcome.

7.3.3.1.4 Objective tax exemptions

Objective tax exemptions are exemptions, which are connected to certain types of property and are justified by several EU Member States' policies. Furthermore, they are mostly territorial. For example, in the Netherlands gift tax case *Q*[66], the granting of an objective tax exemption with regard to the donation of a specific type of estates ("*landgoed*") was under review. The "landgoed exemption" was justified by the protection of the Netherlands natural and cultural heritage and was denied in the case of a donation of a property situated in the UK ('the Bean House'). Similarly, in *Commission v Greece*,[67] the Greek inheritance tax legislation provided, under certain conditions, an exemption concerning the *mortis causa* transfer of the deceased's primary residence located in Greece to Greek or EU national beneficiaries on condition that they were permanently resident in Greece.

I mentioned in chapter 2 that the objective tax exemptions are often not only granted in the case where the deceased and the beneficiaries share a degree of kinship. Instead, they are "attached" to a certain type of inherited or donated property. Therefore, the application of the *Schumacker* doctrine to these exemptions should be denied from the very beginning, as they are often not linked to the beneficiaries' personal and family circumstances and they are not justified by the ability-to-pay-taxes justification. The non-application of the *Schumacker* doctrine to these exemptions was also confirmed in the Court's judgment in *Miljoen et alii* with regard to the capital tax-free allowance of the Netherlands income tax legislation. In this case, the Court ruled that, in line with AG Jaaskinen's reasoning, *"[a]n exemption, such as the one at issue in the main proceedings, which is an advantage granted to all resident taxpayers, irrespective of their personal situation, does not constitute an individual advantage connected with the personal situation of the taxpayer. As the Advocate General stated in point 83 of his Opinion, since such an exemption alters the tax base of the income*

66 CJ, Q (C-133/13).
67 ECJ, *Commission v Greece* (C-244/15).

received by resident taxpayers, it is necessary to take that into account for the purposes of comparing the final tax burdens of resident taxpayers and those of non-resident taxpayers."[68, 69]

Furthermore, I observe that the objective tax exemptions granted by the EU Member State of the objective nexus are treated as income-related deductions through an analogous application of the Court's case law in *Biehl*[70], *Scorpio*[71] and *Gerritse*.[72] In line with this case law, income-related deductions shall always be deducted in the EU Member State of source of income if they are directly connected to income generated there (as it does with its own residents in respect of the same income). In this respect, resident and non-resident income recipients are always objectively comparable in the light of these expenses and the activity generating income in the EU Member State of source.

The Court had already referred to the above-mentioned case law on income-related deductions in *Eckelkamp*[73] and *Arens-Sikken*[74] concerning the deduction of debts connected to property situated in the EU Member State of the objective nexus. In that regard, the Court considered debts connected to immovable property (mortgage-related charges relating to the immovable property, overendowment debts) similar to income-related deductions for which, however, a direct link should be established between the debt and the property concerned.

With regard to the treatment of objective inheritance tax exemptions granted by the EU Member State of the personal nexus, I refer to the *Q* case. Q, a tax resident of the Netherlands, was the owner of a property situated in the UK. She wanted to transfer that property to her son as a gift. Under Netherlands legislation, such a gift could be (partly) exempted from gift tax if the property qualifies as a "*landgoed*" under the Netherlands Law on nature protection. This law, however, only applies to estates situated in the Netherlands. In this case, the Court ruled that a cross-border donation is not objectively comparable to a domestic one considering the objective of the Netherlands Law on nature protection. The objective of this law was to protect the cultural and historical heritage of the Netherlands, which includes estates that are typical of the traditional Netherlands landscape.[75] In light of this legitimate objective, the situation of a taxpayer donating a property situated in the Netherlands that fulfils the requirements set by the Netherlands Law on nature protection is not comparable to that of a taxpayer donating a historic building situated in the territory of another EU Member State. The tax disadvantage, thus, experienced (i.e. no entitlement to the exemptions) by the latter is the inevitable result of the Netherlands legislation considering its stated objective.[76]

It follows from *Q* that the EU Member State of the personal nexus may grant an objective tax exemption only to a domestic asset if the objective of such an exemption is consistent with its legitimate scope. Nevertheless, I observe that the granting of an objective tax

68 CJ, Joined Cases *Miljoen* (C-10/14), *X* (C-14/14) and *Société Générale* (C-17/14), para. 53.
69 See also, CFE ECJ Task Force, "Opinion Statement ECJ-TF 1/2016 on the Decision of the European Court of Justice in Joined Cases *Miljoen* (C-10/14), *X* (Case C-14/14) and *Société Générale* (C-17/14) on the Netherlands Dividend Withholding Tax," *European Taxation* 56, no. 6 (2016): 258.
70 ECJ, *Biehl* (C-175/88).
71 ECJ, *Scorpio* (C-290/04).
72 ECJ, *Gerritse* (C-233/01), paras. 27 and 28.
73 ECJ, *Eckelkamp* (C-11/07), paras. 50 – 54.
74 ECJ, *Arens-Sikken* (C-43/07), para. 57.
75 CJ, *Q* (C-133/13), para. 24.
76 *Id.*, para. 26.

exemption must always be proportionate. The beneficiaries shall always be granted the opportunity to demonstrate that a foreign property may fulfil the objectives of the tax exemption concerned as provided by the EU Member State of the personal nexus. This is also derived from *Q* where the Court stated that the cross-border and domestic donations would be comparable if the property situated in the other EU Member State formed part of the Netherlands cultural and historical heritage.[77]

7.3.3.2 Neutralisation

It should be noted that the term "neutralisation" has two different meanings. *First*, it refers to the obligation of the taxpayers' EU Member State of residence to consider in full their personal and family circumstances (*Schumacker*[78]) by granting them person-related allowances and exemptions unless i) it is released by way of an international agreement with the EU Member State of source, or ii) the EU Member State of source unilaterally or based on an international agreement takes into account these circumstances (*de Groot*[79], *Imfeld*[80]). As mentioned in the previous sections, the Court has already rejected the application of the *Schumacker* doctrine in EU inheritance and gift taxation, thereby requiring the EU Member State of the objective nexus to grant the whole amount of the subjective tax exemptions to a cross-border inheritance and donation.

Second, neutralisation refers to the impact of the application of a tax treaty credit on the discriminatory or restrictive effect of the legislation of the EU Member State of source. Such a credit negates, under certain conditions, the discriminatory or restrictive effect of such legislation.[81] The conditional neutralising effect of the tax credit stems from the Court's case law on dividend taxation as first introduced in *Denkavit*[82] and clarified in *Amurta*.[83] In the latter case, the Court held that a unilateral tax credit (i.e. credit granted under the legislation of the State of residence) could not neutralise the discriminatory taxation in the EU Member State of source.[84] On the contrary, a tax treaty credit may do so on condition that it enables the discriminatory or restrictive effect of the taxation at the EU Member States of source to be fully neutralised.[85, 86] Apparently, the Court considered that the tax treaty forms part of the legal system of both EU Member States, thereby serving as the necessary link between their tax systems.[87] Besides, the granting of a tax

77 *Id.*, para. 28.
78 ECJ, *Schumacker* (C-279/93), para. 32.
79 ECJ, *De Groot* (C-385/00), para. 99.
80 CJ, *Imfeld* (C-303/12), para. 69. See also Hannelore Niesten, "Growing Impetus for Harmonization of Personal and Family Allowances: Current State of Affairs of the Schumacker-Doctrine after *Imfeld and Garcet," EC Tax Review* 24, no. 4 (2015): 196 and Bruno Peeters, "Mobility of EU Citizens and Family Taxation: A Hard to Reconcile Combination," *EC Tax Review* 23, no.3 (2014).
81 It is noted that the Court does not consider neutralization an overriding reason in the public interest. See CJ, *Miljoen et alii*, (C-10/14, 14/14 and 17/14), para. 89 and Karin Spindler-Simader, "Dividend Withholding Taxes after *Miljoen,* and *Société Générale*", *EC Tax Review* 25, no. 2 (2016): 74.
82 ECJ, *Denkavit* (C-170/05), paras. 48 – 53.
83 ECJ, *Amurta* (C-379/05), paras. 78 – 82.
84 *Id.*, para. 78.
85 *Id.*, para. 83.
86 ECJ, *Commission v Spain* (C-487/08), para. 59; ECJ, *Commission v Italy* (C-540/07), para. 38.
87 *Id.*, para. 80.

treaty credit is an obligation stemming from public international law:[88] although the tax treaty credit is granted by the EU Member State of residence, it is, in essence, agreed by both Contracting States.

For some years, it was believed that only a full tax credit could meet the "high standards" that the Court set in *Amurta* and its subsequent case law.[89] Such a requirement, however, seems to run counter to the tax treaty framework where the credit is usually capped up to the amount of the domestic tax, which would be liable if the foreign income was earned domestically. Therefore, in its later case law[90] and most recently in *Miljoen et alii*[91, 92], the Court ruled that neutralisation can also occur even by means of an ordinary tax credit if such a credit "*entirely*" offsets the discriminatory or restrictive part of source taxation. (Italics, VD)[93, 94] If, however, the tax treaty credit refers to national law of the EU Member State of residence, it cannot neutralise the discriminatory or restrictive source taxation.[95] Therefore, only an autonomously formulated tax treaty credit provision can potentially give rise to neutralisation of discriminatory source taxation.

Unlike the first concept of neutralisation, the Court applied the second concept also to EU inheritance and gift taxation, by analogy. Notwithstanding the difference in nature between income and inheritance and gift taxes, the concept can also apply to EU inheritance and gift taxation as it is not dependent on the nature of the taxes concerned but their effect. The neutralisation argument was raised in *Eckelkamp* and *Arens-Sikken* (concerning inheritance taxes) and in *Mattner* (concerning gift taxes). In *Eckelkamp* and *Arens-Sikken*, the EU Member States involved had not concluded an inheritance and gift tax treaty. As a result, in line with *Amurta*, the unilateral credit of Germany in *Eckelkamp* and Italy in *Arens-Sikken* could not neutralise the discriminatory/restrictive effect of the inheritance tax levied in Belgium and the Netherlands, respectively. Similarly, in *Mattner,* the Court

88 ECJ, *De Groot* (C-385/00)

89 CFE ECJ Task Force, "Opinion Statement ECJ-TF 1/2016 on the Decision of the European Court of Justice in Joined Cases *Miljoen* (C-10/14), *X* (Case C-14/14) and *Société Générale* (C-17/14) on the Netherlands Dividend Withholding Tax," *European Taxation* 56, no. 6 (2016): 258. On the AG's Opinion in *Miljoen* see also Jasper Korving, "Miljoen, X and Société Générale: The Final Curtain of the Dividend Withholding Tax Saga?," *EC Tax Review* 24, no. 5 (2015): 281–285.

90 ECJ, *Commission v Italy* (C-540/07), para. 38 and ECJ, *Commission v Spain* (C-487/08), para. 62. See also Opinion of AG in ECJ, *Commission v. Italy* (C-540/07), paras. 58-59.

91 CJ, *Miljoen et alii*, (C-10/14, 14/14 and 17/14).

92 However, according to the CFE ECJ Task Force, "The ECJ, in Société Générale, has (*finally*) made it clear that neutralization does not necessarily require a full tax credit. Rather, an ordinary tax credit can also achieve neutralization if it, in fact, leads to a full credit of the source state tax in the state of residence of the taxpayer (i.e. a set-off for the full amount of the difference in treatment arising under source state legislation)". See CFE ECJ Task Force, "Opinion Statement ECJ-TF 1/2016 on the Decision of the European Court of Justice in Joined Cases Miljoen (C-10/14), X (Case C-14/14) and Société Générale (C-17/14) on the Netherlands Dividend Withholding Tax," *European Taxation* 56, no. 6 (2016): 260.

93 *Id.*, para. 85.

94 See also "Such neutralization can also result from an "ordinary credit" (with a credit limitation), if the dividends are sufficiently taxed in the Member State of the shareholder and that, therefore, effectively a full credit results. Conversely, however, the mere fact that the residence state has "allowed" the source state to levy a (withholding) tax in a tax treaty does not relieve the latter from scrutiny under the fundamental freedoms", Georg W. Kofler, "Tax Treaty "Neutralization" of Source State Discrimination under the EU Fundamental Freedoms?," *Bulletin for International Taxation* 65, no. 12 (2011): 688.

95 *Id.*, paras. 81-82.

did not accept the neutralising effect of the Netherlands gift tax legislation in the absence of an inheritance and gift tax treaty concluded between Germany and the Netherlands.[96]

It follows that there seems to be no reason to argue that the Court will not accept the neutralising effect of a credit provided by an inheritance and gift tax treaty. Therefore, if the Contracting State of the fiscal domicile eliminates double taxation of property listed in Articles 5 and 6 of the treaty by means of a credit under Article 9B of the OECD IHTMTC, the other Contracting State may still be allowed to levy a discriminatory or restrictive inheritance and gift tax on the condition that the credit entirely neutralises the effects of the inheritance and gift tax levied in the other Contracting State and does not refer to domestic legislation of the Contracting State of the fiscal domicile for its application.

7.4 Administrative difficulties

7.4.1 The Council Directive 2011/16/EU

Within the EU, exchange of information on death and gift tax currently takes place under the EU Directive 2011/16/EU on administrative cooperation in the field of taxation (Directive on Administrative Cooperation ("DAC"). As per 1 January 2013, DAC1 repealed the previously issued EU Directive 77/799/EEC concerning mutual assistance by the competent authorities of the EU Member States in the field of direct taxation (the "old Mutual Assistance Directive") which did not apply to death and gift taxes, as the CJ first observed in the *Halley* case (C-132/10). The facts of this case dated back to 2003, when the old Mutual Assistance Directive was applicable. More specifically, the Belgian legislation was providing for a two-year limitation period within which an expert valuation in Belgium may be requested. The limitation period was extended to 10 years for foreign assets because the law did not provide for the possibility to request an expert valuation for foreign assets. The CJ ruled that such a different limitation period resulted in a restriction on the free movement of capital because the application of a longer limitation period in respect of a company with its centre of effective management in another EU Member State might deter Belgian residents from investing or maintaining investments in assets in other EU Member States. Furthermore, such a restriction could not be justified by the effectiveness of fiscal supervision.

Although the old Mutual Assistance Directive did not apply to inheritance taxes, the Court considered that administrative assistance could be requested under the applicable inheritance tax treaty concluded between France and Belgium. In that regard, it ruled that "[i]t is true that the [Council Directive 77/799/EEC] does not apply to inheritance tax. However, it appears from the file submitted to the Court that it may nevertheless have been possible for the Belgian tax authorities to have recourse to other mutual assistance instruments to verify the value of the shares in question, such as, for instance, the convention between France and Belgium for the avoidance of double taxation and the regulation of certain other issues in the field of inheritance tax and registration charges, done at Brussels on 20 January 1959."[97]

96 CJ, *Mattner*, (C-181/12), para. 43.
97 CJ, *Halley* (C-132/10), para. 37.

As stated above, the DAC applies to death and gift taxes. This follows from Article 2(1) of the EU Directive which lays down that: "This Directive shall apply to *all taxes of any kind* levied by, or on behalf of, a Member State or the Member State's territorial or administrative subdivisions, including the local authorities." (Italics, VD). Furthermore, death and gift taxes are not explicitly excluded in Article 2(2) and (3) of the EU Directive.

I observe that the situation where the tax authorities of an EU Member State may request information from the tax authorities of another EU Member State can be common in practice. For instance, the EU Member State of the personal nexus may need to be aware of the deceased's worldwide property to correctly assess its inheritance tax claim. Nevertheless, it should be noted that, in general, the DAC in general focuses at the tax authorities' level and therefore, does not directly deal with administrative difficulties at the micro level as discussed in chapter 3 of this study.

7.4.2 The Council Directive 2010/24/EU

Furthermore, I observe that within the EU, assistance in the collection for the recovery of claims relating to death and gift taxes takes place under Council Directive 2010/24/EU concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures. As per 1 January 2012, the Directive repealed the Directive 2008/55/EC that did not apply to death and gift taxes.

Under Article 2 of the Directive 2010/24/EU, "1. This Directive shall apply to claims relating to the following: a) all taxes and duties of any kind levied by or on behalf of a Member State or its territorial or administrative subdivisions, including the local authorities, or on behalf of the Union; […]". Furthermore, death and gift taxes are not explicitly mentioned in Article 2(3) of the Directive, which lists the taxes to which the Directive does not apply. As a result, death and gift taxes fall within the scope of the Directive.

As a result, the tax authorities of an EU Member State can request assistance from the tax authorities of another EU Member State to collect a tax claim relating to death and gift taxes on its behalf.[98] I observe that in practice, this situation can be very common given that the EU Member State of the personal nexus – which enjoys worldwide justification over the deceased's property – may have to collect its tax claim from a beneficiary who is a resident in another EU Member State.

Nevertheless, just as in the case of the DAC, Directive 2010/24/EU focuses at the tax authorities' level and therefore, in my view, does not deal directly with administrative difficulties at the micro level as discussed in chapter 3 of this study.

7.4.3 The Council Directive 2017/1852/EU

In section 7.1.4.2, I suggested the extension of the scope of the Directive 2017/1852/EU to death and gift taxes. Such an extension will not only contribute to the mitigation of the double taxation problem of cross-border inheritance and donations but also facilitate the collaboration between the EU Member States' tax authorities and guarantee an effective mutual agreement procedure. Like the previous EU Directive, this Directive focuses at the

98 See also Ilse De Troyer, "New Developments in International Administrative Assistance in the Recovery of Taxes," *European Taxation* 58, no. 5 (2018): 182.

tax authorities' level and therefore in my view, does not deal directly with administrative difficulties at the micro level as discussed in chapter 3 of this study.

7.5 Conclusion of chapter 7

In this chapter, I reviewed the progress made in the EU towards addressing the problems of cross-border inheritances and donations. It follows that, although the double and multiple taxation problem of cross-border inheritances and donations is an obstacle to the smooth operation of the internal market, very few initiatives have been taken at the EU level to address this issue. In that regard, I noted that the EC's recommendation was issued some years ago and has not been considered by many EU Member States. Although it contains some innovative provisions, it has some aspects that can be improved. In addition, I observed that the conversion of the recommendation to an EU Directive prerequisites a harmonised single tax base, which, in my view, seems to be a disproportionate solution to the problem of double and multiple taxation and non-taxation of inheritances. On the other hand, a multilateral convention taking the form of an EU Directive based on the optimised OECD IHTMTC and inspired by the innovative provisions of the recommendation has the potential to address the problem of double and multiple taxation of inheritances and donations. The same applies to the extension of the scope of the Council Directive 2017/1852 to double taxation disputes arising from the application of an inheritance and gift tax treaty.

Concerning the double or multiple non-taxation problem, I observed that Article 4.2. of the EC's recommendation deals with double or multiple non-taxation issues. However, due to the lack of common definition of the terms used in the recommendation, double or multiple non-taxation of the cross-border inheritance and donation is still conceivable. In that regard, I noted that the conversion of the recommendation to an EU Directive would be a disproportionate solution to the objective of addressing the double or multiple taxation problem of inheritances and donations, such as in the case of double or multiple taxation. However, the conclusion of a multilateral convention, in my view, would be a step in the right direction when dealing with double or multiple non-taxation issues.

Regarding the discrimination problem of cross-border inheritances and donations, I observed that the Court's case law on EU inheritance and gift taxation has contributed the most to the so-called "negative harmonisation" of the EU Member States' inheritance and gift tax systems, thereby providing guidance to the EU Member States on how to apply an EU compliant inheritance and gift tax system. With regard to the rejection of the *Schumacker* doctrine in EU inheritance and gift taxation, I observed that the Court did not distinguish between objective and subjective tax exemptions and it did not provide a convincing answer why the tax exemptions of the income tax systems differ from the tax exemptions of the inheritance and gift tax systems. Although, in my view, it arrived at the correct conclusion that the *Schumacker* doctrine shall not apply to the latter tax exemptions, the explanation of the Court seems to have some points that required additional explanation (e.g. the objective of subjective tax exemptions of death tax laws as compared to that of subjective tax exemptions of income tax laws). Furthermore, I observed that the neutralisation argument applies in the same way, regardless of the type of the treaty concerned (i.e. an income and capital tax treaty or an inheritance and gift tax treaty).

Finally, concerning administrative difficulties of cross-border inheritances and donations, I observed that the Directives 2011/16/EU and 2010/24/EU apply to death and gift taxes.

Nevertheless, I noted that these EU Directives focus on the tax authorities' level and therefore, do not deal directly with administrative difficulties at the micro level as discussed in chapter 3 of this study. I also suggested that the Directive 2017/1852/EU be amended to apply to disputes arising from the application of an inheritance and gift tax treaty.

It follows that all the above solutions to the problems of cross-border inheritances and donations are separate as they deal with only one problem. Furthermore, the separate solutions do not deal with all the aspects of a particular problem. For example, the EU Directives 2011/16/EU and 2010/24/EU focus on the tax authorities' level and do not deal with administrative difficulties at the micro level. Therefore, it should be explored whether a holistic solution to the problems of cross-border inheritance and gift taxation could apply at EU level.