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COMMISSION STAFF WORKING PAPER
EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT

Accompanying the document

COMMISSION RECOMMENDATION
regarding relief for double taxation of inheritances

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EXECUTIVE SUMMARY

This impact assessment has been prepared to analyse problems of discrimination and double taxation of inheritances within the Internal Market and decide on the best solution on the basis of which the Commission will make a proposal.

More EU citizens than ever are moving abroad within the Internal Market to find work, marry or retire, leaving family members behind in their country of origin. Others are purchasing property and investing in assets abroad. In these circumstances, the application of inheritance taxation to bequests made across borders is becoming an increasingly important issue.

Problem definition

EU citizens and businesses can potentially face two types of inheritance tax problems in cross-border situations. First, they may be exposed to tax discrimination. Second, there is the risk of taxation of a single inheritance by several Member States with no relief or only partial relief for the double taxation.

This problem may lead to overall levels of taxation appreciably higher than those applicable in situations that are purely internal to one or the other Member State involved. An increased tax burden may negatively affect the value of an inheritance and may cause great difficulties for citizens and businesses who take advantage of their right to move and operate freely across borders within the Internal Market.

The problems can arise not just from Member States' inheritance tax laws but also from their private laws on inheritances, or from a combination of both sets of laws.

As for the discrimination problem, when individuals inherit property or other assets across borders, they may be subject to inheritance tax rules that are less favourable than those that would apply if there was no cross-border element.

As for the problem of double or even multiple taxation, this can arise essentially because of differences between Member States' rules concerning who should be taxed and the type of tax applied. In addition, this double taxation can in many cases not be relieved. This is because Member States' domestic relief mechanisms are not comprehensive and they have few bilateral conventions in this area and do not seem to be negotiating more in recent years.

As for the quantification of the problem, the impacts are not significant at macro level. Member States' revenue from domestic and cross-border inheritances taxes together account for less than 0.5% of total tax revenues in EU Member States so cross-border cases alone must account for far less than that figure. However, at micro level, both discrimination and double taxation, when it happens, might have an enormous impact on the individuals actually concerned because of the high rate of taxation that might result. This is notwithstanding the trends towards lower general levels of inheritance taxation.

All EU citizens, businesses and other entities subject to inheritance taxes are potentially affected by these issues. With a steadily increasing tendency in migration and cross-border ownership of assets within the EU, it can be expected that the number of complaints and

referrals to the Court about discriminatory aspects of Member States' inheritance tax laws will increase, as will double taxation.

Analysis of subsidiarity

It is appropriate for the Commission, in the light of its responsibility for ensuring the smooth functioning of the Internal Market and promoting the general interest of the Union to examine and consider action when solutions to cross-border tax problems cannot be found at national level.

There are currently no EU harmonisation rules in the area of inheritance taxes. In the absence of such rules, inheritance taxation falls within the competence of the Member States. However, in the exercise of this competence, they must respect the fundamental freedoms of EU law and are therefore not allowed to discriminate on the basis of nationality or to apply unjustified restrictions to these freedoms. The Court of Justice has confirmed the application of these principles to inheritance tax in several recent cases. However, the Court of Justice has also stated that Member States are not obliged to eliminate double taxation arising through the parallel exercise of their taxing rights.

Given the recent increase in court cases and in complaints, enquiries and responses to relevant public consultations, it appears necessary for the Commission to consider what kind of action could complement and support ongoing infringement proceedings and, at the same time, to propose appropriate solutions to the double taxation of cross-border inheritances.

The objectives

The general objective of the initiative is to allow citizens to exercise their right to move and operate freely within the Internal Market and not be deterred by cross-border inheritance tax obstacles. To this end, the initiative would aim at:

promoting the elimination of discrimination in the area of inheritance taxation; and

reducing the double taxation of inheritances within the EU,

in particular in order to avoid an excessively high tax burden or even confiscatory rate of overall taxation.

The policy options

Policy Options A to address tax discrimination related to cross-border inheritances

Policy Option A1 - Continuation of current situation

Policy Option A2 – Publication of principles for non-discriminatory inheritance tax systems

Under this option, the a staff working paper could be published that would assemble the principles flowing from the case-law on inheritance taxes that should govern the design of inheritance tax systems. Following the publication of these principles, EU citizens would be more aware of the rules which Member States must respect when taxing cross-border inheritances. The document could also assist Member States in bringing their inheritance tax provisions into line with EU law.

Policy Option A3 - Compulsory rules on abolishing of discriminatory features of Member States' domestic inheritance tax legislation Under this option, the Commission would propose the principles set out in the relevant European case law for adoption as compulsory rules at EU level.

Policy Options B to address unrelieved double taxation of cross-border inheritances

Policy Option B1 - Continuation of current situation

Policy Option B2 – Commission recommendation regarding (unilateral) national provisions designed to relieve double taxation of inheritances The Commission could identify the elements that would make national tax rules interact more coherently with each other so as to eliminate double taxation in a comprehensive way and invite Member States to make changes to their laws on that basis.

Policy Option B3 – Commission recommendation regarding relief for double taxation through bilateral agreements between Member States designed to relieve double taxation of inheritances The Commission could recommend that 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***). The first sub option (B3.a) was considered less appropriate from the start because the relevant OECD Model has not been amended to address shortcomings identified and therefore would not resolve all the problems effectively. Another reason why the current Model might not be an ideal point of departure is the fact that the OECD is currently considering its update.

Policy Option B4 – Binding rules governing bilateral arrangements: 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. Although suggested by some stakeholders, drawing up these rules would take a disproportionate amount of effort given that they would have to be unanimously adopted and this option would not be likely to solve the problem as long as Member States are not prepared to enter into bilateral inheritance tax agreements in the first place.

Policy Option B5– EU- wide multilateral double tax convention As suggested by some stakeholders and commentators, Member States could conclude a multilateral double taxation convention on estates and inheritances. However this option was considered less appropriate from the start as it is 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 which would fall within Policy Option B.6.

Policy Option B6 – Binding EU legislation An EU-wide binding instrument, taking the form of a Directive, could provide for i) a single harmonised basis for taxation, e.g. taxing only where the assets or the deceased were located (***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*); (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 first sub option (B6.a) was considered inappropriate as such, as it would be ineffective unless combined with common definitions such as of assets and with rules to deal with dual residence/nexus, as proposed in another sub option (B.6.b).

Assessment of the most significant impacts

The following impacts have been analyzed:

Fundamental freedoms

Costs to taxpayers and tax administrations

Social effects

Economic effects

As regards the social and economic effects, we focus on the individuals concerned, because at macro level it is unlikely that the impact of the adoption of solutions to address cross-border inheritance tax problems would be significant, given the low share that inheritance taxes represent of Member States' total revenues.

In terms of possible solutions to the tax discrimination problem of cross-border inheritances (Policy Options A), both the publication of a set of principles and compulsory rules could promote the respect of fundamental freedoms to a greater extent; and, in case of compulsory rules, lead to a high degree of legal certainty which could reduce the need for court actions. For the reasons given, both solutions could also reduce the cost for taxpayers and tax administrations. As for the social and economic effects, both options should bring about increased confidence about the implications of cross-border movement and more trust in the Internal Market.

As regards the policy options to address unrelieved double taxation of inheritances (Policy Options B), the 'Do nothing' option would mean that double taxation would continue, which makes the exercise of the fundamental freedoms more difficult. The lack of availability of relief can be costly in individual cases. Regarding social effects, the lack of comprehensive solutions is most likely to impact on the middle classes as the wealthy are likely to have tax advisers to help with tax planning and poorer individuals are not as likely to inherit across borders. The economic effects of such double taxation do not at present appear to affect an important percentage of citizens but can seriously affect those citizens who make use of their right to engage in cross-border activity.

Both the option of a Commission recommendation on action to be taken by Member States regarding national relief mechanisms (Policy Option B.2) and relief for double taxation through bilateral agreements between Member States (Policy Option B.3) could help to reduce the number of instances in which cross-border inheritances are subjected to double taxation. This would ease the exercise of fundamental freedoms. Extending the level of double taxation relief available in cross-border inheritance tax cases could mean a reduction

of costs for taxpayers and could over time benefit an increasing number of taxpayers who make use of their right to engage in cross-border activity.

Binding EU legislation which would compel Member States either to design their tax systems in such a way as to prevent the likelihood of double taxation, or to give double taxation relief, would be likely to lead to more certain effects than the previous options.

Comparing the policy options

In order to assess the policy options to eliminate discrimination (Policy Options A), the following criteria were used:

Incentive: Incentive for Member States to change their discriminatory rules

Effectiveness: in terms of achieving the objective of enforcing EU law and increasing certainty regarding the types of provisions that are discriminatory

Proportionality: Going no further in terms of EU measures than is necessary to achieve the objective

Efficiency: The extent to which the objectives can be achieved for a given level of resources/at least cost

Flexibility: Ease of adjustment to reflect changes in case law and domestic legislation

The following tables provide a comparison of the ratings of the policy options as negative, neutral or positive.

Comparison of policy options A

Criteria	A1 – status quo	A2 – publication of a set of principles	A3 - legislation
Incentive to change law	0	+	+
Effectiveness	0	+	+
Proportionality	+	+	0
Efficiency	-	+	0
Flexibility	n/a	+	0

Conclusion: The preferred option is Policy Option A.2 because, by supporting the Commission's infringement actions, it would address the current tax discrimination problems efficiently, flexibly and in a cost-effective way.

In order to assess the policy options to reduce double taxation (Policy Options B), the following criteria were used:

Effectiveness: in terms of achieving the objective of reducing double taxation and ensuring certainty in this regard

Proportionality: Going no further in terms of EU measures/EU harmonisation than is necessary to achieve the objective

Efficiency, in particular ease of implementation: The extent to which the objectives can be achieved for a given level of resources/at least cost, in particular regarding ease of implementation

Flexibility: in terms of scope, ease of adjustability to reflect changes in laws and practices

Comparison of policy options B

Criteria	<u>B1</u>	<u>B2</u>	<u>B3.b</u>	<u>B3.c</u>	<u>B6.b</u>	<u>B6.c</u>	<u>B6.d</u>
	no change	improved unilateral relief	Inheritance tax treaties based on EU Model	Income tax treaties with inheritance provisions	Binding common definitions and basis	Binding relief plus dispute settlement	B6.b + B6.c
Effectiveness	-	+	+	+	++	++	++
Proportionality	0	+	+	+	--	-	--
Efficiency/ease implementation	0	++	--	--	--	-	--
Flexibility	n/a	++	-	-	--	-	--

Conclusion: **The preferred option is Policy Option B.2**, as an effective and certainly proportionate way to tackle double taxation. Other options would be significantly less cost-effective and more time-consuming and there is a question mark over their political feasibility. Option B.6.c is one that may be considered at a later date if necessary in the light of the review of the implementation of Option B.2. The preference for Option B.2 over Options B3.b and B3.c, both of which concern solutions via bilateral actions by Member States, is also based on the fact that Member States do not seem to prioritise the conclusion or revision of double taxation treaties on inheritances.

The preferred option

The preferred option, which is a combination of policy options A.2 and B.2, is, in brief:

The principles flowing from the case-law on inheritance taxes that should govern the design of inheritance tax systems could be assembled in a single, published document. The idea

would be to make EU citizens more aware of the rules which Member States must respect when taxing cross-border inheritances. The document could also assist Member States in bringing their inheritance tax rules into line with EU law. It would, for example, describe the types of rules which the Court has identified as breaches of the fundamental freedoms.

In addition, the Commission could adopt a Recommendation (under Article 292 of the TFEU) identifying the elements that would eliminate double taxation in a comprehensive way while not requiring Member States to change their substantive inheritance tax rules. It would suggest that Member States make changes to their domestic mechanisms for double taxation relief on that basis. The ultimate aim could be to ensure that the overall tax burden on a cross-border inheritance would not be higher than in an internal situation by making already-existing unilateral reliefs work better.

Monitoring and evaluation

The Commission could prepare regular evaluation reports focusing on data on cross-border migration; ownership of cross-border assets (including financial assets and immovable property); domestic inheritance tax rates as well as on amendments to Member States' domestic law to remove discrimination and reduce double taxation; the evolution of bilateral agreements; and the relevant Court cases.

The Commission's right to present a legislative proposal in the future if deemed appropriate would of course remain unaffected.