Revue européenne et internationale de droit fiscal

European and International Journal of Tax Law

2016 4

The EU Regulation 650/2012 on International Successions. Some issues from a tax perspective

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Introduction

On 27 July 2012, the *Official Journal of the European Union* published the EU Regulation No. 650/2012 of the European Parliament and the Council, of 4 July 2012, on many aspect of succession and on the creation of a European Certificate of Succession. This includes aspects with regard to jurisdiction, applicable law, recognition and enforcement of decisions and acceptance and enforcement of authentic instruments. The Regulation entered into force 20 days after its publication but it is applicable (except for certain rules) as from 17 August 2015.

But, the Regulation explicitly excludes from its scope all tax and administrative matters. However, tax law applies on situations recognized under other branches of law (civil law, commercial law, etc.); thus, any change in the law regulating those situations will indirectly affect the tax law applicable to them. In this regard, there are some issues included in the Regulation that could have tax implications. This article discusses some of those issues that could implicitly or indirectly be affected by taxes.

First and according to the Commission, 450 000 cross-border successions take place in the EU every year which represent a value estimated at more than EUR 120 billion. From the Commission point of view the existence of different national rules made inheritances involving more than one EU country complex and costly. Private international law governing the international successions is usually is complex to apply due to the differences between civil law legislations, the contradictions between them and the complexity of the norms of conflict.

The Regulation attempt to conciliate the consequences of these different systems with the objective of guaranteeing the free movement of persons, the early organisation by citizens of their succession in a Union context and the protection of the rights of heirs and legatees and of persons close to the deceased, as well as of the creditors of the succession. Since it is considered that these targets cannot be sufficiently achieved by the Member States on their own, the EU takes the initiative in accordance with the principle of subsidiarity[1] without going beyond what it is necessary to achieve the objectives (principle of proportionality as set out in the same article).[2]

Therefore, according to the Commission point of view the new Regulation makes cross-border inheritance simpler by clarifying which EU country's courts will have jurisdiction to deal with the inheritance and which law the courts will apply to the succession.

1. Article 5 of the Treaty on European Union and the Treaty on the Functioning of the European Union 2012/C 326/01.

2. Recital 80 of the Regulation: "Since the objectives of this Regulation, namely the free movement of persons, the organization in advance by citizens of their succession in a Union context and the protection of the rights of heirs and legatees and of persons close to the deceased, as well as of the creditors of the succession, cannot be sufficiently achieved by the Member States and can therefore, by reason of the scale and effects of this Regulation, be better achieved at Union level, the Union may adopt measures in accordance with the principle of subsidiarity as set out in Article 5 of the Treaty on European Union. In accordance with the principle of proportionality, as set out in that Article, this Regulation does not go beyond what is necessary in order to achieve those objectives".

I. The Scope of the Regulation

A. A broad scope of application of the Regulation

From a general perspective, the Regulation will apply to the succession to the estates of deceased persons (Art. 1) and includes all civil-law aspects of succession to the estate of a deceased person, namely all forms of transfer of assets, rights and obligations by reason of death, whether by way of a voluntary transfer under a disposition of property upon death or a transfer through intestate succession.[3]

The Regulation is applicable in the territory of all Member States, (with the exception of United Kingdom, Ireland and Denmark), as from 17 August 2015.[4]

B. The Exclusions

B.1. The general exclusion from the scope of the Regulation

According to Recital 10, the Regulation does not apply to revenue matters or to administrative matters of a public-law nature. Thus, the national law of every Member State will determine the taxes applicable to the succession and their amount, whether these be taxes payable by the deceased at the time of death or any type of succession-related tax to be paid by the estate or the beneficiaries. It is also a question of the national law to establish whether the release of succession property to beneficiaries under the Regulation or the recording of succession property in a register should be subject to the payment of taxes.

Article 1 includes this clear purpose when indicating that the Regulation shall not apply to revenue, customs or administrative matters, and that any recording in a register of rights in immovable or movable property, including the legal requirements for such recording, and the effects of recording or failing to record such rights in a register.[5]

Although the Regulation applies to almost all aspects of a succession, for sake of clarity, a number of questions which could be seen as having a link with matters of succession are explicitly excluded from its scope, particularly any aspects related to grants, contracts of life insurance, trusts, matrimonial regimes, maintenance obligations, and the nature of property rights.[6]

B.2. The specific exclusions of trusts and gifts prior to the decease

First, all the issues related to the creation, administration and dissolution of trusts are intended to be excluded from the scope of the Regulation, Accordingly, Art. 1(2)(j) establishes the exclusion from the scope of the Regulation the creation, administration and dissolution of trusts. But this should not be understood as a general exclusion of trusts. If a trust is created under a will or under statute in connection with intestate succession the law applicable to the succession under the Regulation should apply with respect to the devolution of the assets and the determination of the beneficiaries.[7]

Further, the transfer of property rights, interests and assets created or transferred otherwise than by succession, for instance by way of gifts, are also excluded from the scope of the Regulation.[8] However, the applicable law to the succession which determines whether gifts or other forms of dispositions inter vivos giving rise to a right in rem prior to death should be restored or accounted for the purposes of determining the shares of the beneficiaries in accordance with the law applicable to the succession.[9]

II. The selection of the country and the governing law of a succession

A. The connecting factors to establish the country dealing with the succession

Regarding the jurisdiction dealing with the succession, as a general rule, the courts of the Member State in which the deceased had his habitual residence at the time of death shall have the jurisdiction to deal with the succession as a whole.[10] If the habitual residence is not located in a Member State, the courts of a Member State in which assets of the estate are located shall have the jurisdiction provided the deceased had the nationality of that Member State at the time of death or, the deceased had his previous habitual residence in that Member State and no more than five years had elapsed since the change of residence.[11]

In case no Member State had jurisdiction according to the mentioned rules, the courts of the Member State in which assets were located shall have jurisdiction to rule on those assets.[12]

3. Recital 9 of the Regulation.
4. Article 84.
5. Article 1(1).
6. See Recitals 11, 12, 13 and 14.
7. Recital 13.
8. Article 1(2)(g).
9. Recital 14.
10. Article 4.
11. Article 10 (1).
12. Article 10 (2).

In case the deceased had chosen the law of a Member State to rule his succession, the parties concerned may choose the courts of that member State.[13]

B. The connecting factors to establish the law governing the succession

The law governing the succession will be the law chosen by the deceased provided that it is the law of his nationality at the time of making the choice or at the time of death. If the deceased possess multiple nationalities he may choose the law of any of them.[14]

Next, provided there is no election by the deceased, the law applicable to the succession as a whole shall be the law of the state in which he has his habitual residence at the time of death.[15] However, as an exceptional rule established in the Regulation, if, according to all the circumstances of the case, at the time of death the deceased was manifestly more closely connected with a state other than the State of his habitual residence the law applicable will be the one of that other State.[16] From the wording of this rule and its location it is relevant to notice that those circumstances will not change the habitual residence of a deceased but they will change the law applicable.

Finally, it is important to take into consideration that the law applicable to the succession may be the law of a third state, i.e. a non-EU member state. In this case, the Member state dealing with the succession has the obligation of applying that law.[17]

C. The meaning of "habitual residence" and "close connection"

The concept of "habitual residence" is not defined in the Regulation. Therefore, the fact that that this is a concept of succession civil law and not a tax concept must be taken into consideration. To clarify the civil concept of habitual residence Recitals 23, 24 and 25 should be taken into consideration.

The first idea that comes into the mind of tax practitioners is that the concept from a civil law perspective are less straight forward than from the tax perspective. Domestic tax rules usually establish a time limit period under which when certain period elapses (e.g. more than 183 days in a year period) the person concerned is considered as a tax resident. Sometimes also the economic interest is taken into consideration, i.e. when he obtains most of his income in certain country he will be considered as a tax resident in that country.

In this respect, the Regulation does not explicitly establish a certain period of time in order to consider a person as a habitual resident in a certain state. It obliges to take into consideration all the circumstances that maybe crucial in order to ascertain a stable connection with the state concerned. But it does not explicitly establish a time limit or a certain period to consider those circumstances. However, Recital 23[18] indicates that "(...) in order to determine the habitual residence, the authority dealing with the succession should make an overall assessment of the circumstances of the life of the deceased during the years preceding his death [emphasis added] and at the time of his death, taking account of all relevant factual elements, in particular the duration and regularity of the deceased's presence in the State concerned and the conditions and reasons for that presence. The habitual residence thus determined should reveal a close and stable connection with the State concerned taking into account the specific aims of this Regulation".

Accordingly, it appears that the permanence in a country for only 183 days would not be enough for civil purposes. The plural "years" could be interpreted as that at least 2 years should be taken into consideration in order to establish whether a "close and stable connection" exists or not.

On the other hand, according to Recital 25,[19] the "habitual residence" strictly considered should not

13. Article 5 (1).
14. Article 22 (1).
15. Article 22 (1).
16. Article 21 (1) et (2).
17. Article 20.

18. (23) In view of the increasing mobility of citizens and in order to ensure the proper administration of justice within the Union and to ensure that a genuine connecting factor exists between the succession and the Member State in which jurisdiction is exercised, this Regulation should provide that the general connecting factor for the purposes of determining both jurisdiction and the applicable law should be the habitual residence of the deceased at the time of death. In order to determine the habitual residence, the authority dealing with the succession should make an overall assessment of the circumstances of the life of the deceased during the years preceding his death and at the time of his death, taking account of all relevant factual elements, in particular the duration and regularity of the deceased's presence in the State concerned and the conditions and reasons for that presence. The habitual residence thus determined should reveal a close and stable connection with the State concerned taking into account the specific aims of this Regulation.

19. (25) With regard to the determination of the law applicable to the succession the authority dealing with the succession may in exceptional cases – where, for instance, the deceased had moved to the State of his habitual residence fairly recently before his death and all the circumstances of the case indicate that he was manifestly more closely connected with another State – arrive at the conclusion that the law applicable to the succession should not be the law of the State of the habitual residence of the deceased but rather the law of the State with which the deceased was manifestly more closely connected. That manifestly closest connection should, however, not be resorted to as a subsidiary connecting factor when-

be taken into consideration when "the deceased had moved to the State of his habitual residence fairly recently before his death" and still maintains closer connections with another state in which case the law of the habitual residence should not be applicable. This "fairly recently" move to another state could be completed by the possible 2-year term stated in Recital 23. The question arises on what should be the maximum term to take into consideration in order to verify whether the close connections exist? To answer this question, one could only refer to Art. 10(1) (b) which establishes the subsidiary competent jurisdiction (and does not refer to the law of the succession) based on the habitual residence criterion.[20] This provision considers that provided no more than a 5-year period has elapsed from changing the habitual residence from a Member State to a third state, the jurisdiction of that member state maybe competent to rule on the succession (if the estate is located in that member state). Thus, we could interpret the Regulation as establishing a 2-5-year period in order to ascertain whether the connection with the concerned state exists or not.

The Regulation takes into consideration that the time limit may not be enough in certain complex cases in order to establish which the habitual residence is. Those cases refer especially to expats moving for professional or economic reasons but keeping their center of interest in another state.[21] This notion of "center of interest" is not related to any economic interest (as it is usually the case in tax law) but refers the family and social life connections with the state concerned. Now, there may be cases where it is difficult to establish the habitual residence and those family and social life connections are not easy to establish in one single state because "the deceased lived in several States alternately or travelled from one State to another without settling permanently in any of them" in which case the nationality of the location of the assets of the estate could be taken into consideration as factual circumstances to establish the habitual residence.

These circumstances may sound familiar to tax practitioners dealing with international tax issues. Art. 4 of the OECD and UN Model Tax Conventions establishes the tiebreaker rule concerning the residence of those who may benefit from the Convention.[22] When the two contracting states claim the residence of the same taxpayer, paragraph 2 of article 4 establishes the criteria to be taken into consideration in order to determine the (only one) residence for tax purposes. The center of vital interests, which is similar to the family and social connections, plays a secondary role in the tiebreaker rules, and only plays a role after the permanent home element. Nationality is considered as the last element to take into consideration in order to finally ascertain his residence.

In conclusion, the habitual residence for succession purposes may be different from the habitual residence for tax purposes. This means that the succession may be ruled by the law of a state (either a member state or a third state), the jurisdiction ruling on the estate maybe in another member state, and the taxation of that estate and/or the heirs, maybe subject to the competence of another state. If the

ever the determination of the habitual residence of the deceased at the time of death proves complex.

20. Article 10. Subsidiary jurisdiction.
1. Where the habitual residence of the deceased at the time of death is not located in a Member State, the courts of a Member State in which assets of the estate are located shall nevertheless have jurisdiction to rule on the succession as a whole in so far as:
(a) the deceased had the nationality of that Member State at the time of death; or, failing that, EN L 01/118 *Official Journal of the European Union*, 27 July 2012.
(b) the deceased had his previous habitual residence in that Member State, provided that, at the time the court is seised, a period of not more than five years has elapsed since that habitual residence changed.

21. Recital (24). In certain cases, determining the deceased's habitual residence may prove complex. Such a case may arise, in particular, where the deceased for professional or economic reasons had gone to live abroad to work there, sometimes for a long time, but had maintained a close and stable connection with his State of origin. In such a case, the deceased could, depending on the circumstances of the case, be considered still to have his habitual residence in his State of origin in which the centre of interests of his family and his social life was located. Other complex cases may arise where the deceased lived in several States alternately or travelled from one State to another without settling permanently in any of them. If the deceased was a national of one of those States or had all his main assets in one of those States, his nationality or the location of those assets could be a special factor in the overall assessment of all the factual circumstances.

22. OECD MC. Article 4 RESIDENT 1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of incorporation, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein. 2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows: (a) He shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests); (b) If the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode; (c) If he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national; (d) If he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

legislations are not aligned, e.g. because they come from different civil law systems (e.g. common law vs continental law) there will be cases where it is difficult to ascertain where in the law some tax events may fit, or even whether some events are subject to taxation or not. This happens with certain institutions which exist in common law countries which is difficult to fit them in tax provisions of civil law countries.[23] This means that Regulation opens the application of the different inheritance tax systems to all the EU member States and conversely, that all domestic inheritance civil law systems are potentially subject to all the tax systems of the EU member states.[24] From this point of view, even though the Regulation has unified the rules applicable to the succession it may not have achieved the simplification of the international inheritance tax planning.

III. Specifics issues

A. Countries with multi legal succession law systems

The Regulation envisages the situations where there is more than one civil legislation within the state whose legislation is applicable to the succession, establishing the priority of the internal conflict of laws rules.[25] Further, the Regulation is not applicable to internal conflicts of laws. Only in the absence of such internal rules the Regulation sets out the connecting factors, i.e. habitual residence at the time of death, closest connection and location of the relevant element.[26]

B. Successions which take place at different moments in time

The transfer of property that a succession implies usually takes place at a certain specific moment, i.e. either when the heirs accept the assets or when the deceased dies; and it always implies the demise of the decedent. However, there are legal systems where the succession may begin to take place before the demise.

In this regard, the Regulation seems not to accept that agreements as to succession enforceable during the life of the future decedent should be considered as a succession. Recital 11 limits the scope of the Regulation to succession mortis causa. Further, Article 3(1)(a) defines "succession" as the succession to the estate of a deceased person covering all transfers of assets upon death. In addition, article 3(1)(b) defines "agreement as to succession" as an agreement which creates, modifies or terminates rights to the future estate of one or more persons' party to the agreement. Besides, Recital 14 envisages that Property rights, interests and assets created or transferred otherwise than by succession, for instance by way of gifts, should also be excluded from the scope of this Regulation. However, it should be the law specified by the Regulation as the law applicable to the succession which determines whether gifts or other forms of dispositions inter vivos giving rise to a right in rem prior to death should be restored or accounted for the purposes of determining the shares of the beneficiaries in accordance with the law applicable to the succession.

However, there are civil law systems that accept the possibility of this type of agreements. Thus, one of the issues that may arise is the possibility of conflicts of different applicable laws when the succession does not happen in one single moment (e.g. there is an agreement as to succession[27]) and there is a change of residence or nationality between the different moments of the transmission. According to the Regulation there will be only one unique law applicable regardless of the characteristics of the elements concerned (movable or immovable) and their location.[28]

Further, if the agreement as to succession enforceable during the life of the decedent is considered as a type of succession there could be more than one tax system applicable to the same succession and different taxes paid in different moments. In this case, the taxes paid before should be taken into consideration for the assessment of the remainder assets of the succession, once the decedent party to the agreement passes away.

23. The disconnection between different legal systems is expressly recognized by the Regulation regarding rights in rem. See Recitals 13 and 14 and article 31.

24. If for instance, a German person moves to Spain seven months before he dies, he would be considered as tax resident in Spain and his heirs taxed in Spain but the law applicable to the estate should be the German one since he could not be considered as an habitual resident in Spain.

25. Spain is the typical country where there are multiple civil law systems and different inheritance tax regulations with important implications for the application of the Regulation. See A. ATXABAL RADA, "El Reglamento Sucesorio europeo y sus implicaciones fiscales", Academia Vasca de Derecho, *Boletín Jado*, Bilbao, Año XII, No. 25, Diciembre 2013, pp. 357-377.

26. Article 36, 37 and 38.

27. Article 23.

28. Recital 37: In order to allow citizens to avail themselves, with all legal certainty, of the benefits offered by the internal market, this Regulation should enable them to know in advance which law will apply to their succession. Harmonised conflict-of-laws rules should be introduced in order to avoid contradictory results. The main rule should ensure that the succession is governed by a predictable law with which it is closely connected. For reasons of legal certainty and in order to avoid the fragmentation of the succession, that law should govern the succession as a whole, that is to say, all of the property forming part of the estate, irrespective of the nature of the assets and regardless of whether the assets are located in another Member State or in a third State. Art. 1 establishes the law applicable to the succession as a whole.

C. The issue with partnerships

The topic of partnerships implies one of the classic and usually unresolved issues arising in international tax law when those entities are considered as fiscally transparent in one country and opaque in another country.

For instance, an issue could arise when an expat from an EU member state is resident in Spain both for tax purposes and civil law purposes and he is a partner of a partnership resident in Spain, and the partnership is the owner of real estate located in a country where the partnership is not recognized as an independent entity. If he chooses his national law as the law governing his succession when he dies, the state where the property is located could consider that the heirs are subject to inheritance tax whereas the state where the partnership is located would not see any transfer of immovable property but the possible transfer of the interest in the partnership. The question could arise as to consider the existence of the partnership and/or its tax treatment as part of the law of succession or should it be considered as a commercial law issue and, therefore, out of the scope of the Regulation. The tax treatment regarding inherited assets may be different according to its nature, movable or immovable property. Further, some countries do not accept the jurisdiction and taxation of other countries on immovable assets located within their jurisdiction as we have seen regarding UK. To the author opinion, subject to a better criterion and according to the objectives of the Regulation, the law of succession chosen by the taxpayer should rule the whole issues arising from the succession in order to simplify the procedures.

This means that the tax administration of a Member State could tax a taxable even that does not exist under its own legislation.

The wording of Art. 1(2)(h) seems to provide a solution by excluding from the scope of the Regulation the "questions governed by the law of companies and other bodies, corporate or unincorporated, such as clauses in the memoranda of association and articles of association of companies and other bodies, corporate or unincorporated, which determine what will happen to the shares upon the death of the members". However, although the consideration of partnerships as independent entities maybe considered as a question governed by company law, the classification as fiscally transparent entities is a question of tax law.

D. EU Regulation with respect to third countries and UK, Ireland and Denmark

Tax practitioners outside the EU should take into account that the Regulation is meant to be of universal application as Article 20 establishes.[29] Besides, third states may be affected through the renvoi rules existing within their legislation. According to article 24, the application of the law of a third state shall mean the application of the rules of law in force in that State, including its rules of private international law in so far as they make a renvoi to the law of a Member State or the law of another third State (with certain exceptions). Further, as discussed above, the jurisdiction of a Member State may be universally competent to rule on the succession if the deceased was a national of that state or had been habitually resident in that state within the previous 5 years, provided there are assets in that state. It is important to mention that there is no de minimis rule on the value of those assets.[30]

In addition, it must be stressed that the new Regulation does not apply in UK, Ireland and Denmark. This means that in principle residents in those states are not subject to the rules of the Regulation, but residents in those countries with assets in participating EU countries may also be affected by the Regulation as we have seen before. Nationals of those states who are residents in the other EU Member States are subject to the Regulation.[31]

Now, the first issue that arises from this situation is whether the concept of "Member State" within the Regulation covers all EU Member States or only the ones in which it is applicable. According to the EU treaties the terms "member states" and "third states" are clearly defined, i.e. UK, Ireland and Denmark are certainly Member states and should be considered as such for the purposes of the Regulation. However, it seems to be the opinion of the persons involved in the legislative process that those countries should not

29. Art. 20. Universal application. Any law specified by this Regulation shall be applied whether or not it is the law of a Member State.

30. Article 10.

31. So, if for instance, a UK national is domiciled in UK, but lives in France and owns real estate in both France and England, when he dies without having made a will. France will apply the Regulation, i.e. the French law, considering the French courts as competent to apply that law including its forced heirship rules, to the whole succession. However, the English courts most probably will not accept this situation and will apply English intestacy law to the English property because it is immoveable property located in England. To avoid this situation, the UK national could have elected his national law, i.e. English law to apply in a will, so that French courts and tax administration would have applied English law to his whole estate. However, if he chose the French law to apply, UK would still apply English law to the immovable property in this country.

be considered as member states for the purposes of the Regulation. However, the wording of the Regulation does not cover this interpretation. The different views may have an important consequence regarding the renvoi rule in article 34(1). This article only applies to third states so it would not be applicable to UK, Ireland or Denmark.

After the Brexit it is clear that at certain moment in the near future UK will have to be considered as a third country with all the consequences included in the Regulation. However, until the process of the exit had not finished, it is my opinion that it should be considered as a Member State.

It is probably that the courts of certain Member States will consider UK, Ireland and Denmark as third states for the purposes of the Regulation in which case the European Court of Justice will have to decide on the issue.

Conclusion

First, EU Regulation 650/2012 provides for legal certainty regarding the jurisdiction and the law applicable to international successions. The Regulation explicitly excludes the tax issues from its scope. However, since tax law is always based on the other branches of law, it is important to take into consideration the possible tax consequences of the Regulation.

Next, the Regulation establishes the law of the member state where the deceased was a resident as the law governing the succession and the courts of that state as the courts having the jurisdiction to rule the succession. The main difficulties may arise from the different meanings of "residence" that the Regulation and tax laws may have.

Finally, tax practitioners and tax administrations may be aware that in the future they will have to apply the inheritance taxes of their domestic jurisdictions to successions ruled in accordance with other states' legal systems, including non-EU member states. This will create difficulties in establishing whether a taxable event has taken place, when the taxable event takes place, what are the taxable assets, etc. On the other hand, tax practitioners will have to be prepared for the situation where tax administrations of other Member States will tax successions ruled by their domestic civil laws.