A Comprehensive Analysis of ECJ Case Law on Discriminatory Treatment of Cross-Border Inheritances – Part 2

In this two-part article, the author provides a comprehensive analysis of 13 ECJ decisions on the discriminatory treatment of cross-border inheritances. Part 1, published in European Taxation 11 (2015), categorized the cases, examined the most common EU freedom at stake and outlined the first step of the ECJ’s analysis of the concept of restriction, as well as “indirect discrimination”. Part 2 discusses the requirement for a direct link between debts and immovable property, provides an overview of the justifications invoked by Member States and the possibility of such justifications being accepted by the ECJ in EU/EEA and third-country scenarios and explores the role of the proportionality principle. A comparison of ECJ case law on inheritance taxation with personal and corporate income tax cases is also given.

8. The Condition of a Direct Link between Debts and Immovable Property

The Copenhagen Economics Study96 concluded that Member States’ inheritance tax rules are in conflict with the rules on free movement of capital if they:
(1) provide for requirements that are less favourable in respect of some assets that are part of the inheritance when these assets are situated abroad;
(2) limit the deductibility of debts or liabilities relating to assets forming part of the inheritance with regard to non-residents;
(3) apply a less favourable inheritance tax treatment to legacies made to a charity established in another Member State (rather than a domestic charity);97 or
(4) offer more significant personal reductions to resident taxpayers.

European Union

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Arens-Sikken v. Staatssecretaris van Financiën (Case C-43/07)98 and Eckelkamp v. Financiën van de Belastingdienst Particulieren/Ondernemingen buitenland te Heerlen (Case C-11/07).99 The obligation to transfer legal title (despite transferring economic ownership), charges/debts secured on immovable property and an over endowment debt resulting from a testamentary parental partition inter vivos, respectively, could not be deducted from the basis of assessment and, as a result, a higher inheritance tax burden was imposed if the deceased was a non-resident of the situs state. These debts would have been taken into consideration with regard to the value of the inheritance property and presumably would have led to a lower inheritance tax rate had the deceased been a resident of the situs Member State.

It should be noted that the ECJ case law on this issue seems to be very consistent. Barbier (which was the first inheritance tax case) should have been clearer on the principles regarding the deductibility of debts referred to in article 13 of the Law on Inheritance Tax 1964,100 given that this decision was issued six months after the pivotal decision in Gerritse (Case C-234/01).101 The ECJ focused on the comparability test and did not provide guidance on the nature of the debts resulting from the obligation to transfer legal title. The direct link between the Mr Barber’s debt and the immovable property was only confirmed in the subsequent decision in Arens-Sikken, where the ECJ, in paragraph 43, mentions that, “[t]he debt was therefore directly linked to the immovable property”. Eckelkamp refers to all of the aforementioned cases regarding the deductibility of debt/liabilities and provides for more guidance. It was only in Eckelkamp that the ECJ clarified the nature of such debts and explicitly mentioned the condition of a direct link with the estate, referring explicitly to Gerritse.104

Therefore, according to the Copenhagen Economics Study, the ECJ case law can be divided into four categories. The first refers to national tax schemes that deny the deductibility of debts/liabilities related to assets forming part of an inheritance with regard to non-residents.105 Although the Study does not mention the relevant case law, this category includes Barbier (Case C-364/01),106 Arens-Sikken (Case C-43/07)107 and Eckelkamp (Case C-11/07).108 The obligation to transfer legal title (despite transferring economic ownership), charges/debts secured on immovable property and an over endowment debt resulting from a testamentary parental partition inter vivos, respectively, could not be deducted from the basis of assessment and, as a result, a higher inheritance tax burden was imposed if the deceased was a non-resident of the situs state. These debts would have been taken into consideration with regard to the value of the inheritance property and presumably would have led to a lower inheritance tax rate had the deceased been a resident of the situs Member State.

98. Supra n. 96, p. 31.
103. DE: ECLI 12 June 2008, Case C-234/01, Arnoud Gerritse v. Finanzamt Neukölln-Nord, ECJ Case Law IBFD.

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96. Copenhagen Economics, Study on Inheritance taxes in EU Member States and Possible Mechanisms to Resolve Problems on Double Inheritance Taxation in the EU p. 8 (Copenhagen Economics 2011).
97. F Vanistendael, Taxation of Charities p. 92 (IBFD 2015), Online Books IBFD.
According to Gerritsen, the distinction between a resident and non-resident is not relevant when it comes to business expenses that are directly linked to the activity that generated the taxable income in the Member State and, as a result, a Member State is not allowed to discriminate between residents and non-residents as regards such expenses. 105 Subsequently, in Bouanich (Case C-265/04), 106 Scorpio (Case C-290/04), 107 CentroEquestre (Case C-345/04), 108 ACT Group Litigation (Case C-374/04) 109 and Conijn (Case C-346/04) 110 it was decided that costs are situated in the tax jurisdiction of the source state if such costs are directly linked to the income that the source state has chosen to tax.

In inheritance taxation cases, however, the relevant business activity is not always connected to the inherited immovable property, but whether or not a direct link between the debt and the estate exists can easily be assessed. Therefore, in Eckelkamp the focus was on demonstrating such a direct link between the debt and the immovable property. The problem is that the ECJ did not decide whether such a link existed and instead decided that “it is for the Belgian court to assess whether there was a direct link between the mortgage debt and immovable property in Belgium”. 111

Regardless, Eckelkamp is an important decision because it provides guidance for taxpayers who can demonstrate, before their national courts, that the debts at issue that are not deductible in their hands because the deceased is a non-resident taxpayer, are directly linked to the immovable property and, therefore, their treatment should not be different from the treatment of the same type of debts of a resident deceased. The same concept was confirmed in Arens-Sikken, but the ECJ surprisingly did not decide the case on the basis of this consideration because it had already been demonstrated by the national court that the over endowment debt was directly linked to the immovable property. 112

Following the decision in Arens-Sikken, Eckelkamp also held that the direct link between debts and immovable property is to be assessed by the national tribunal. Given these developments, there is no longer a need to refer a question of EU law to the ECJ. The analysis herein underlines the following; a distinction between taxpayers based on their residence is not allowed in respect of expenses and debts that are directly linked to the immovable property at issue.

9. Comparative Review of the Justifications Invoked by Member States in Inheritance Taxation Cases (Second Step)

9.1. Effectiveness of fiscal supervision

Once the ECJ concludes that there has been a restriction of a fundamental freedom, it then examines any justifications invoked by the Member States. The acceptable justifications raised in taxation cases are gradually developed by the ECJ based on the “rule of reason” and they should be interpreted strictly. A critical analysis of the justifications invoked by the Member States in inheritance taxation cases follows.

One of the justifications invoked by Member States is the effectiveness of fiscal supervision. This justification was involved in Geurts (Case C-464/05), 113 Halley (Case C-132/10) 114 and Welte (Case C-181/12). 115 In Halley, however, it was invoked by the Belgian government in conjunction with the justification of the need to prevent tax avoidance and, consequently, the ECJ considered these two justifications together, as will be mentioned in section 9.2. The justification of effectiveness of fiscal supervision is an extension of the justification of “administrative difficulties” that Member States may encounter in applying their tax rules. 116

It should be mentioned that, only in Halley did the ECJ accept this justification, but the national inheritance legislation was found to be disproportionate (i.e. not necessary to attain the objective) under the “necessity test”. The Mutual Assistance Directive (77/799) 117 has a limited scope in respect of this issue because it applies only to EU Member States and not to inheritance taxes. The latter was confirmed in Geurts 118 and Halley. 119 Surprisingly, however, in Welte, the ECJ mentioned that “it [was] true that the said directive does not apply to inheritance taxes, but rejected the justification of fiscal supervision due both to the simplicity of obtaining a death certificate in the other non-EU Member States (based on an obligation derived from a bilateral convention), and the fact that German authorities provided the full tax-free allowance when an heir resident in Germany acquired immovable property located in another EU or non-EU Member State.”

9.2. The limited material scope of the Mutual Assistance Directive (77/799)

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105. Gerritsen (C-234/01), para. 53.
109. UK: ECJ, 12 Dec. 2006, Case C-374/04, Test Claimants in Class IV of the ACT Group Litigation v. Commissioners of Inland Revenue, ECJ Case Law IBFD.
111. Eckelkamp (C-11/97), para. 54.
112. Arens-Sikken (C-43/07), paras. 24-45. The ECJ stated that “it is not necessary, for the purposes of establishing the existence of a restriction prohibited in principle by Article 56(1) EC [article 63 TFEU], to determine whether there is a direct link between the over endowment debts and the immovable property included in the estate.”
118. Geurts (C-464/05), para. 28.
119. Halley (C-132/10), para. 37.

At this point, it should be mentioned that the Geurts, Halley and Welte cases were decided based on the Mutual Assistance Directive (77/799), which was repealed by the Mutual Assistance Directive (2011/16).121 Pursuant to the preamble to the new Directive, "Directive 77/799/EEC should be repealed and replaced by a new legal instrument. That instrument should apply to direct taxes and ordinary taxes that are not covered by other Union legislation". Further,122

Clearly, rules should also make it possible in particular to cover all legal and natural persons in the Union, taking into account the ever-increasing range of legal arrangements, including not only traditional arrangements such as trusts, foundations and investment funds, but any new instrument which may be set up by taxpayers in the Member States.

Additionally, article 2 of the Mutual Assistance Directive (2011/16) states that "[t]his Directive shall apply to all taxes of any kind levied by, or on behalf of, a member state or the state's territorial or administrative subdivisions, including the local authorities", which means that it is wide enough to cover inheritance taxes. Therefore, there is no reason to exclude inheritance taxes from the material scope of the new Directive and the subsequent protection and exchange of information provided by this legal instrument.

9.1.3. ECJ taxpayer protection

Despite the fact that the Mutual Assistance Directive (77/799) did not apply to inheritance taxes, the ECJ nevertheless protected taxpayers. For example, in Geurts, the ECJ underscored the possibility of the Belgian tax authorities asking the taxpayers (i.e. Mr Jogten, Maria Geurts and the son of Mr Jogten) to provide evidence and additional information.123 Strictly speaking, however, since the Directive did not apply, the ECJ should not have upheld the proposed justification, since, when the justification of the effectiveness of fiscal supervision is invoked, the ECJ argumentation is based on the effective provisions of the Mutual Assistance Directive. Therefore, if the Mutual Assistance Directive is not applied, like in inheritance taxation cases, it would be more consistent to reject the relevant justification.

It is true, however, that based on the Mutual Assistance Directive (77/799), Member States were routinely denied the ability to rely on administrative and supervisory difficulties as justifications for less favourable treatment of a cross-border situation if they could use the assistance directives, but it appears the ECJ has re-evaluated the effective super-

9.1.4. Comments on the Halley case

Three important things should be noted with regard to the Halley decision:124 the ECJ’s reference to Passenheim-van Schoot (Joint Cases C-155/08 and C-157/08), the fact that the ECJ considered the former Mutual Assistance Directive (77/799) provided equivalent protection to bilateral tax treaties125 and the alternatives that Member States could use in order to obtain the necessary information.126

With regard to Passenheim-van Schoot its use was ill advised. The case concerns income taxes that were covered by the provisions of the former Mutual Assistance Directive (77/799). Indeed, Member States could use this instrument to obtain any necessary information. In Halley, in contrast, inheritance taxes were not within the scope of the Directive.

The second observation refers to alternatives that Member States have, aside from a unilateral request for information (as mentioned in Geurts). Member States can use the provisions of an inheritance tax treaty allowing for the exchange of information. Furthermore, the ECJ reaffirmed this view in Commission v. Italy (Case C-540/07),127 which refers to an EEA situation. The Italian national legislation provided for a less favourable tax treatment of outbound profit distributions made to parent companies resident in EEA Member States as compared to purely domestic or

120. Welte (C-181/12), paras. 65-66.
123. Geurts (C-464/05), para. 28.
125. Halley (C-132/10), paras. 33-35.
126. NL. ECI, 11 June 2009, Joint Cases C-155/08 and C-157/08, X and E.H.A. Passenheim-van Schoot v. Staatssecretaris van Financiën, ECJ Case Law IBFD.
127. Id., para. 36.
128. Id., para. 37.
129. IT. ECI, 19 Nov. 2009, Case C-540/07, Commission of the European Communities v. Italian Republic. ECJ Case Law IBFD.
cross-border intra-EU profit distributions. In its conclusion, the ECJ put emphasis on the existence of a mechanism for administrative cooperation and concluded that a restriction may be justified where there is no agreement in place on mutual administrative assistance in the field of taxation that is as effective as the Mutual Assistance Directive (77/799).130

Finally, according to the ECJ, the administrative assistance under EU directives and bilateral tax treaties is, in principle, equivalent.131 This, however, is debatable, when taking into consideration enforcement mechanisms and the uniform application of EU law in general,132 as well as the fact that, under international tax law, a claim that administrative difficulties necessitate a different substantive treatment of domestic and cross-border situations is perfectly understandable.

It is expected that any new case decided by the ECJ will be decided based on the Mutual Assistance Directive (2011/16), which, as mentioned in section 9.1.2, has been broadened to cover inheritance taxes.

9.1.5. The specific comparability test in the Welte case

Despite the fact that the Welte case was issued on 17 October 2013, the proceedings were still governed by the former Mutual Assistance Directive (77/799). In paragraphs 62 and 63 the Court implicitly goes one step further in deciding the territorial scope of the Directive. Two points should be mentioned: the heirs were living in Switzerland, as mentioned in subsection 9.1.1., and there are, indeed, some nuances concerning third-country situations as mentioned in subsection 9.1.4. The ECJ, for example, in A (Case C-101/05)133 (not an inheritance tax case), decided that a Member State may refuse a tax advantage in third-country situations if compliance with the conditions can be verified only by obtaining information from the competent authorities of a third country and that third country is not under any contractual obligation to provide information and the Member State proves that it is impossible to obtain that information from that country.

In Welte, no information was given as to whether Germany and Switzerland had concluded a treaty on inheritance taxation or on the exchange of information and, therefore, it could be argued that the justification of the effectiveness of fiscal supervision should have been accepted based on the facts and circumstances (if there was no minimum standard for the exchange of information).134 Nevertheless, it seems that the comparability assessment is the key in terms of why the ECJ decided in favour of the taxpayer, in this case allowing them the same treatment as the German tax authorities provide when the deceased or the heir is living in Germany. Given that, even when there was a cross-border element, Germany provided the same tax advantage as applied in the domestic situation, the justification of the effectiveness of fiscal supervision should be rejected.135 Therefore, since the same difficulties can arise when the German authorities are required to inspect information regarding the inheritance property of a person who resides in Germany and acquires by succession immovable property located in Germany from a person who was residing, at the moment of his death, in a third country, the justification was rejected because even in this cross-border scenario the heir residing in Germany was entitled to the full tax-free allowance. It should be mentioned that the same approach was applied in Commission v. Netherlands (Case C-521/07), where the Court seemed to hold that a Member State may not successfully rely upon the fiscal supervision justification when it has acknowledged, in similar situations, that such information is not necessary.136

9.2. Fight against tax avoidance

Given that the payment of estate and inheritance tax can easily be avoided if gifts are not taxed, most jurisdictions levy a gift tax in addition to estate or inheritance tax. Furthermore, most Member States apply a general anti-avoidance provision to combat tax avoidance or other special anti-avoidance rules.137 The justification of the fight against tax avoidance does not, however, fall within the scope of these anti-avoidance rules, since it has, as its point of reference, the inheritance tax itself and not its correlation with gift or estate tax.

In Halley, the justification of the effectiveness of fiscal supervision was invoked in conjunction with the justification of tax avoidance and the ECJ considered the two “taken together”.138 The ECJ should, however, have been clearer regarding the latter justification and applied the objective and subjective test of abuse of corporate income tax cases introduced in Cadbury Schweppes (Case C-196/04),139 as has been applied in other cases. Additionally, the reference to the case law of each justification independently was another source of confusion given that the aim was to prove that these justifications should be “taken together” as in Marks and Spencer (Case C-446/03),140 which was also issued before September 2011.

In addition, the justification of the fight against tax avoidance was rejected recently in Commission v. Spain (C-127/12), even in respect of the free movement of

130. Id., paras. 65-76.
133. SE: ECJ, 18 Dec. 2007, Case C-101/05, Staatverket v. A. ECJ Case Law IBFD.
134. PL: ECJ, 10 Apr. 2014, Case C-190/12, Emerging Markets Series of DFA Investment Trust Company v. Dyrektor Izby Skarbowej w Bydgoszczy, ECJ Case Law IBFD.
135. Id., at pp 65-66.
136. NL: ECJ, 11 June 2009, Case C-521/07, Commission of the European Communities v. Kingdom of the Netherlands, ECJ Case Law IBFD.
139. UK: ECJ, 12 Sep. 2006, Case C-196/04, Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v. Commissioners of Inland Revenue, ECJ Case Law IBFD.
140. UK: ECJ, 13 Dec. 2003, Case C-446/03, Marks & Spencer plc v. David Halsey (Her Majesty’s Inspector of Taxes), ECJ Case Law IBFD.
capital under article 40 of the EEA Agreement because, although this justification has a legitimate objective, Spain did not provide any evidence as to how the lack of mutual assistance between a Member State and an EEA Member State could justify the legislation concerned. Therefore, in this case, the Court’s rejection of the justification was a matter of proof, and not the existence of an EEA situation, in respect of which justifications of restrictions can more easily be accepted by the ECJ, provided proper evidence is furnished, following the Skatteverket v. A (Case C-101/05) decision:

[...], the taxation by a Member State of economic activities having cross-border aspects which take place within the Community is not always comparable to that of economic activities involving relations between Member States and third countries. According to the Court, it may also be that a Member State will be able to demonstrate that a restriction on the movement of capital to or from third countries is justified for a particular reason in circumstances where that reason would not constitute a valid justification for a restriction on capital movements between Member States.

It should be reiterated that the EFTA countries are treated as third countries in considering the justification of a restriction, as seen in Rimbaud (Case C-72/09), which was mentioned in section 4.2.2. of Part 1 of this article, published in European Taxation 11 (2015).

9.3. Survival of small and medium-sized enterprises and other social reasons

The survival of small enterprises was the justification invoked by the Belgian government in Geurts in order to justify not granting the exemption from the inheritance tax in respect of small enterprises that did not employ at least five full-time workers in the Flemish region. This justification was rejected, however, based on the fact that the internal and cross-border situations were comparable. While the Court, in paragraph 26 of the decision, stated that, under specific circumstances, this justification could not be accepted, the Belgian government had not demonstrated why it was particularly important to grant this advantage to undertakings that have their seat in Belgium and not to undertakings that were established in another Member State. The truth was that the loss of tax revenue justification was hiding behind the stated justification, since Belgium, by extending the exemption to these small and medium-sized enterprises not established in its territory, would lose tax revenue. Furthermore, although the Belgian legislation did not make a distinction based on the residence of the small enterprise, it provided for indirect discrimination, since it is mostly companies in Belgium that employ full-time workers in the Flemish region.

The social reasons justification was also invoked in Jäger (Case C-256/06), which is similar to Barbier. Based on the German legislation of the Jäger case, the granting of the tax-free amount and the valuation at a reduced rate constituted the tax advantage, since the agricultural land and forests were outside Germany. If the land had been in Germany, however, specific favourable valuation methods and a tax-free allowance would have been provided. The German government invoked the social reason that the advantage was granted in order to compensate for the specific costs involved in maintaining the social role fulfilled by agricultural and forestry activities and to prevent the heir from being forced to sell or relinquish the agricultural holding in order to pay the inheritance tax. The social reasons justification was not, however, accepted for the same reason as the justification in favour of the survival of small and medium-sized enterprises in Matria. Since the German government did not clearly show that the situation of an heir holding property in Germany is different from that of an heir holding property in another Member State, since both heirs bear specific costs, and since agricultural holdings in other Member States will likely be subject to inheritance tax pursuant to the situs principle, the justification was rejected.

9.4. Loss of tax revenue

The loss of revenue is perhaps the most commonly rejected justification invoked by Member States and relates to the idea that compliance with EU law might cause a financial burden. While it is true that ECJ decisions are “expensive”, the primacy of EU law takes precedence over any national argument on the financial impact of ECJ decisions. Consequently, this justification is always rejected by the ECJ. It should be noted, however, that other justifications invoked are closely connected with budgetary concerns. The justification of a “balanced allocation of taxing powers”, as illustrated, for example, in Marks & Spencer (Case C-446/03), has a budgetary background, something that the ECJ has to take into consideration when it examines this justification. The nature of this justification is, however, not purely budgetary (it is also related to internationally accepted principles and the functioning of tax treaties).

The ECJ only explicitly refers to the justification of a loss of tax revenue in Missionwerk (Case C-25/10), stating that: It is settled law that the need to prevent the reduction of tax revenues is neither among the objectives stated in article 65 of the TFEU nor an overriding reason in the public interest capable of justifying a restriction on a freedom instituted by the Treaty.

As a result, the argument of the Belgian government regarding an extension of the favourable tax advantage was rejected since it related to budgetary reasons, especially

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142. ES: ECJ, 3 Sept. 2014, Case C-127/12, European Commission v. Kingdom of Spain, paras. 83-84, ECJ Case Law IBFD.
145. Geurts (C-464/05), para. 25.
147. See Corderwener et al., supra n. 132, at p. 1957.
148. Marks & Spencer (C-446/03).
149. BE: ECJ, 10 Feb. 2011, Case C-25/10, Missionwerk Werner Heukelbach eV v. Belgian State, para. 31, ECJ Case Law IBFD.
given the fact that the Belgian government did not demonstrate that charitable institutions established abroad and charitable institutions established in Belgium are not comparable as far as their purposes are concerned.

9.5. Coherence of the tax system

The coherence of the tax system is also a justification that Member States use in order to justify the non-extension of an advantage to a cross-border situation. This justification is connected with the concept that Member States could lose tax revenue due to a possible deduction that is subsequently offset by the taxation of future income. It was initially accepted in Bachman (Case C-204/90)\(^{150}\) and Commission v. Belgium (Case C-300/90).\(^{151}\) where the ECJ ruled that there was a link between the deductibility of premiums and the taxability of subsequent income.

The coherence justification was invoked in Jäger, Mattner, Welte and in Commission v. Germany. It should be mentioned that these cases refer to the tax competence of the situs state.

In Jäger, the German government argued that there is a direct link between specific obligations that result from the subordination of holdings in Germany to the general interest, on the one hand, and the particular kind of valuation applied to those holdings, on the other. The ECJ, however, explicitly rejected, in paragraph 51 of the case, this justification, since the non-resident heirs own agricultural land in Germany and incur the same costs as heirs who both reside and own property in Germany. It seems that, yet again, the comparability assessment was important with regard to the consideration of a justification.

The Mattner and Welte cases are similar. The ECJ states in Welte that:\(^{152}\)

The tax advantage resulting, in the member state in which the inherited immovable property is located, from the application of a full allowance against the taxable value in a case where that inheritance involves at least one resident of that State is not offset in that State by any particular tax charge by way of inheritance tax.

As a result, in both cases, the ECJ did not prove that there was a direct link between granting a tax-free allowance, which has an impact on the value of the property, and an inheritance tax charge. The immovable property in the situs states is taxed regardless of whether the tax-free allowance or a lower tax-free allowance is granted to the taxpayer. This is similar to the last indication ("the taxation of immovable property as such") with regard to the comparability assessment, as mentioned in section 6.3.2.3. of the first part of this article. Consequently, there was no direct link between granting a full allowance to resident taxpayers and the offsetting of that advantage by a particular tax levy. The same applied in Commission v. Germany, which is, in fact, the infringement procedure case underly-

9.6. Neutrality argument/double deduction

9.6.1. Neutrality argument in general

In evaluating whether or not a discriminatory restriction exists, the ECJ, in principle, does not take into account the tax treatment in another country. This approach is logical, as discrimination is a difference in treatment of similar situations by one Member State, which is consistent with the prohibition against compensatory taxation.\(^{153}\) Therefore, if the source state discriminates against the cross-border situation relative to the domestic one, it cannot, in principle, raise the argument that the discrimination is negated by the tax system of the residence state. Consequently, each Member State must apply non-discriminatory treatment in its legal system, irrespective of the legal circumstances of the same taxable activity in other Member States.\(^{154}\)

The neutrality argument was first raised in Amurta (Case C-379/05),\(^{155}\) which refers to discriminatory dividend taxation, and was rejected by the ECJ. As an example, it mentions the lack of a tax treaty between the state of residence and the situs Member State, and/or the ineffectiveness of the unilateral tax credit granted by the state of residence.\(^{156}\) The ECJ applied the treaty-based overall approach and required full "neutralization", something that is not provided either by the current ordinary tax credit of the state of residence based on a tax treaty or the unilateral tax credit. To be, however, more precise, neutralization based on the unilateral tax credit is not an argument \textit{a priori}, since the ECJ rejects it from the very beginning, without considering its factual and legal application. The "all or nothing approach", however, remains in respect of the credit granted based on the tax treaty and, therefore, any "partial neutralization" by the granting of an ordinary tax credit does not negate the source state's obligation to provide the tax benefit.\(^{157}\)

As a result, in corporate taxation cases, like Amurta (Case C-379/05),\(^{158}\)European Communities v. Italian Repub-

\begin{itemize}
\item \footnote{G. Kofler, Tax Treaty Neutralization of Source State Discrimination under the EU Fundamental Freedoms, 65 Bull. Int. Taxn. 12, p. 684 (2011), Journals IBFD.}
\item \footnote{Id., at p. 684.}
\item \footnote{NL: ECLI 8 Nov. 2007, Case C-379/05, Amurta SGPS v. Inspecteur van de Belastingdienst/Amsterdam, ECJ Case Law IBFD.}
\item \footnote{Id. at paras. 78-79.}
\item \footnote{Kofler, supra n. 153.}
\item \footnote{Amurta (C-379/05), paras. 78-80.}
\end{itemize}
lic and European Commission v. Kingdom of Spain (Case C-487/08), the ECJ rejected the neutrality argument when it was based on unilateral relief by the state of residence, but clarified that, “it cannot be excluded that a Member State may succeed in ensuring compliance with its obligations under the Treaty through the conclusion of a convention for the avoidance of double taxation with another Member State.”

But, “[i]f it is […] for the national court to establish whether account should be taken, […] of the DTC, and, if so, to determine whether that convention enables the effects of the restriction on the free movement of capital […], to be neutralised”.

Moreover, in the Commission v. Spain case, the ECJ clarified that:

It must be recalled that the Court has held that in order to attain the objective of neutralisation, the application of the method of deduction should enable the tax on dividends levied by the Member State from which the dividends are paid to be deducted in its entirety from the tax due in the Member State of residence of the taxpayer receiving those dividends in such a way that, if those dividends are ultimately taxed more heavily than the dividends paid to taxpayers residing in the Member State from which those dividends are paid, that heavier tax burden may no longer be attributed to that Member State, but to the State of residence of the recipient taxpayer which exercised its power to impose taxes.

Based on the aforementioned considerations, in almost all of the cases where the neutrality argument was raised by the source state, the ECJ rejected it, since total neutralization was not allowed due to the existence of the ordinary tax credit in conjunction with insufficient taxation in the state of residence (for example, the dividends were not sufficiently taxed in the Member State of the shareholder/residence state). Nevertheless, what is noteworthy is that the ECJ accepted (partly), for the first time, the neutrality argument in the recent decision in Joined Cases J.B.G.T. Miljoen (Case C-10/14), X (Case C-14/14) and Société Générale SA (Case C-17/14), in respect of the latter in light of the facts and the effects of the Belgium-Netherlands Income and Capital Tax Treaty (2001).

It was apparent that the restriction alleged was entirely neutralized by the fact that, in France, the tax on dividends for the 2000 to 2007 tax years inclusive was offset in full.

9.6.2. Neutrality argument in inheritance tax cases

The “neutrality argument” in inheritance taxation is directly related to the double dip of losses argument, since, according to national governments, there is a possibility that the inheritance debt will be taken into consideration twice, i.e. in the situs and residence state.

The neutrality argument was first raised in the Eckelkamp and Arens-Sikken cases, which were decided on the same day (11 September 2008) and deal with the method of assessing inheritance duties in a situation similar to that applicable in Barbier. In both cases, the estate of the deceased was located in the referring country. The ECJ, in replying to the neutrality argument, which was linked to the “double deduction” of debts justification (both in the residence and source state), took the opportunity to reaffirm its prior statement as set forth in the Amurta case. It answered that a Member State cannot rely on the existence of a tax advantage granted unilaterally by another Member State in order to escape its obligations under the EC Treaty.

However, the ECJ did not answer whether or not this would be different in respect of a tax credit on the basis of a tax treaty.

The neutrality argument was also mentioned in Mattner, in which the ECJ reiterated the previous case law and subsequently rejected it in respect of the granting of unilateral relief. The author maintains that the same answer should be given in respect of a credit based on a tax treaty. The existence, however, of a full tax credit (in comparison to the ordinary tax credit) depends on the Member State’s tax system and the estate located therein.

9.6.3. Neutrality argument in personal income tax cases

It is true that the neutrality argument is considered differently in the context of personal income tax cases. In a more recent case, Infeld (Case C-303/12), the ECJ differentiates its ruling from Amurta, Eckelkamp and Arens-Sikken, explicitly mentioning that:

[...] such a justification cannot be invoked by a taxpayer’s State of residence in order to evade its responsibility in principle to grant to the taxpayer the personal and family allowances to which he is entitled, unless that State is released by way of an international agreement from its obligation to take full account of the personal and family circumstances of taxpayers residing in its territory who work partially in another Member State or it finds that, even in the absence of such an agreement, one or more of the States of employment, with respect to the income taxed by them, grant advantages based on the personal and family circumstances of taxpayers who do not reside in the territory of those States but earn taxable income there.

Therefore, the existence of a tax treaty or unilateral relief granted by the residence state can justify the decision by the state of employment not to grant a tax advantage. These advantages will, in any event, be granted by the Member State of residence of the taxpayer, which is able to duly take into account the personal circumstances of the taxpayer. Also of note is that the neutrality argument in Infeld is connected to the justification of the preservation of the
allocation of the power to impose tax between Member States. 170

9.6.4. Why the neutrality argument should be rejected in inheritance tax cases

It is true that Member States take into consideration, in applying their inheritance taxes, inter alia, the net value of the estate, as well as the relationship between the heirs and the deceased. These are not, however, the “family and personal circumstances” that Imfeld mentions in paragraph 69. Therefore, inheritance taxation matters should follow the Amurta line of reasoning and the subsequent rejection of the neutrality argument. Four reasons justify this opinion, which are examined in sections 9.6.4.1. to 9.6.4.3.

9.6.4.1. The distinction between personal income taxes and inheritance taxes

It is true that the Imfeld case relates to personal income taxation. Despite the fact that both taxes can be classified as direct taxes, there are considerable differences between them. Both taxes are personal and direct and their tax rate is determined mainly according to the value of the inherited property to the heir in respect of inheritance taxes and earned income in respect of income taxes. Furthermore, personal criteria like the relationship between the heir and the deceased or the marital status of the taxpayer are taken into account in the final assessment of both taxes.

Inheritance taxes, however, are not levied by all Member States (nine Member States, i.e. Austria, Cyprus, Estonia, Latvia, Malta, Portugal, Romania, the Slovak Republic and Sweden do not have either an estate tax or an inheritance tax), while all Member States impose income taxes. Furthermore, the ability to pay, without a doubt, plays an important role with regard to the application of income taxes, since the deceased is taxed according to his lifetime ability to pay income tax on his revenue from labour and wealth. 171 The ability to pay in inheritance and gift taxes, however, is taken into account at the level of the heir/beneficiary. When A inherits EUR 50,000 from his father, his ability to pay increases by EUR 50,000, irrespective of the residence of his father.

Given the differences between personal and inheritance tax, it seems that the ECJ takes the position that these two taxes are considerably different and, therefore, there is no need to apply this doctrine, in order to buttress its argument that residents and non-residents are in a comparable situation. This consideration is not, however, in line with other ECJ case law on wealth taxation, where the ECJ applies the Schumacker 172 doctrine and the 90% rule, as an indicator of comparable situations. The non-application of Schumacker, in general, is discussed in section 10.

As a final note, and with regard to the double deduction argument, the author contends that, even if this argument can be accepted as a justification, it is not in line with the proportionality principle, especially taking into consideration the argumentation regarding the effectiveness of fiscal supervision justification in section 9.1. If both the situs and the residence state grant such an advantage, Member States are responsible to exchange the necessary information. Furthermore, it should be noted that if a tax treaty is in force, the primary taxing rights belong to the situs state, which should provide the deduction. Nevertheless, this does not mean that, due to the danger of a double deduction when there is no tax treaty, the situs state should abstain from granting a tax advantage. In other words, Member States are not allowed to refuse to grant an advantage because they have not concluded a tax treaty in order to circumvent their EU law obligations. Furthermore, negative integration requires the Court to take into account the legislation of a single Member State and to evaluate its compatibility with EU principles.

9.6.4.2. The small number of OECD bilateral tax treaties on inheritance matters

There is only a small number of OECD tax treaties on inheritance matters. 173 In June 2010, only 33 tax treaties were in force while 351 would be required to secure complete coverage for all Member States. Furthermore, it is generally accepted that the OECD Estate and Inheritance Draft Model Convention (1966) 174 is, for the most part, inadequate to cope with discrepancies among domestic laws and avoidance of double taxation. 175

9.6.4.3. Limited scope of unilateral mechanisms

Such a limited scope is owing to narrow or differing interpretations of national terms, the granting of an ordinary tax credit and the tax system of the situs state.

In some Member States, unilateral relief for foreign taxes is limited to a subset of assets, typically real estate and/or other immovable assets, and this limits the scope of relief, which only covers inheritance and estate taxes, not other taxes levied on the deceased’s assets.

Similar to income taxation, the breadth of the credit provision may vary between Member States that levy an inheritance tax. In this respect, several states limit the relief to the amount of domestic tax that would be due on certain assets that are considered to be located in a foreign country. 176 For example, as the state of residence, the Netherlands provides for the possibility of an inheritance tax credit, which is limited to both the actual foreign tax and the corresponding amount of the Netherlands’ inheritance tax that would be due in the absence of the unilateral measure. This means that most states provide for an


172. DE: ECJ, 14 Feb. 1995, Case C-279/93, Finanzamt Köln-Altstadt v Roland Schumacker, ECJ Case Law IBFD.

173. See Copenhagen Economics, supra n. 96, at p. 10.

174. OECD Estate and Inheritance Draft Model Convention (28 June 1966), Models IBFD.

175. Id. at p. 51.

176. G. Maisto, General Report, Death as a taxable event and its international ramifications in Cahier de droit fiscal international, vol. 95b, p. 45 (Sdu Fiscale & Financiele Uitgevers 2010), Online Books IBFD.
ordinary tax credit and not a full one, which is not contrary to EU law.\footnote{177} Finally, some other Member States only grant unilateral relief for taxes levied at the national level and not local taxes.

\section*{10. The Non-Application of the Schumacker Doctrine}

Following from this article’s discussion on the ECJ analysis of comparable situations (section 7.) and the justifications invoked by Member States (section 9.), it is useful to address another important finding: the fact that the Schumacker doctrine does not apply in inheritance taxation cases.\footnote{178}

Based on the Schumacker doctrine, “residents and non-residents are not in a comparable situation with respect to direct taxes.”\footnote{179} When a non-resident earns most (i.e. 90\%) of his income in a Member State other than that of his residence, however, he should be treated as a resident, meaning that the state of employment/source should take his personal and family circumstances into account.

If the Schumacker doctrine were to be applied in inheritance taxation cases, this would lead to the conclusion, parallel to paragraphs 30 and 31 of Schumacker, that resident deceased and non-resident deceased are not in a comparable situation with respect to inheritance taxation (the former is subject to unlimited liability on his inheritance on a worldwide basis, while the latter is taxed only on the value of property located in the source state. However, when more than 90\% of the non-resident deceased’s property is located in the Member State of situs, he should be treated as a resident deceased and should be granted all the benefits that the resident deceased enjoys.

The Schumacker doctrine favours national governments, because the high percentage, as a condition for equal treatment between residents and non-resident deceased persons, is not easily reached in the source state, since the deceased owns property (for example, a house) in his state of residence, that amounts to more than 10\% of this total property.

This finding is not extensively discussed in the literature, although the ECJ \textit{silently} rejected the Schumacker doctrine in Welte, in particular in paragraphs 48-51 thereof. It is true, however, that the German and Belgian governments’ arguments followed the Schumacker reasoning, as they were trying to prove that the situation of the non-resident Mrs Welte was not comparable to a German resident.\footnote{180} It should also be noted that, in paragraph 15 of Welte, the ECJ refers to the \textit{percentage} of property owned by Mrs Welte in Germany, concluding that only 62\% of Mrs Welte’s property was located in Germany, i.e. less than 90\%, in holding that she should be treated as a resident deceased.

Advocate General Wattel tried to explain this difference relative to income tax cases. He quoted paragraph 55 of the Welte case,\footnote{181} stating that it is not understandable in the light of the Schumacker doctrine, but he agreed with the non-application of the Schumacker doctrine. He also recently delivered an Opinion on a similar case before the Netherlands Supreme Court. In his Opinion\footnote{182} he quotes Gladpootjes (2010)\footnote{183} on the difference between the Schumacker case and the Mattner case, in order to explain the Court’s rejection of the 90\% rule:

\begin{quote}
\textit{Comparison between taxpayers with unlimited liability and those with limited liability}

The settled case law that there is a difference between residents and non-residents is based on the fact that the first group has an unlimited tax liability and the second group a limited tax liability. We must keep in mind that this case law concerns mainly income tax. It is essential to investigate what the background of a certain exemption is. The background of the tax exemption in the income tax is usually based on the presumption that below a certain subsistence level, no tax is due. Apparently, the purpose of the tax exemption for gifts is a different one. The exemption depends on the family relation. The residence is irrelevant. See para. 36 of the judgement. From that point of view, there is no justification to treat Ms Mattner less favourably than a resident of Germany.

Furthermore, he refers to Paternotte’s (2013)\footnote{184} comment, which is also helpful:

The tax allowance for an inheritance acquired by a fully liable taxpayer from his deceased spouse (or parent as in the Mattner case) seems to be observed by the CJ in the same way it observed directly related costs in cases such as Eckelkamp (ECJ 11 September 2008, Case C-11/07 Eckelkamp e.a., ECR 1-I-6845) and Arends-Sikken (ECJ 11 September 2008, C-43/07 Arends-Sikken, ECR 1-I-6887). I refer to paras 55 and 56, where the CJ compares the limited liable taxpayer inheriting a German immovable property to a fully liable taxpayer inheriting (only) a (German) immovable property of the same value. In my opinion, this goes too far. From the facts, it is clear that 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?

Therefore, Paternotte maintains that this type of comparison employed in the aforementioned cases “goes too far”, given the low percentage of 62\%, and Advocate General Wattel agrees, mentioning that it is a matter of the Member States’ competence to extend benefits to non-residents who do not meet the 90\% condition, not a matter of EU law.\footnote{185}

As the Advocate General concludes, it is true that the ECJ makes a distinction between its case law on income taxation and on inheritance taxation with regard to the application of the Schumacker doctrine. In not calculating

\footnote{181}{It follows that, as the amount of the tax-free allowance does not depend on the amount of the taxable value but is granted to the heir in his capacity as a taxable person, the fact that the non-resident heir of a non-resident deceased has limited tax liability does not, for the purposes of that allowance, make the situation of that heir objectively different from that of the non-resident heir of a resident deceased or from that of the resident heir of a resident or non-resident deceased” (Welte (C-181/12), para. 55).
\footnote{182}{NL: HR, Opinion of Advocate General Wattel, 27 June 2014, 14/00521.
\footnote{183}{D. Gladpootjes, Mattner, Free movement of capital, Calculation of gift tax, Court of Justice, HR 7.10 (2010).
\footnote{184}{R. Paternotte, \textit{Comparison between taxpayers with unlimited liability and those with limited liability}, HR 1 186 (2013).
\footnote{185}{AG Opinion in 14/00521, para. 8.14.}
percentages and safeguarding equal treatment based on numbers it is following a different direction. It focuses on the object and purpose of the legislation and the taxation, as such, by the source state, as mentioned in section 6.3.2.1 of Part 1 of this article. Advocate General Wettl seems to be satisfied with this outcome, since he was never a big “fan” of the Schumacker doctrine and he hopes that the ECJ will apply the “comparability test”, employed in the area of inheritance taxation, to income tax cases. It should be mentioned that the Netherlands Supreme Court agreed with the Opinion of Advocate General Wettl and extended the granting of the spousal exemption to cross-border inheritances, stating, however, that the Schumacker doctrine was not followed in Welte and in the recently decided Commission v. Germany case. 186

This leads to the one and only conclusion: a proportionate benefit should be granted to the non-resident, based on the percentage of income earned or property located in the situs Member State. The author acknowledges, however, that further research should be conducted on this topic.

11. The “Underestimated” Proportionality Assessment in Inheritance Tax Cases (Step 3)

The only case in which the ECJ applied the proportionality method in respect of inheritance tax laws is the Halley case. The rejection of the justification invoked was not, however, clear enough since, in paragraph 30 of the case, the ECJ simply confirmed that the effectiveness of fiscal supervision and the prevention of tax evasion constitute overriding reasons of public interest, which are capable of justifying, in general, a restriction on the exercise of the freedoms of movement guaranteed by the TFEU. Therefore, without clearly confirming whether or not these two justifications can be accepted in this case, the ECJ simply went on to the third step of testing the proportionality of the national legislation. The Court mentioned in paragraph 31 that:

Even supposing that the legislation at issue in the main proceedings is appropriate to ensuring the attainment of the objectives relating to the need to ensure effectiveness of fiscal supervision and the prevention of tax evasion, it must be noted that such legislation goes beyond what is necessary to ensure the attainment of the objective pursued.

The Court accepted the suitability of the measure (“suitability test”) and examined its necessity (“test of necessity”), finally concluding that the legislation was not necessary to attain both of the objectives, which are effective fiscal supervision and the prevention of tax evasion.

Why, however, was Halley decided on the basis of the justification of the restriction introduced by the Belgian inheritance legislation, while the Welte case was decided on the basis of justifications that weren't legitimate? As mentioned in section 9.1., the argument of effectiveness of fiscal supervision was invoked, and, in the first case, the ECJ ruled that the tax legislation was not necessary to attain this objective, while in Welte the ECJ noted that the restriction of the freedom of capital cannot be justified by the effectiveness of fiscal supervision. The author cannot justify why these two cases were decided on a different basis and contends that Halley was decided correctly on the basis of the proportionality of the national legislation, also given the fact that the Mutual Assistance Directive (77/799) did not cover inheritances taxes.

12. Conclusions and Recommendations

12.1. Conclusions

Due to the increasing cross-border mobility of individuals and assets (especially intangible assets), more and more inheritances involve at least one cross-border element in the European Union. This cross-border element can, for example, be a foreign located heir, asset and/or deceased. From a macro perspective, the revenue from inheritance and estate taxes amounts to less than 0.5% of total tax revenue in most Member States and this percentage includes both domestic and cross-border inheritances. Further, 10% of successions involve a cross-border element. 187

Nevertheless, from the perspective of EU citizens, the problems are significant: the EUR 350,000 that the Member State does not grant to the non-resident heir as a tax-free amount has a different value for the Member State itself and for the non-resident heir. Therefore, the economic significance of the problems depends on whether the issue is examined from the point of view of the Member State or EU citizen.

This article discussed the problem of discriminatory treatment of cross-border inheritances, which deters EU citizens from investing or moving to another Member State. It was not before the Barbier case, in 2003, that the ECJ reviewed the Netherlands inheritance tax rules and concluded that they are contrary to the free movement of capital. In 2015, the ECJ issued decisions on discriminatory treatment of inheritance taxation and, in most cases, it identified the discriminatory element of the national legislation; countries like Belgium, Germany and the Netherlands were forced to amend their national legislation in order to eliminate any discrimination against cross-border inheritance and gift taxation. Further, the Commission recently referred Greece to the ECJ regarding its inheritance taxation of bequests to non-profit organizations in another EU Member State or EFTA State.

A number of important findings were arrived at in this article:

- In most instances the free movement of capital was the fundamental freedom at stake, since the ECJ views an inheritance in another country as an investment. This has an important impact on the territorial scope of the protection granted by EU law, as the freedom of capital is the only freedom that covers third-country situations. It is true, however, that justifications

186. NL: HR, 9 Jan. 2015, 14/00521, BNB 87, para. 2.5.3. (2015).

187. See Copenhagen Economics, supra n. 96, at p. 72.
for restrictions in third-country scenarios are more easily accepted with regard to EEA/third-country situations.

- The ECJ case law on inheritance taxation is consistent; concepts like the applicable freedom, the restriction, the justifications, the neutrality argument and the requirement of a direct link between debts and immovable property are clearly and consistently argued.

- The condition of a direct link between the debts and immovable property has been consistently applied and the ECJ has respected the competence of national courts to interpret national law. This competence, however, does not seem to have been respected with regard to the rejection of the justification of effectiveness of fiscal supervision.

- The ECJ protects the taxpayer even when the available legal instruments are not sufficient. This was true in Welte where, despite the fact that the Mutual Assistance Directive (77/799) was not applicable, the ECJ ultimately protected the taxpayer by interpreting German law. It is doubtful, however, whether, in this case, the ECJ overstepped the limits of its competence by interpreting national law.

- The ECJ has rejected the neutrality argument following argumentation similar to that applied in dividend taxation cases. This means that the ECJ has made a distinction between inheritance tax and personal income tax cases with regard to this argument.

- The same is true in respect of the comparability assessment between residents and non-residents, as the ECJ did not follow the Schumacker doctrine, i.e. the 90% rule is not used as an indicator of residents and non-residents being in a comparable situation.

- The proportionality principle has not played an important role in inheritance taxation cases, since, in most cases, the justifications invoked were rejected. The author argues, however, that in some cases, the justifications should be accepted, but that, ultimately, the proportionality principle should "protect" the taxpayer. This also "protects" the role of the ECJ, which will not overstep the line between its competence and the national courts’ competence.

12.2. Recommendations

12.2.1. Clarifications regarding the importance of the comparability assessment

The role of the comparability assessment should be clarified. Under the current case law, the ECJ does not apply the comparability assessment in a consistent way. The comparability assessment, in some cases, belongs to the first step of the ECJ analysis, i.e. the identification of the disadvantage of the cross-border situation, while in other cases, it is included in the second step, i.e. in the “rule of reason” analysis. Despite the fact that the comparability assessment is considered a focal point of ECJ case law, the author expects more guidance from the ECJ on this issue. Furthermore, a crystal clear role of the comparability assessment would provide guidance in respect of litigation before the ECJ.

12.2.2. The role of the Schumacker doctrine

The ECJ does not apply the Schumacker doctrine in assessing whether or not residents and non-residents are in a comparable situation. Despite the fact that the outcome of the currently applicable comparability test guarantees the protection of the cross-border situation, the rejection of the Schumacker doctrine should be clearer, i.e. not implicit as it was in Welte. The Schumacker doctrine has been applied to ECJ immovable property transfer tax case law.

12.2.3. Neutrality argument in inheritance taxation cases

What is the correlation between the ECJ case law on personal taxation and that on inheritance tax with regard to the neutrality argument? The author argues that this correlation is not clear, but this does not imply that the ECJ should change its argumentation on the neutrality argument.