The New German Inheritance and Gift Tax Act – finally meeting the constitutional principles?

An overview after the promulgation in the Federal Law Gazette on November 9, 2016

by Dr. Stefan Königer (Certified Tax Advisor)

According to the new Inheritance and Gift Tax Act (IGTA), a multitude of (systematic) changes results for the determination of non-privileged assets, above all due to the consideration of debts, a materiality limit for non-operating assets as well as the joint financial statement. The requirements of the newly introduced 30% valuation haircut in case of limitations on disposition for family businesses will hardly be achievable in practice. Bulk acquisitions starting from EUR 26 million are henceforth leading to definite tax burdens. Up to an acquisition of maximum EUR 90 million, a decreasing tax relief is foreseen; furthermore, 50% of the (received) private assets or the non-privileged business assets are to be used to pay the tax. The retrospectivity of the IGTA/Valuation Act of July 1, 2016 and January 1, 2016 respectively will lead to the Federal Constitutional Court promptly having to deal with the new regulations again.

1. The New Inheritance and Gift Tax Act – an odyssey

By judgement of December 17, 20141, the Federal Constitutional Court declared the previous tax relief regulations for business assets (§§ 13a, 13b IGTA old version) as unconstitutional. The legislator was requested to submit a revision consistent with the constitution until June 30, 2016. Thereupon, the Federal Ministry of Finance released the draft of a „Law for the Adjustment of the Inheritance and Gift Tax Act to the Jurisdiction of the Federal Constitutional Court“ on June 2, 2015 (*cf. Draft of the Federal Ministry of Finance from June 2, 2015*). With minor amendments, it was officially introduced into the legislative procedure by decision of the cabinet on July 8, 2015 (*cf. Draft Legislation of the Federal Government from July 8, 2015*). However, particularly with regard to the far-reaching decrease of the privilege as well as the indefinite term ‘main purpose’ (*cf. Federal Council printed matter 353/16*), the Federal Government (*cf. Reply of the Federal Government to the Federal Council printed matter 353/15*) did not accept the criticism of the Federal Council. Since neither the hearing in the Finance Committee of the Federal Parliament led to a breakthrough (cf. Proceedings of the Financial Committee from October 12, 2015), a compromise paper was already prepared until February 11, 2016; however, a final agreement of the coalition could only be announced on

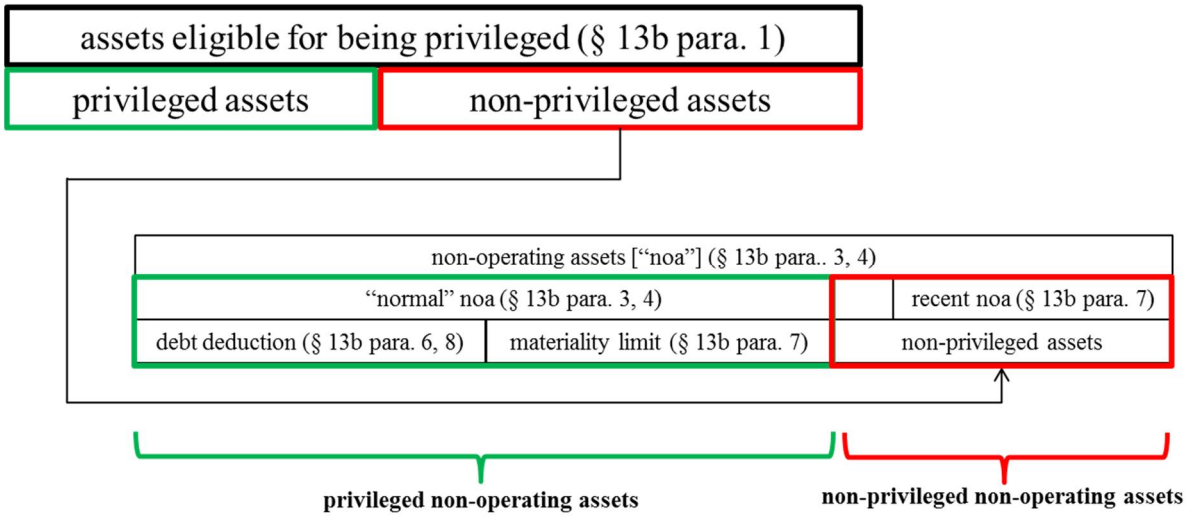
June 20, 2016 (*cf. Agreement Paper of the Grand Coalition from June 20, 2016*). Yet, after the acceptance of the amendments by the Federal Parliament on June 24, 2016 (*cf. Federal Council printed matter 344/16*), the Federal Council refused its acceptance (*cf. Federal Council printed matter 344/1/16)*; the conciliation committee that was appealed to only reached an agreement on September 22,2016 (*cf. Federal Parliament printed matter 18/9690*). The Federal Parliament passed the New Inheritance and Gift Tax Act on September 29, 2016 (*cf. Federal Council printed matter 555/16*). After the consent of the Federal Council on October 14, 2016 (*cf. Federal Council printed matter 555/16 (decision)*), the law was announced in the Federal Law Gazette on November 9, 2016 (*cf. Federal Law Gazette 2016, pt. 1, p. 2464*).

2. Privileged Assets

2.1. Overview

For the relief of business assets, agricultural and forestry businesses and shares in corporations, it is necessary but not sufficient that assets eligible for being privileged within the meaning of § 13b para. 1 IGTA are at hand. In fact, according to the IGTA, only the finally privileged assets are tax exempt as residue from assets eligible for being privileged and non-privileged assets (overview 1).

The point of origin for the determination of the non-privileged assets is the definitive catalog of non-operating assets in § 13b para. 3, 4 IGTA. Debts, which are not already to be taken into account in this connection (e.g. for the calculation of financial means (*§ 13b para. 6 sent. 1 in connection with § 13b para. 4 no. 5 sent. 1 IGTA*) or for assets backing pension scheme obligations (*§ 13b para. 6 sent. 1 in connection with § 13b para. 3 IGTA*)), with the exception of the recent non-operating assets and the recent financial means (*§ 13b para. 8 IGTA*), can then be offset against the non-operating assets pursuant to § 13b para. 6 IGTA. These so-called net non-operating assets are, pursuant to § 13b para. 7 IGTA, in the amount of 10% of the fair market value of the business assets reduced by the net non-operating assets, regarded as privileged assets (so-called materiality limit for non-operating assets). The remaining amount, however, at least recent non-operating assets (*§ 13b para. 7 sent. 2 IGTA*) as well as recent financial means (§ 13b para. 4 no. 5 sent. 2 IGTA) are always subject to full taxation (*§ 13b para. 7 sent. 2 IGTA*).



Overview 1: (Non-)privileged business assets

2.2. Begünstigungsfähiges Vermögen

The assets eligible for being privileged include pursuant to § 13b para. 1 IGTA:

- the domestic business section of the agricultural and forestry assets within the meaning of § 168 para. 1 no. 1 Valuation Act and the self-cultivated real estates within the meaning of § 159 Valuation Act, as well as corresponding assets within the EU or the EEA;

- domestic business assets (*§§ 95 to 97 para. 1 sent. 1 Valuation Act*) upon the acquisition of a whole commercial business or a branch of a business, an interest in an original commercial (*§ 15 para. 1 sent. 1 no. 2 Income Tax Act (ITA)*), commercially infected (*§ 15 para. 3 no. 1 ITA*), deemed commercial (*§ 15 para. 3 no. 2 ITA*) or independently active partnership (*§ 18 para. 4 sent. 2 ITA*), an interest of a personally liable partner in a limited joint-stock partnership or an interest in it or corresponding assets in the EU or the EEA;

- shares in a corporation with a domestically registered office or domestic place of management or within the EU or the EEA if the deceased or the donor held a direct share in the nominal capital of more than 25%. The minimum share can also be reached via pool agreements, according to which the deceased or donor as well as the other pool members are mutually obliged to only uniformly dispose of the shares or to solely transfer to shareholders that are liable to the same obligation and to uniformly execute the voting right towards non-pooled shareholders.

In comparison with the former regulations, the catalog of assets eligible for being privileged has therefore almost remained unchanged. Merely in a few points, clarifications have been included in the legal references.

2.3. Privileged assets

The assets eligible for being privileged are privileged pursuant to § 13b para. 2 sent. 1 IGTA and thus tax exempt pursuant to §§ 13a, 13c IGTA, insofar as these do not consist of non-privileged assets. The latter result from the non-operating assets pursuant to § 13b para. 3, 4 IGTA, which remain after the deduction of the debts within the meaning of § 13b para. 6, 8 IGTA as well as the so-called materiality limit for non-operating assets within the meaning of § 13b para. 7 IGTA (cf. also overview 1 in section 2.1 and the explanations in section 2.4.)

In order to avoid cases of abuse, it is assumed that the assets eligible for being privileged pursuant to § 13b para. 2 sent. 2 IGTA, consist entirely of non-privileged assets if the non-operating assets pursuant to § 13b para. 4 no. 1 to 4 IGTA as well as the gross financial means pursuant to § 13b para. 4 no. 5 IGTA amount to at least 90% of the fair market value of the assets eligible for being privileged within the meaning of § 13b para. 1 IGTA. In this context, however, non-operating and financial means, which, by means of fiduciary relationships, solely and permanently serve the settlement of pension scheme obligations and are not accessible to other creditors, are not to be included in the assessment of the 90%-threshold (§ 13b para. 2 sent. 2 IGTA).

2.4. Non-privileged assets

2.4.1. Modified definition of non-operating assets (§ 13b para. 4 IGTA)

2.4.1.1. Real estates made available for use to third parties (no. 1)

According to applicable law, real estates made available for use to third parties, parts of real estates, rights and buildings equivalent to real estates represent non-operating assets. The previous derogations have been mostly taken over (e.g. making available of real estates due to a company split-up within a group or so-called housing companies). The non-operating assets catalog was merely complemented by the regulation of § 13b para. 4 no. 1 subpara. e) IGTA. Therefore, the making available of real estates that serve the selling of own goods and products within the scope of supply contracts, are henceforth explicitly excluded from the classification as non-operating assets, so that e.g. in case of the making available for use of gas stations for the selling of petroleum products legal security has occurred. Another practical case of application concerns the making available for use of restaurants by breweries for the purpose of sales promotion of their products.

2.4.1.2. Shares in corporations of not more than 25% (no. 2)

Analogously to the previous legal situation, shares in corporations with a direct share in nominal capital of not more than 25% are non-operating assets. This does not apply if these belong to the main purpose of the business of a credit institution or a financial services institution within the meaning of § 1 para. 1, 1a Credit Institutions Act or an insurance company that is subject to supervision pursuant to § 1 para. 1 no. 1 Insurance Supervision Act. The pooling clause *(§ 13b para. 1 no. 3 sent. 2 IGTA*) applies as well (*§ 13b para. 4 no. 2 sent. 2 IGTA*).

2.4.1.3. Works of art and the like, as well as items serving the private lifestyle (no. 3)

The previous catalog of § 13b para. 2 sent. 2 no. 5 IGTA that contained works of art, art collections, scientific collections, libraries and archives, coins, precious metals and precious stones, is now extended by stamp collections, vintage cars and sailplanes. The catchall element "items typically serving the private conduct of life" ensures that also other items that are not explicitly mentioned, represent non-operating assets. Merely if the trade, the production or the processing of the aforementioned items is the main purpose of the commercial business, non-operating assets do not exist (*§ 13b para. 4 no. 3 IGTA*).

2.4.1.4. Securities and comparable receivables (no. 4)

§ 13b para. 4 no. 4 IGTA was only adapted regarding the references to the respectively current version of the law, as compared to the current legal situation. Therefore, securities and comparable receivables represent harmful non-operating assets, insofar as these do not pertain to the main purpose of the commercial business of a credit institute or financial services institution within the meaning of § 1 para. 1, 1a Credit Institutions Act or an insurance company that is subject to supervision pursuant to § 1 para. 1 no. 1 Insurance Supervision Act.

2.4.1.5. Financial means (no. 5)

Throughout the IGTA, the definition of the so-called financial means in § 13b para. 4 no. 5 sent. 1 IGTA remained unchanged, so that they still include means of payment, credit balances, monetary claims and other receivables. Contrary to the previous legal situation, the positive balance of the contributed and the withdrawn financial means in the last two years before the decisive point in time when the tax becomes chargeable is to be classified as so-called recent financial means and thus always as non-operating assets (*§ 13b para. 4 no. 5 sent. 2 IGTA*). Furthermore, on the one hand, the amount of the non-harmful financial means over-

hang was reduced from 20% to 15% of the fair market value of the business assets to be stated; on the other hand, pursuant to § 13b para. 4 no. 5 sent. 3 IGTA it only applies if the main purpose of the business or the subordinated corporation serves an agricultural (*§ 13 para. 1 ITA*), original commercial (*§ 15 para. 1 sent. 1 no. 1 ITA*) or self-employed activity (*§ 18 para. 1 no. 1, 2 ITA*). Thereby, pursuant to § 13b para. 4 no. 5 sent. 4 IGTA, the activity can also be carried out by a company within the meaning of § 13 para. 7 ITA, § 15 para. 1 sent. 1 no. 2 ITA or § 18 para. 4 sent. 2 ITA.

2.4.1.6. Exception 1: Non-operating assets serve the settlement of pension scheme obligations

If, according to the previous legal situation, only receivables from pension plan reinsurances for the settlement of pension scheme obligations have not been classified as non-operating assets, § 13b para. 3 IGTA henceforth clarifies that non-operating assets within the meaning of § 13b para. 4 no. 1 to 5 IGTA, which solely and permanently serve the settlement of debts from pension scheme obligations and are not accessible to all remaining, not directly entitled creditors,, do not represent non-operating assets insofar as their fair market value equals the pension scheme obligations.

In order to avoid a double counting of financial means and debts, these are neither considered for the test of financial means pursuant to § 13b para. 4 no. 5 IGTA nor the debt deduction from non-operating assets within the meaning of § 13b para. 6 IGTA (*§ 13b para. 3 sent. 2 IGTA*).

2.4.1.7. Exception 2: Reinvestment of non-operating assets in case of acquisitions by way of death

In case of non-operating assets within the meaning of § 13b para. 4 no. 1 to 5 IGTA, which were acquired by way of death, the attribution to non-operating assets ceases to apply retroactively pursuant to § 13b para. 5 sent. 1 IGTA if, on the one hand, within two years after the point in time when the tax becomes chargeable, these are invested in assets eligible for being privileged within the meaning of § 13b para. 1 IGTA, which were acquired by the deceased and directly served an agricultural *(§ 13 para. 1 ITA*), original commercial (*§ 15 para. 1 sent. 1 no. 1 ITA*) or self-employed activity (*§ 18 para. 1 no. 1, 2 ITA*) and do not represent non-operating assets. On the other hand, the investment has to occur based on a preconceived plan

of the deceased; a reinvestment in non-operating assets is not possible (*§ 13b para. 5 sent. 2 IGTA*).

Furthermore, an attribution of financial means within the meaning § 13b para. 4 no. 5 IGTA to the non-operating assets ceases to apply retroactively if they are used based on a preconceived plan of the deceased, in order to pay the remuneration within the meaning of § 13a para. 3 sent. 6 to 10 IGTA in case of recurring seasonal fluctuations (*§ 13b para. 5 sent. 3, 4 in connection with sent. 2 IGTA*).

The acquirer has to prove that the requirements are at hand in the case of § 13b para. 5 sent. 1 IGTA as well as of § 13b para. 5 sent. 3 IGTA (*§ 13b para. 5 sent. 5 IGTA*).

2.4.2. Determination of the net value of non-operating assets ("debt deduction") pursuant to § 13b para. 6, 8 IGTA

If, according to the previous legal situation, the non-operating assets test was conducted without considering debts, henceforth § 13b para. 6 sent. 1 IGTA stipulates that the fair market value of the non-operating assets ("gross non-operating assets") is to be reduced by those debts which pursuant to § 13b para. 3, 4 IGTA have not already been "used" (= remaining debts), i.e. not offset against financial assets or assets backing pension scheme obligations; these debts are allotted pro rata to the non-operating assets.

The amount of reduction results pursuant to § 13b para. 6 sent. 2 IGTA from its multiplication with the ratio of the fair market value of the non-operating assets („gross non-operating assets") to the fair market value of the business assets plus the remaining debts pursuant to § 13b para. 3, 4 IGTA.

However, it is to be noted that recent financial means within the meaning of § 13b para. 4 no. 5 sent. 2 IGTA, as well as non-operating assets that are not to be attributed to the business for at least two years (*§ 13b para. 7 sent. 2 IGTA*), are excluded from the debt deduction. Moreover, economically not burdening debts (e.g. in case of subordination of the creditor, *c.f. Federal Parliament printed matter 18/8911, p. 4*) cannot be considered regarding the debt deduction. Also debts that exceed the average debts of the previous three years before the point in time when the tax becomes chargeable, are generally not to be considered for the debt deduction pursuant to § 13b para. 6 IGTA. Merely if the increase of debts was caused by the operational activity, a further deduction is possible (*§ 13b para. 8 sent. 2 clause 2 IGTA*).

The lower limit of the net non-operating assets is always the sum of recent non-operating assets and recent financial means (*§ 13b para. 8 sent. 3 IGTA*).

2.4.3. Materiality limit for non-operating assets pursuant to § 13b para. 7 IGTA

After the fair market value of the net non-operating assets is determined, it is reduced pursuant to § 13b para. 7 sent. 1 IGTA by 10% of the fair market value of the business assets after the deduction of the fair market value of the net non-operating assets (so-called materiality limit for non-operating assets). Recent non-operating assets as well as recent financial means always represent pursuant to § 13b para. 7 sent. 2 IGTA non-privileged assets and are thus not included in the materiality limit for non-operating assets pursuant to § 13b para. 7 sent. 1 IGTA.

2.5. Group structures (§ 13b Abs. 9 IGTA)

One of the fundamental amendments of the IGTA includes the determination of the (non-)privileged assets in corporate structures. If, according to the previous law, the determination of the non-operating assets was carried out at each level of holding, according to the new regulation in § 13b para. 9 IGTA, a so-called joint financial statement has to occur, based on which the privileged assets are then determined.

For this purpose, a 'consolidated' view is to be carried out, according to which, for the purposes of the application of § 13b para. 2 to 8 IGTA, all (in-)direct interests in partnerships and shares in corporations with a share in the nominal capital of more than 25% (*analogously: pooled shares due to the reference in § 13b para. 9 sent. 5 IGTA to § 13b para. 4 no. 2 IGTA*), independently of the registered office or place of management, are to be recorded according to the respective interest or share. The financial means, economic assets within the meaning of § 13b para. 4 no. 1 to 4 IGTA as well as the debts determined this way are then to be summarized in a so-called joint financial statement; recent financial means and recent non-operating assets are to be stated separately (*§ 13b para. 9 sent. 2 IGTA*). Thereby, pursuant to § 13b para. 9 sent. 3 IGTA, such receivables and liabilities are not to be included, which exist between the companies to be included in the joint financial statement or in relation to the transferred business or corporation (so-called debt consolidation within the group). For the determination of the harmful financial means (*§ 13b para. 4 no. 5 IGTA*), the net non-operating assets (*§ 13b para. 6, 8 IGTA*) as well as the materiality limit for non-operating assets (*§ 13b para. 7 IGTA*) it is to be resorted to the joint financial statement. In case of interests in a part-

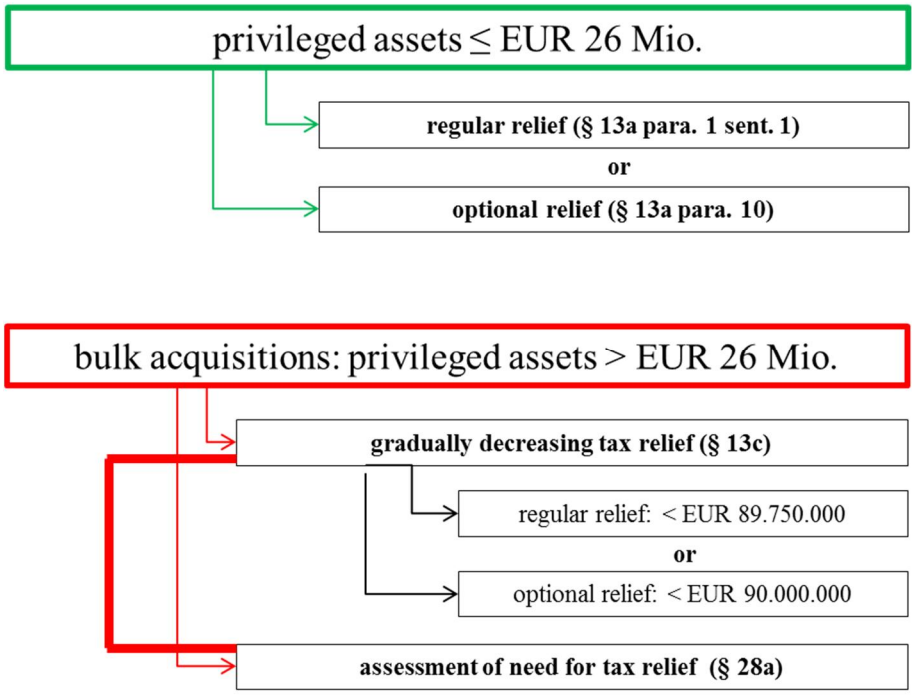
nership, the joint financial statement does not include the receivables and liabilities relating to the partnership.

3. Types of Relief

3.1. Overview

According to the new regulation of the IGTA, pursuant to § 13a para. 1 sent. 1 IGTA, privileged assets remain 85% tax-exempt in case of acquisitions of up to EUR 26 million (so-called regular relief). Furthermore, as under previous law, a (gradually) decreasing deduction amount is applied (*§ 13a para. 2 IGTA*). Alternatively, generally, a relief of 100% (so-called optional relief) can be irrevocably applied for pursuant to § 13a para. 10 IGTA.

If the acquisition of the privileged assets within the meaning of § 13b para. 2 IGTA exceeds EUR 26 million, the taxable person can choose between the (gradually) decreasing relief pursuant to § 13c IGTA and the assessment of need for tax relief pursuant to § 28a IGTA. However, a choice regarding the gradually decreasing relief only exists if the acquisition does not amount to at least EUR 89.75 million (regular relief) or EUR 90 million (optional relief) (overview 2).



Overview 2: Types of relief for privileged business assets

3.2. Acquisition of privileged assets of up to EUR 26 million

As according to already applicable law, the regular relief of 85% - as well as the gradually decreasing deduction amount pursuant to § 13a para. 2 IGTA - applies to the privileged assets within the meaning of § 13b para. 2 IGTA, however, henceforth limited to an acquisition in the amount of up to EUR 26 million. Similar to § 14 IGTA, for the determination of the limit of EUR 26 million pursuant to § 13a para. 1 sent. 2 IGTA, all acquisitions of privileged assets within the meaning of § 13b para. 2 IGTA within ten years by the same person are added together with the respective fair market value at the point in time when the tax becomes chargeable. Moreover, acquisitions before the (retroactive) coming into effect of the IGTA on July 1, 2016 are to be included as well (*§ 37 para. 11 sent. 2 IGTA*).

Due to the methodically changed tax relief, the application for the irrevocable optional relief pursuant to § 13a para. 10 IGTA is in principle always possible as an alternative to the regular relief pursuant to § 13a para. 1 sent. 1 IGTA. Only in those cases, in which the assets eligible for being privileged within the meaning of § 13b para. 1 IGTA consist of more than 20% of non-operating assets pursuant § 13b para. 3 and 4 IGTA, the optional relief cannot be applied for (*§ 13a para. 10 sent. 2 IGTA*). For this purpose, the relevant quota is determined by the ratio of the sum of the fair market values of the respective economic assets of the non-operating assets pursuant to § 13b para. 3, 4 IGTA (thus before considering any possibly remaining debts) to the fair market value of the business (*§ 13a para. 10 sent. 3 IGTA*).

3.3. Acquisitions of privileged assets > EUR 26 million (bulk acquisitions)

3.3.1. (Gradually) decreasing tax relief (§ 13c IGTA)

If the acquisition of the privileged assets within the meaning of § 13b para. 2 IGTA exceeds EUR 26 million, a so-called bulk acquisition is at hand. Consequently, upon an irrevocable application by the acquirer (*§ 13c para. 2 sent. 5 IGTA*), the 85% (regular relief) or 100% (optional relief) tax relief is reduced by one percent respectively for each full EUR 750,000 by which the acquisition of the privileged assets within the meaning of § 13b para. 2 IGTA exceeds EUR 26 million. In case of the regular relief, this results in no tax relief being granted from an acquisition of EUR 89.75 million. In case of the optional relief, mathematically, in fact, only from an acquisition of EUR 101 million no tax relief would be possible anymore; nonetheless, § 13c para. 1 sent. 1 IGTA regulates that from an acquisition of EUR 90 million no tax relief applies anymore (*§ 13c para. 1 sent. 2 IGTA*). If, within ten years, an acquisition

of privileged assets within the meaning of § 13b para. 2 IGTA is made by the same person and if the limit of EUR 26 million is exceeded by the final acquisition, the previous tax-exemption ceases to apply retroactively.41 Instead – as an alternative to the assessment of need for tax relief pursuant to § 28a IGTA – a request for application for the (gradually) decreasing tax relief can be submitted.

If a request pursuant to § 13c IGTA has already been submitted, the tax-exemption granted for the pre-acquisitions ceases to apply insofar as it does not correspond to the decisive tax relief based on the final acquisition. This does not apply if a request for assessment of need for tax relief within the meaning of § 28a para. 1 sent. 1 IGTA was submitted for the pre-acquisition (*§ 13c para. 2 sent. 3 IGTA; cf. section 3.3.2.*). Moreover, acquisitions before the (retroactive) coming into effect of the IGTA on July 1, 2016, are also to be included in the addition (*§ 37 para. 12 sent. 3 IGTA*).

§ 13c para. 2 sent. 1 IGTA clarifies that § 13a para. 3 to 9 IGTA apply accordingly in case of the (gradually) decreasing tax relief. Therefore, with regard to the total payroll (cf. section 4.1.), holding (cf. section 4.2.) and procedural regulations (cf. section 5) as well as optional relief (cf. section 3.2.), it can be referred to the respective explanations.

3.3.2. Assessment of need for tax relief (§ 28a IGTA)

If the privileged assets within the meaning of § 13b para. 2 IGTA exceed the limit of €26 million, the acquirer can pursuant to § 28a para. 1 sent. 1 IGTA apply for (tax) remission insofar as he proves that he is not personally able to pay the tax (without considering a tax relief) from his so-called available assets.

The available assets include 50% of the sum of the fair market values of the assets transferred by inheritance or gift that do not represent privileged assets within the meaning of § 13b par. 2 IGTA as well as of the assets that belong to the acquirer at the point in time when the inheritance or gift occurs and which are no privileged assets within the meaning of § 13b para. 2 IGTA (*§ 28a para. 2 IGTA*). If an application for (tax) remission pursuant to § 28a IGTA is submitted, consequently, all assets of the acquirer are to be valuated according to the general regulations of the Valuation Act and in case of assets eligible for being privileged within the meaning of § 13b para. 1 IGTA, the (non-)privileged assets within the meaning of § 13b para. 2 IGTA are to be determined.

The afterwards remaining tax can be deferred and is interest-bearing (*§ 28a para. 3 sent. 3 IGTA in connection with §§ 234, 238 General Fiscal Code*) for up to six months, insofar as its collection at the due date would represent a significant hardship for the acquirer. This is especially the case if the payment of the tax requires extra borrowing or available assets have to be sold. Notwithstanding the deferral of § 28a para. 3 IGTA, a deferral pursuant to § 222 General Fiscal Code or § 28 para. 1 IGTA may come into consideration.

However, the tax waiver is pursuant to § 28a para. 4 IGTA subject to the condition subsequent that the total payroll and holding regulations, which apply in case of the so-called optional relief, are adhered to and that the acquirer does not receive any additional available assets within the meaning of § 28a para. 2 IGTA within ten years after the point in time when the tax becomes chargeable. In the former case, the tax waiver is reduced pro rata; in the latter case, the tax waiver fully ceases to apply, however, pursuant to § 28a para. 4 no. 3 sent. 2 IGTA, an application for (tax) remission can be submitted anew. Herein, then the newly acquired assets are to be taken into consideration.

3.4. Deferral regulation

According to the amendment of § 28 para. 1 IGTA, in case of an acquisition by way of death, the acquirer of privileged assets within the meaning of § 13b para. 2 IGTA is eligible for a deferral regarding the allotted inheritance tax of up to seven years (*§ 28 para. 1 sent. 1 IGTA*) However, the deferral is only interest-free for the first annual amount, i.e. one seventh, which is due within one year after the determination of the tax. Otherwise, interest on the deferred amount incurs at the amount of 0.5% for each full month since the determination.

The deferral ends ("guillotine effect") as soon as the acquirer violates the respective total payroll or holding regulations (*§ 28 para. 1 sent. 5, 6 IGTA*). The hereby resulting tax itself cannot be deferred (*§ 28 para. 1 sent. 7 IGTA*). Furthermore, the deferral ends if the acquirer transfers or gives up the business (*§ 28 para. 1 sent. 8 IGTA*).

3.5. Valuation haircut for "family businesses"

Depending on the compensation clause in the partnership agreement/articles of association or the statute, the IGTA stipulates a valuation haircut of up to 30% (merely) of the privileged assets within the meaning of § 13b para. 2 IGTA. Accordingly, the following regulations have to be included in the partnership agreement/articles of association or the statute:

- the withdrawals or distributions are limited to maximum 37.5% of the taxable profit of the company, not considering payments of taxes on income allotted to the share/interest,

- the disposition of the interests or shares is limited to co-partners, relatives within the meaning of § 15 General Fiscal Code or a foundation set up in the interest of a family (*§ 1 para. 1 no. 4 IGTA*), and

- in case of withdrawal from the company, a settlement is provided that lies below the fair market value of the interest or share (*§ 13a para. 9 sent. 1 IGTA*).

Thereby, it is to be observed that the provisions have to correspond to the actual circumstances and are only granted for privileged assets within the meaning of § 13b para. 2 IGTA (*§ 13a para. 9 sent. 1, 2 IGTA*). On the other hand, the provisions have to have already existed for two years before the point in time when the tax becomes chargeable and are also afterwards to be adhered to for at least 20 years (*§ 13a para. 9 sent. 4 IGTA*). Otherwise, if the provisions or the actual circumstances are not complied with, the valuation haircut ceases to apply retroactively ("guillotine effect", *§ 13a para. 9 sent. 5 IGTA*). Most partnership agreements/articles of association or statutes should not be able to meet the aforementioned requirements, so that in these cases a use of the valuation haircut applies at the earliest in two years after the modification of the partnership agreements/articles of association or statutes. Nonetheless, § 13a para. 9 IGTA should remain a „red tape", as the subsequent holding period of 20 years may actually not be observable, above all in cases of reorganizations or sales (and later amendments of the partnership agreements/articles of association or statutes).

4. Total payroll and holding regulations

4.1. Total payroll regulation

Due to the unconstitutionality of the former total payroll regulation, the IGTA now provides a regulation that is formed based on the number of employees. Thus, the total payroll regulation is not applied if the initial total payroll amounts to EUR 0 or the business has no more than five employees. In case of more than five to ten employees, the minimum total payroll amounts to 250% of the initial total payroll over a period of five years (regular relief) or 500% of the initial total payroll over a period of seven years (optional relief, assessment of need for tax relief), in case of more than ten to fifteen employees, 300% or 565%, as well as in case of more than fifteen employees, 400% or 700% (overview 3).

	minimum total payroll	
employees	regular relief (5 years)	optional relief (7 years)
≤ 5[1]	-	-
> 5 and ≤ 10	250%[2]	500%[2]
> 10 and ≤ 15	300%[2]	565%[2]
> 15	400%[2]	700%[2]

[1] Analogously: initial total payroll = EUR 0

[2] % of the decisive initial total payroll

Overview 3: Total payroll regulation for privileged business assets

The definition of the (initial) total payroll generally remained unchanged. Additionally, it was regulated that for purposes of the total payroll regulation, remunerations paid to employees, who are on maternity leave or doing an apprenticeship, draw sickness benefits or parental benefits, remain unconsidered (*§ 13a para. 3 sent. 7 IGTA*). These persons also remain unconsidered regarding the calculation of the relevant number of employees for the total payroll.

Also after the amendment, according to § 13a para. 3 sent. 5 IGTA, a cancellation of the tax relief or the tax waiver occurs insofar as the minimum total payroll is undercut. This applies mutatis mutandis to the case of assessment of need for tax relief. (§ 28a para. 4 sent. 1 no. 1 IGTA). For the determination of the total payroll as well as the number of employees, the (in-)direct interests in partnerships as well as the shares in corporations with a(n) (in-)direct share in the nominal capital of more than 25% with a registered office or place of management in the EU or the EEA are (furthermore) to be included (*§ 13a para. 2 sent. 11, 12 IGTA*). The duties of notification in case of violation of the total payroll have been taken over by § 13a para. 7 IGTA.

4.2. Holding regulations

The previous holding regulations for tax-exempt assets (§§ 13a, 13b IGTA) that were regulated in § 13a para. 5, 6 IGTA have been adopted unaltered by § 13a para. 6, 7 IGTA, apart from few actualizations of the legal references as well as linguistic clarifications. The holding regulations are applied analogously in the case of the assessment of need for tax relief pursuant to § 28a para. 4 sent. 1 no. 2 IGTA.

The reinvestment clause was modified in such a way that the sales proceeds have to be invested in privileged assets within the meaning of § 13b para. 2 IGTA within six months, in order to avoid subsequent taxation.

5. Procedural (new) regulations

In case of the addition of acquisitions of privileged assets pursuant to § 13a para. 1 sent. 1, 2 IGTA as well as pursuant to § 13c para. 2 sent. 2 IGTA, a (generous) suspension of expiration regarding the limitation of the determination period was introduced in § 13a para. 1 sent. 4 IGTA, according to which the assessment period for the tax of the previous acquisitions does not end before the end of the fourth year, after the tax office competent for the inheritance and gift tax gained knowledge of the final acquisition.

The regulations for the determination of the initial total payroll, the number of employees as well as the decisive annual total payrolls are now codified in § 13a para. 4 IGTA and generally remained unchanged. In case of shares in corporations pursuant to § 11 para. 1 Valuation Act listed on the stock exchange, the locally competent tax office decides regarding the aforementioned determinations pursuant to §152 no. 3 Valuation Act (*§ 13a. para. 4 sent. 2 IGTA*).

As already presented, the duties of notification in case of violation of total payroll or holding regulations were transferred from § 13a para. 6 IGTA to § 13a para. 7 IGTA. Moreover, the particular burdens of proof for foreign privileged assets within the meaning of § 13b para. 2 IGTA at the point in time when the tax becomes chargeable, as well as during the decisive total payroll and holding regulations are still to be observed (*§ 13a. para.8 IGTA*).

If a valuation haircut pursuant to § 13a para. 9 IGTA is granted, within the decisive 20-year-period, the acquirer has to notify the tax office about changes regarding the limitation of withdrawals or distributions and the limitation on disposition as well as regarding compensation clauses in the articles of association/partnership agreement or statutes within one month. This also applies to changes of the actual circumstances (*§ 13a. para. 9 sent. 6 no. 1 IGTA*). Thereby, the assessment period does not end before the end of the fourth year, after which the competent tax office for the inheritance and gift tax gained knowledge hereof (*§ 13a. para. 9 sent. 6 no. 2 IGTA*).

The regulation for the determination of the (recent) financial means as well as of the (recent) non-operating assets of § 13b para. 2a IGTA was mostly transferred to § 13b para. 10 IGTA

and adapted to the modified tax relief. The regulation was complemented by the case of shares in corporations pursuant to § 11 para. 1 Valuation Act that are listed on the stock exchange, according to which the locally competent tax office decides regarding the aforementioned determinations pursuant to §152 no. 3 Valuation Act (*§ 13b. para. 10 sent. 4 IGTA*).

If an application for (tax) remission pursuant to § 28a para. 1 sent. 1 IGTA was filed, the granted tax waiver pursuant to § 28a para. 4 sent. 2 IGTA is subject to revocation and, in case of a violation of the total payroll or holding regulations or in case of the acquisition of available assets pursuant to § 28a para. 2 IGTA is to be (partly) revoked retroactively (*§ 28a para. 4 sent. 3 IGTA*). The former is to be notified within six months after the end of the seven-year total payroll term, the latter as well as an acquisition of available assets within one month after the realization of the respective facts (*§ 28a para. 5 sent. 1, 2 IGTA*). The limitation period for the payment of the tax that is not included in the application for (tax) remission does not end before the end of the fifth year, after which the competent tax office for the inheritance and gift tax has gained knowledge of the violation of the total payroll or holding regulations or the acquisition of available assets (*§ 28a para. 6 IGTA*).

6. Other

6.1. Amendment of the Valuation Act

Within the framework of the IGTA, furthermore, the regulation of the capitalization rate that is decisive for the simplified income approach, was modified. It is now uniformly 13.75. In contrast to the amendments of the IGTA, the amendment of the Valuation Act does not become effective on July 1, 2016, but already retroactively on January 1, 2016 (*§ 205 para. 11 Valuation Act*).

Hereby, this is accompanied by an unconstitutional actual retroactivity, as a retroactive disadvantage may arise for valuation dates between January 1, 2016 and June 30, 2016: If so far the regular or optional relief was gained due to the higher multiplier in the amount of 17.85 based on a base rate of 1.1%72, this is not possible anymore because of the amendment of § 203 para. 1 Valuation Act (new version); possibly, high additional inheritance and gift tax burdens may arise.

6.2. Continued applicability of the inheritance tax beyond June 30, 2016 and retroactive application as of July 1, 2016

From an inheritance and gift tax perspective, it is also questionable if - due to its unconstitutionality – the IGTA expired after June 30, 2016 (despite the embedded retroactivity in the amended version) or if it continued (unchanged) to be valid until the amendment was announced in the Federal Law Gazette on November 9, 2016.

The predominant opinion in the tax journals (*cf. inter alia Drüen, DStR 2016, p. 643*) assumes that in the absence of a constitutional basis and explicit appointment of a date regarding an amendment or limitation of the continued validity by the Federal Constitutional Court, no legal basis exists for inheritance and gift tax collection after June 30, 2016. However, the fiscal authority (*cf. Federal Ministry of Finance from June 21, 2016, Federal Tax Gazette 2016, pt. I, p. 5*) as well as few authors in tax journals (*cf. Guerra/Mühlhaus, Erbschaftsteuerreform 2016, p. 146*) hold the opinion that the former law was still fully applicable until the amendment was passed. A concluding clarification of this question is likely to occur by the Federal Constitutional Court, as some taxable persons willing to take a risk may have speculated that in case of a transfer of non-privileged assets after June 30, 2016 until the announcement of the amendment, an „inheritance and gift tax free“ period might have occurred. Furthermore, it is questionable how the retroactivity is to be seen in relation to events of succession in this period. In my view, the retroactivity as of July 1, 2016 should not be permissible, as this contradicts the general rule of law as well as the cut-off date principle of the IGTA (*cf. Guerra/Mühlhaus, Erbschaftsteuerreform 2016, p. 230*).

7. Summary

After long political struggles, the Inheritance and Gift Tax Act is finally reformed. Whether this reform is permanent, remains to be seen, because it is to be expected that the Federal Constitutional Court will again decide about its constitutionality. Until then, the taxable person and his advisor will face new, not to be underestimated challenges. The so far already complex Inheritance and Gift Tax Act has now become even more complex, as e.g. due to the inclusion of private assets, the choice between different possibilities of privilege, versatile special regulations and exceptions. Even more than until now, tax planning and the (not to be underestimated) duties of tax declaration and notification become an “expert matter“.