

INTRODUCTION

OVERVIEW

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A. Basic Structure of the German Inheritance and Gift Tax Act

I. Overview

- 1 The Inheritance and Gift Tax Act is organized in five parts:

Part	Title	Explanations
Part 1	Tax liability	A. II.
Part 2	Valuation	A. III.
Part 3	Calculation of tax	A. IV.
Part 4	Tax assessment and tax collection	A. V.
Part 5	Authorization provisions and final provisions	A. VI.

- 2 For reasons of clarity and better practical orientation, first, the structure of the Inheritance and Gift Tax Act is presented. In this context, provisions with practical relevance, which can be found in detail in the respective commentary of §§ 1–39, are addressed. Thereby, special guidance is provided for the international practitioner.

II. Part 1—Tax liability

- 3 According to § 1, the following taxable transactions are subject to inheritance and gift tax:

Taxable transactions (§ 1)	Regulation in detail
Acquisition by way of death	§§ 3, 4, 6
Gifts inter vivos	§ 7
Earmarked gifts	§ 8
Foundations and associations set up in the interest of a family	-

- 4 Regulations in detail regarding the acquisition by way of death can be found especially in § 3; cases of provisional or subsequent inheritance (§ 6), as well as the continuing regime of common property (§ 4), are of little practical relevance. The same applies to earmarked gifts (§ 8). Gifts inter vivos are conclusively regulated in § 7.
- 5 Whether there is ultimately a taxable transaction within the meaning of the Inheritance and Gift Tax Act is determined by the regulation for personal tax liability in § 2. Cases of unlimited tax liability are regulated in § 2 para. 1 no. 1, 2, para. 3; the limited tax liability is linked to the so-called domestic assets within the meaning of § 121 of the Valuation Act. In particular, the question of whether (un)limited tax liability applies in Germany is crucial from an international tax planning perspective.
- 6 Acquisitions by way of death (§ 3) include in particular acquisitions by inheritance, bequests, asserted claims to a compulsory portion, gifts mortis causa or transfers of assets to a foundation, or total assets under foreign law (e.g., trusts). Section 3 also applies to foreign laws of succession.
- 7 The termination of the community of accrued gain(s) of spouses by way of death or otherwise is regulated in § 5. The claim to equalization of accrued gains is not part of the acquisitions by way of death (§ 3) or the gift inter vivos (§ 7). In particular, § 7 is of major practical relevance, for example, in the context of trust distributions.
- 8 The point in time when the tax becomes chargeable, which is of particular importance among others for the valuation as well as the calculation of the tax, is stated in § 9.

III. Part 2—Valuation

- 9 On the one hand, the second part of the Inheritance and Gift Tax Act includes the determination of the taxable acquisition of the decisive valuation date, as well as the valuation provisions. The valuation regulations are of particular

practical relevance, since the fair market value of the transferred economic assets does not always correspond to the determined value for tax purposes. On the other hand, tax exemptions are regulated in part 2, which are usually limited to economic assets located in the European Union or European Economic Area:

Norm	Title
§ 10	Taxable acquisition
§ 11	Valuation date
§ 12	Valuation
§ 13	Tax exemptions
§ 13a	Tax exemption for business assets, agricultural and forestry businesses, and shares in corporations
§ 13b	Privileged assets
§ 13c	Tax relief for bulk acquisitions of privileged assets
§ 13d	Tax exemption for real estate rented out for residential purposes

10 The taxable acquisition pursuant to § 10 is determined as follows:¹

1.	Tax value of the business section of the agricultural and forestry asset
	- Tax exemptions pursuant to § 13 para. 1 no. 2, 3
	+ Tax value of the business assets
	- Tax exemptions pursuant to § 13 para. 1 no. 2, 3
	+ Tax value of the shares in corporations
	= Subtotal
	- Tax exemptions pursuant to § 13a, § 13c
	+ Tax value of the residential section and the business dwellings of the agricultural and forestry asset
	- Tax exemption pursuant to § 13 para. 1 no. 2, 3, 4b, 4c
	- Tax exemption pursuant to § 13d
	+ Tax value of the real property
	- Tax exemptions pursuant to § 13 para. 1 no. 2, 3, 4a–4c

¹ Cf. Inheritance Tax Reg. R E 10.1 para. 1 (2011).

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- Tax exemptions pursuant to § 13d
 - + Tax value of the remaining assets
 - Tax exemptions pursuant to § 13 para. 1 no. 1, 2
 - 2. Tax value of the liabilities of estate, insofar as not excluded from deduction, at least lump sum for costs of succession (once per event of succession)
 - 3. Accrual of assets according to tax values (1.)
 - Deductible liabilities of estate (2.)
 - Further tax exemptions pursuant to § 13
 - 4. Enrichment of the acquirer (3.)
 - Potentially tax-exempt equalization of accrued gains § 5 para. 1
 - + Potentially pre-acquisitions to be added pursuant to § 14
 - Personal tax allowance pursuant to § 16
 - Special pension allowance pursuant to § 17
- = **Taxable acquisition (to be rounded down to full EUR 100)**
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11 In the context of § 10, it also has to be considered that the inheritance and gift tax taken over by the deceased, or the donor or a third party, increases the taxable acquisition (§ 10 para. 2). The combination of rights and liabilities or encumbrances does not lead to their expiration (§ 10 para. 3). Of particular practical importance is also the regulation of § 10 para. 6, according to which debts and encumbrances are only deductible insofar as these are not economically related to (partially) tax-exempt economic assets. Neither benefits nor services to the entitled persons according to the deed of foundation or association's statutes, nor the inheritance tax itself or obligations that benefit the aggrieved person, however, reduce the taxable acquisition (§ 10 para. 7–9). Settlement claims based on the withdrawal by way of death of a partner of a partnership or a GmbH (a limited liability company) are only subject to tax at the amount of the nominal value, even if the actual market value of the interest or share within the meaning of § 12 exceeds the settlement claim (§ 10 para. 10).

12 The decisive valuation date pursuant to § 11 is generally determined according to point in time when the tax becomes chargeable (§ 9).

13 The valuation of the taxable acquisition at the valuation date is carried out according to § 12. The real property is valued as follows:

- Undeveloped properties: §§ 178, 179 of the Valuation Act
- Improved properties: §§ 180 and the following of the Valuation Act
- Special cases: §§ 192 and the following of the Valuation Act

- 14 Thereby, the taxable person can always prove the lower fair market value based on a market value report pursuant to § 198 of the Valuation Act. The valuation of foreign real estate generally depends on market value reports, and in exceptional cases also analogously to the above-mentioned domestic valuation methods.
- 15 Shares in corporations not listed on the stock exchange, as well as business assets, are valued according to the following scheme:
1. Derive the fair market value from sales between third parties not longer than one year ago.
 2. Consider the earnings prospects of the company or another valuation method for nontax purposes recognized in the ordinary course of business.
Alternative:
Use the simplified income approach (§§ 199–203 of the Valuation Act), if it does not lead to obviously incorrect values.
 3. The lower limit is the net asset value (exception: deriving the fair market value from sales between third parties; see 1).
- 16 For foreign shares in corporations, as well as foreign business assets, the aforementioned valuation system applies analogously.
- 17 The fair market value of an interest in a noncommercial asset management partnership results from the pro rata sum of the fair market values of the economic assets and debts, which are to be determined according to the respectively relevant valuation provisions.
- 18 The valuation of agricultural and forestry assets occurs pursuant to §§ 157–175 of the Valuation Act; however, in practice, it mostly plays a secondary role.
- 19 Mineral resources, which are not part of the business assets, are stated with their values subject to income tax.
- 20 For other assets, the general regulations of the first part of the Valuation Act apply (§§ 1–16 of the Valuation Act).
- 21 The tax exemptions are regulated in § 13. This includes in particular the acquisitions of
- household items and other movable tangible items,
 - real estate, art, and scientific collections,
 - family home,
 - reversion of assets to (forefathers) parents of their descendants,
 - renunciation of claim to a compulsory portion/right to receive the equivalent of the statutory share in an estate,
 - grants for the purpose of maintenance and education,
 - common occasional gifts, and
 - grants to religious communities, foundations serving general welfare, or political parties.

- 22 Tax exemptions for business assets, agricultural and forestry businesses, and shares in corporations are part of §§ 13a–13c. Thereafter, acquisitions of privileged assets within the meaning of § 13b para. 2 of up to EUR 26 million are privileged at 85% (regular relief) or 100% (optional relief), if the respective total payroll and holding regulations pursuant to § 13a para. 3, 6 in connection with para. 10 are adhered to. For any exceeding, so-called bulk acquisitions, a gradual decrease of the privilege occurs by 1 percentage point for each full EUR 750,000.
- 23 Finally, § 13d provides a tax exemption for real estate rented out for residential purposes, which are located within the European Union or the European Economic Area, at the amount of 10% of the fair market value.

IV. Part 3—Calculation of the tax

- 24 The third part of the Inheritance and Gift Tax Act is also of particular relevance for international estate and gift tax planning. Part 3 includes the following norms:

Norm	Title
§ 14	Consideration of previous acquisitions
§ 15	Tax classes
§ 16	Tax allowances
§ 17	Special pension allowance
§ 18	Membership contributions
§ 19	Tax rates
§ 19a	Tax rate limit for the acquisition of business assets, of agricultural and forestry businesses, or of shares in corporations

- 25 The inheritance tax to be determined is to be calculated as follows:

1.	Tariff inheritance tax pursuant to § 19
–	Deductible tax pursuant to § 14 para. 1
–	Relief amount pursuant to § 19a
=	Sum 1
2.	– Reduction pursuant to § 27 (thereby divide tax according to sum 1 pursuant to § 27 para. 2 and additionally observe threshold of § 27 para. 3)
–	Creditable tax pursuant to § 6 para. 3
=	Sum 2

3.	–	Creditable tax pursuant to § 21 (thereby divide tax according to sum 2 pursuant to § 21 para. 1 sent. 2)
	=	Sum 3
		Minimum tax pursuant to § 14 para. 1 sent. 4, maximum tax limited pursuant to § 14 para. 3 (half the value of further acquisition)

- 26 The addition of acquisitions by the same person within 10 years (§ 14) is of particular practical relevance. The tax class (§ 15) depends on the personal relation of the deceased or donor to the acquirer. This applies accordingly to the amount of tax allowances (§ 16). In case of limited tax liability, an allowance of EUR 2,000 always applies. For acquisitions by way of death, the surviving spouse as well as children of up to 27 years of age are granted a special pension allowance (§ 17). The amount of the decisive tax rate (§ 19) in turn depends on the tax class as well as on the fair market value of the taxable acquisition within the meaning of § 10. If natural persons of tax class II and III acquire business assets, a relief amount is applied pursuant to § 19a.

V. Part 4—Tax assessment and tax collection

- 27 In the fourth part of the Inheritance and Gift Tax Act, the tax assessment and tax collection are regulated in §§ 20–35. For international successions and transfers of assets inter vivos, particularly the crediting of foreign tax (§ 21), as well as declaration and notification duties, are to be considered (§§ 30–33). Moreover, part 4 also includes the following norms:

Norm	Title
§ 20	Person liable to tax
§ 21	Crediting of foreign inheritance tax
§ 22	De minimis limit
§ 23	Taxation of pensions, uses, and services
§ 24	Annuitization of the tax liability in the cases of § 1 para. 1 no. 4
§ 25	(Ceased to apply)
§ 26	Tax reduction in the case of the cancellation of a foundation or the dissolution of an association set up in the interest of a family
§ 27	Multiple acquisitions of the same assets
§ 28	Deferral

Norm	Title
§ 28a	Assessment of need for tax relief
§ 29	Expiration of the tax in special cases
§ 30	Notification of the acquisition
§ 31	Tax declaration
§ 32	Announcement of the tax assessment notice to representatives
§ 33	Duty of notification for custodians, administrators of assets, and insurance companies
§ 34	Duty of notification of the courts, public authorities, officials, and notaries
§ 35	Local competency

- 28 For the taxable transactions within the meaning of § 1, § 20 regulates the tax liability.
- 29 In case of unlimited tax liability, comparable foreign inheritance tax can be credited to the German inheritance tax (§ 21), while specifics related to Conventions for the Avoidance of Double Taxation have to be considered.
- 30 If pensions, uses, or services within the meaning of § 23 are acquired, the acquirer can apply for a taxation of the annual value instead of an immediate taxation of the net present value.
- 31 The substitutional inheritance tax of foundations and associations set up in the interest of a family within the meaning of § 1 para. 1 no. 4 can be paid (with interest) within 30 equal annual partial amounts (§ 24). Section 26 regulates tax relief in case of the cancellation of a foundation set up in the interest of a family or the dissolution of an association within a period of maximum four years after the substitutional inheritance tax became chargeable.
- 32 Additionally, multiple acquisition of the same assets by persons of tax class I within 10 years is partially relieved by § 27.
- 33 Deferral regulations for private and business assets are provided by § 28. For privileged assets within the meaning of § 13b para. 2, an application for deferral can be made under the requirements of § 28. The assessment of need for tax relief of business assets is regulated in § 28a.
- 34 The Inheritance and Gift Tax Act expires retroactively pursuant to § 29, among others, also if the donor makes use of contractual or legal rights to revoke, or grants between spouses are credited to the claim to equalization of, accrued gains.
- 35 Requirements for the notification of acquisitions by way of death or gifts inter vivos to tax authorities, as well as their content, are regulated in § 30, procedural aspects regarding the tax declaration in § 31, and specifics of the

announcement in § 32. Duties of notification of custodians, administrators of assets, insurance companies, courts, public authorities, officials, and notaries are specified in §§ 33, 34.

- 36 The local competency of the tax office for the respective acquisition procedure results from § 35.

VI. Part 5—Authorization provisions and final provisions

- 37 The fifth part of the Inheritance and Gift Tax Act, which contains authorization provisions and final provisions, is generally of minor importance in practice, since the competency of the Federal Government in particular, as well as the Federal Ministry of Finance and the timed application of the respective legislative provisions, is regulated. For reasons of completeness, also these norms are listed:

Norm	Title
§ 36	Authorizations
§ 37	Application of the law
§ 37a	Special provisions on the occasion of the reunification of Germany
§ 38	(Ceased to apply)
§ 39	(Ceased to apply)

B. Relation to other types of taxes

- 38 Items taxable according to the Inheritance and Gift Tax Act do not exclude the raising of other taxes. In this context, income taxes and the real property transfer tax are of particular importance.

- 39 The increase of the financial capacity as a result of a gratuitous acquisition is basically subject to the Inheritance and Gift Tax Act. Insofar, the acquisition cannot lead to income tax burdens² simultaneously. Nevertheless, double taxation can occur, because, for example, deferred income tax burdens at the time of the deceased's death are not taken into consideration as liabilities of estate.

- 40 A double taxation with inheritance or gift tax and real property transfer tax is avoided through § 3 no. 2 of the Real Property Transfer Tax Act. For the applicability of § 3 no. 2 of the Real Property Transfer Tax Act, a taxable event pursuant to the Inheritance and Gift Tax Act is sufficient. However, § 3

² Cf. Federal Finance Court of November 26, 1986, II R 190/81, FEDERAL FISCAL GAZETTE, pt. II, 175 (1987).

no. 2 of the Real Property Transfer Tax Act does not apply to indirect gifts of real estates.³ The gratuitous acquisition of interests in partnerships or shares in corporations with real estate basically comes under § 3 no. 2 of the Real Property Transfer Tax Act. However, particularities have to be considered if at least 95% of the shares of a corporation are united in the hands of the acquirer for the first time. Furthermore, real property transfer tax may arise insofar as considerations are paid and no tax exemption other than § 3 no. 2 of the Real Property Transfer Tax Act applies.

- 41 Acquisitions and generous grants, which are subject to the Inheritance and Gift Tax Act, are tightly linked with the German Civil Code. In particular, § 3 refers to the regulations of the Civil Code. Economic ownership is only of minor importance for the inheritance and gift tax.

C. Current developments

- 42 The Federal Constitutional Court declared the tax relief for business assets pursuant to §§ 13a, 13b unconstitutional on December 17, 2014.⁴ The mentioned regulations violate the principle of equality of Article 3 of the German Constitution and were criticized for their dimension and the resulting possibilities of tax planning.
- 43 Firstly, the privileged status of business assets acquired is disproportionate insofar as the tax relief exceeds small and medium entities without including an assessment of need for tax relief. Secondly, the exception of the total payroll's regulation for businesses with up to 20 employees is disproportionate. Thirdly, the regulation concerning non-operating assets violates Article 3 of the German Constitution, as even if the privileged business assets consist of up to 50% of non-operating assets, the tax relief applies without a feasible justification. Fourthly, the Federal Constitutional Court uncovered possible tax planning instruments, which are against the intention of the tax relief and which are contrary to the principle of equality.
- 44 Therefore, the legislative body passed the recent amendments on November 9, 2016.⁵

³ Cf. § 7 recital 17–20.

⁴ Cf. Federal Constitutional Court of December 17, 2014, 1 BvL 21/12, FEDERAL FISCAL GAZETTE, pt. II, 50 (2015).

⁵ Cf. FEDERAL LAW GAZETTE, pt. 1, 2464 (2016).