The Private Wealth & Private Client Review

Fifth Edition

Editor
John Riches

Law Business Research

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EDITOR'S PREFACE

The first six months of 2016 have been characterised by turbulence for the world in general, and particularly for those holding significant private wealth. The key development of 2016 to date has been the publication of the 'Panama Papers'. The response to the publication from governments and the Organisation for Economic Co-operation and Development (OECD) has reinforced trends seen in prior years towards greater transparency and regulation in the domain of cross-border holding structures and in the context of beneficial ownership information.

i Panama Papers

Many have pointed to the irony surrounding the approach taken by the International Consortium of Investigative Journalists (ICIJ) in Washington in the context of its publication of the Panama Papers. The ICIJ's website sets out an elaborate procedure for whistle-blowers to provide information to them on a 'confidential' basis and the organisation has been resolute in its assurances that it will keep its sources confidential. So while the ICIJ argues for full transparency of information about the holding of private wealth, it does not consider that this standard should apply to those who provide information about wealthy families, even if the information is secured by unlawful means. Clearly, the Panama Papers have highlighted some issues concerned with offshore structures being used to provide a veil of secrecy to allow unlawful activity to go undetected and there is no sympathy for those whose unlawful acts have been exposed. Of deeper concern, however, is those who have sought to defend their privacy and yet have been accused of wrongdoing on a completely false basis – the case of Emma Watson who placed her home in the name of an offshore nominee to protect herself against stalkers serves to illustrate this trend. What has been striking from a UK perspective is the extent to which journalists from respected media organisations comment on issues relating to offshore structuring using language that is sensationalist in tone and frequently wildly inaccurate. The apparent furore over the former prime minster David Cameron's holding in an entirely conventional offshore fund structure established by his late father for third-party investors was reported by the BBC as an 'offshore fund trust'. The impression one gained from this reporting was that the journalist concerned was merely including as many words in the article that he felt had negative connotations to achieve maximum effect, regardless of their technical inaccuracy.

While the Tax Justice Network asserts in a 28 June 2016 report that 'trusts become the preferred choice by tax dodgers, corrupt officials or money launderers' to avoid transparency, there is precious little evidence of the large-scale use of trusts that has been unearthed by recent revelations such as the Panama Papers. A perspective that will not be published in any newspaper in the context of the Panama Papers is to explain that the vast majority of offshore trusts are used by tax-compliant families for legitimate wealth structuring and intergenerational succession planning. However, we should not assume that this will silence those who oppose trusts as a matter of principle. The party line of the Tax Justice Network and others is that the reasons trusts escape frequent references in the context of scandals is because they are so effective in hiding wrongdoers and so are very difficult to detect. They clearly have no idea about the depth of scrutiny a family is subject to in terms of anti-money laundering or know-your-client procedures to establish a trust in a well-regulated offshore finance centre.

I do not suggest that we can afford to be complacent about the scope for misuse of offshore vehicles in any way, but it is essential we take every opportunity to explain to policymakers the entirely legitimate purposes for which the overwhelming majority of families employ trusts and similar structures as part of their succession planning and wealth structuring.

ii The Common Reporting Standard (CRS) update

We are now fully in the era of the CRS, which became effective on 1 January 2016. Certain aspects of the CRS are causing a degree of confusion in terms of implementation, especially in the trust arena. Many of the difficulties here stem from the basic conceptual framework, copied over from the Foreign Account Tax Compliance Act (FATCA), which treats a trust fund as a 'financial account'. The most notable 'glitch' in this framework is in identifying those persons connected with trusts who need to be reported on. When trustees self-report as reporting financial institutions, the concept of an 'equity interest' does not name protectors. Alternatively, if one turns to the parallel list for trusts that are passive non-financial entities, protectors are expressly named. The OECD's own position set out in a recent FAQ is that the protector should always be named, but the formal legal basis included in the CRS model treaty is doubtful. It is to be hoped that in the second half of 2016 it will be possible to obtain clearer guidance on many areas of ambiguity so that all parties are fully prepared for the first wave of CRS-related disclosure for the 2016 financial year, which will be required before May 2017.

One silver lining to this confusion and uncertainty on protectors is a renewed focus on the choice of an appropriate person to serve in a protector role. In some cases, families are electing to formalise governance processes around fiduciary holding structures and introduce independent professional protectors in place of close relatives or family friends whose understanding of their duties may have been somewhat limited.

There already appears to be a two-speed world in the context of CRS with an enthusiastic group of early adopters who have signed the Multilateral Competent Authority Agreement so as to be able to exchange information with as many nations as possible, while a more reticent group of nations plan to adopt CRS on a bilateral treaty-by-treaty basis. The EU and Crown Dependencies and Overseas Territories are in the first group, while notably the Bahamas, Hong Kong, Singapore and Switzerland are in the second.

There is an emerging trend of consolidation of offshore structures into single jurisdictions to reduce complexity and multiple service provider compliance. It will be interesting to see which jurisdictions win out in this time of transition and, in particular, whether those international finance centres such as Jersey and Cayman that have placed themselves in the early adopter group will benefit from this stance. It is becoming apparent that many clients are keen to demonstrate their commitment to working in a transparent environment to forestall the type of ill-informed criticism unleashed in the wake of the Panama Papers.

iii Exchange of Beneficial Ownership Information (EBOI)

EBOI is the latest initiative being promoted by the G5 in Europe (the UK, Germany, France, Spain and Italy) and was a direct response to the Panama Papers' publication. EBOI builds on the same concepts that underpin the CRS and FATCA. The aim is, in parallel to the tax-related disclosure generated by FATCA and the CRS, to require the annual provision of beneficial ownership information on companies, trusts, foundations and similar legal arrangements or entities. The starting point is to require all jurisdictions that participate to maintain an accurate register in the hands of competent authorities to identify the beneficial owners of all such legal entities and arrangements.

The OECD is due to report back on the framework for potential implementation of EBOI in October 2016. What is increasingly apparent from the initial proposals is that their scope could well be significantly wider than the CRS framework. Where EBOI could widen the disclosure of information further is in requiring every single entity within a holding structure to have its own beneficial ownership register. If one takes, for example, the disclosure that relates to the holding structure ultimately held through a trust, the current rules under the CRS enable trustees that are themselves reporting financial institutions to take overall responsibility for reporting on the entire structure. If all underlying entities held within the trust are themselves reporting financial institutions or active non-financial entities (NFEs), only a single report is provided in relation to the trust as a whole. However, under EBOI, it may well be necessary to make multiple disclosures on all holding entities in a trust even though they have a common set of beneficial owners. The same rules could also apply for multiple layer holding structures ultimately held by individuals.

At inception, the proposals for EBOI are based around the idea of access being provided to 'competent authorities' such as regulators and law enforcement agencies. Predictably, there are already calls from NGOs for such registers to be made public. While many jurisdictions (for example, Jersey and Bermuda) have required beneficial ownership information on companies to be provided to them for many years, the effect of the EBOI proposals seems likely to require the creation of trust registers in many jurisdictions for the first time. It remains to be seen how these registers would work in practice. It is proposed that there will be an annual requirement to update the register to note any material changes. Potentially, this annual update will need to be provided in parallel to CRS and FATCA-type data, which tax authorities required by the end of May, with reference to the position as at the end of the prior calendar year.

iv Public registers of beneficial ownership

The UK's People with Significant Control (PSC) register has been operational since 30 June 2016. It will be interesting to see the approach taken by EU jurisdictions in implementing the Fourth Anti-Money Laundering Directive. The PSC register substantially implements that directive in the UK, although its terms are not completely aligned with the Fourth Anti-Money Laundering Directive.

It is already apparent, in considering the information to be provided for the PSC register, that the ultimate quest to name natural persons rather than entities can give rise to some unexpected results. As with the CRS, particular difficulties arise where a UK company is ultimately controlled by a trust. This is because in considering the application of the rules in a trust context, one does not name, for example, corporate trustees. One is required to look to individuals who control those corporate entities. This means that the information provided with respect to those natural persons is unlikely to have any meaningful connection with stated objectives of the legislation in providing greater clarity for third parties dealing with the company as to who, ultimately, influences its activities. It is also striking that in cases where the corporate trustee is owned by a listed group or controlled by a private equity firm, there may, in some circumstances, be no ultimate PSC required to be named.

If one contrasts the position here with that applicable to the French Trust Register, (ironically, made public on the same date, 30 June 2016), the information required to be made public under the French Register is extensive and, unlike the PSC register, requires one to provide details of the beneficiaries as well as the names of the trust. There is also a separate requirement to file a stand-alone 'event-based return' if the terms of a trust are modified in any way during the course of a calendar year.

The EU has recently published proposals to amend the Fourth Anti-Money Laundering Directive in the wake of the Panama Papers. In this context, it seems likely that the initial decision taken in 2015 not to require details of trusts to be placed on a public register will be reversed. If this proposal gains wider support (as seems likely), it will be interesting to see whether it will be modelled on the French register or will be more analogous to the UK PSC register.

iii Conclusion

In closing, it has never been more important for advisers to give balanced and considered advice to families on how best to structure their arrangements, not just in the light of prevailing family circumstances and tax considerations, but also in the knowledge of the likelihood that information about the holding structure will be subjected to greater regulatory, government and potentially public disclosure in the years ahead. The paradigm that currently prevails in Western Europe is markedly different from that applicable in Asia, the Middle East and Latin America.

It remains to be seen whether, in the long term, many international families who have compliant structures that are fully disclosed to tax authorities will favour the United States as a tax-favoured jurisdiction from which to administer their family structures. This is on the basis that with a thriving domestic trust industry, the US could well be seen as a reputable jurisdiction which protects families from unwarranted public intrusion into their personal affairs to a greater extent than traditional offshore finance centres if beneficial ownership registers do become public in due course.

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August 2016

Chapter 16

GERMANY

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I INTRODUCTION

Private wealth and private client law in Germany are characterised by a high number of tax and legal regulations on the one hand and a high level of judicial review on the other. Not only the civil and finance courts, but also the state and federal constitutional courts ensure the consistent and proportionate application of civil law and tax law. Moreover, taxes on assets are currently low; for example, wealth tax has not been levied in Germany since 1997 (its reintroduction, however, is discussed by politicians from time to time).

Accordingly, large private assets and family-owned enterprises have been created in recent decades. Private wealth and private client law in Germany therefore primarily deals with individuals living in Germany, and German family-owned companies structuring assets in Germany and other jurisdictions.

II TAX

i Introduction

Unlimited tax liability in Germany is determined by the concept of residence for both income tax and inheritance and gift tax purposes. Residence is assessed using objective criteria. An individual is a German resident if he or she has either a permanent home[2] or a habitual abode[3] in Germany. The resident individual's worldwide income or assets are subject to income tax, as well as inheritance and gift tax. The concept of domicile, however, is not recognised by German law.

1 Andreas Richter is a partner and Anna Katharina Gollan is a counsel at P+P Pöllath + Partners.
2 Section 8 of the General Fiscal Code (AO).
3 Section 9 of the AO.

With regard to income tax, there is a progressive tax rate ranging from 14 to 45 per cent. Additionally, a solidarity surcharge of 5.5 per cent of the tax due is levied. This surcharge is intended to finance the German reunification of 1990. As mentioned, income tax is levied on the worldwide income of residents. Non-residents pay tax on income from German sources (e.g., income effectively connected with a permanent establishment in Germany, income from employment in Germany (including self-employment), income from German real estate or dividends and capital gains from German companies in cases of a substantial shareholding). Non-residents do not pay income tax on non-business interest income. Income from capital investments (e.g., dividends) is subject to withholding tax at a flat rate of 25 per cent plus the solidarity surcharge; a tax treaty may allow a partial refund.

Concerning inheritance and gift tax, each beneficiary is liable for the tax on the value of his or her share of the estate received, regardless of his or her personal wealth. The inheritance and gift tax rates range from 7 to 50 per cent, depending on the relationship between the transferor and the beneficiary and the value of the share of estate received. Spouses and descendants pay inheritance and gift tax at a rate of 7 to 30 per cent. Spouses receive a personal allowance of €500,000 and a maintenance allowance of up to a maximum of €256,000. Children receive a personal allowance of €400,000 and an age-dependent maintenance allowance of up to €52,000; grandchildren receive a personal allowance of €200,000. Transfers between most other relatives are taxed at a rate of 15 to 43 per cent. Between unrelated persons, the applicable tax rate is 30 or 50 per cent (for more than €6 million).

Unlimited tax liability is triggered if either the transferor or the beneficiary is resident in Germany, regardless of whether the assets received are effectively connected to Germany. If neither the transferor nor the beneficiary is resident, inheritance and gift tax is only due on certain property situated in Germany (e.g., real estate and business property). The transfer of a German bank account between non-residents generally does not trigger inheritance or gift tax.

Besides income tax and inheritance and gift tax, only a few other taxes are relevant for private clients. A transfer tax with different regional rates ranging from 3.5 to 6.5 per cent applies to the acquisition of real estate or a substantial shareholding (at least 95 per cent) in a company holding real estate. At the discretion of the relevant local authority, an annual property tax ranging from 1 to 4 per cent may be due on the value of real estate (as assessed by the local authorities). The relevant values were last assessed in 1964 or 1935. Thus, property tax is low in comparison to the property's market value. Wealth tax has not been levied in Germany since 1997.

ii Inheritance and Gift Tax Act

Since 2009, the new Inheritance and Gift Tax Act has been in force in Germany. The reform was necessary after the German Federal Constitutional Court (BVerfG) declared the former Inheritance and Gift Tax Act invalid because of the unequal evaluation of different types of assets; equality of taxation is constitutionally guaranteed in Germany. The judgment, as well as the reform itself, triggered extensive political debate concerning the taxation of assets and especially of business assets. The core problem was, and still is, if and how business assets must be exempt from taxation to prevent insolvency because of the tax burden carried – as mentioned above – by the beneficiary; for example, the new shareholder who received the shares of an enterprise but no cash assets from which he or she might pay inheritance tax.

Because of the great importance of small and medium-sized enterprises in Germany, the legislative authorities decided to enact extensive tax exemptions for business assets of all kinds.

Until 30 June 2016, in general, the exemptions of the Inheritance and Gift Tax Act for business assets were applicable to all business assets and agricultural property. A basic business asset relief and an optional business asset relief were available. According to the basic relief, 85 per cent of the business assets was part of the tax base, and the remaining 15 per cent was taxed immediately. There was an additional tax allowance for a transfer of business assets amounting to a maximum of €150,000. If the taxpayer chose the optional relief, 100 per cent of the business assets was not to be part of the tax base.

Business property could only benefit from the basic relief if it did not contain more than 50 per cent of passive non-operating assets. Passive non-operating assets were, generally speaking, leased real estate, minority shareholdings of 25 per cent or less, securities, cultural property and liquid funds if they exceed, after deduction of debt, 20 per cent of the business's total value. The optional relief was only available if the business assets consist of no more than 10 per cent of passive non-operating assets. Where the 50 per cent and 10 per cent requirements are satisfied respectively, passive non-operating assets could only benefit from the business assets relief if they were part of the transferred business two years prior to the transfer.

Besides business assets, real estate and agricultural and forestry assets could benefit from tax exemptions.

These exemptions led to a number of tax-effective configurations, which – according to the Federal Fiscal Court of Germany (BFH) – could be used to achieve preferential tax treatment for any kind of assets if the transferor chooses an appropriate configuration.[4] The BFH has consistently expressed its doubts concerning the constitutionality of the current Inheritance and Gift Tax Act. As the transfer of assets could be exempt from tax by structuring the assets in advance, equality of taxation was not ensured, according to the court. Even if the possibility of exempting liquid funds had meanwhile been limited, the BFH's concerns were still valid for a number of cases. As a consequence, the BFH had once again requested the BVerfG to give a ruling on the constitutionality of the current Inheritance and Gift Tax Act.

In its decision of 17 December 2014, the BVerfG held that the beneficial rules regarding the gratuitous transfer of business assets are inconsistent with the principle of equality in taxation.[5] According to the judgment, the privileges for business assets are disproportionate, insofar as they go beyond small and medium-sized enterprises without an economic needs test. Enterprises with up to 20 employees are disproportionately privileged by the aggregate wages and salaries regulation. The preferential treatment of up to 50 per cent administrative assets applies without any viable justification and the law allows for tax planning, which the Inheritance and Gift Tax Act does not aim to achieve and which cannot be justified under the principle of equality. The BVerfG declared the continued application of the beneficial regulations and ordered the legislator to legislate by 30 June 2016.

The German Bundestag approved the coalition's agreement of 20 June 2016 on an Inheritance and Gift Tax, but the Federal Council (Bundesrat) called the mediation committee, so that the amending law has not yet been determined. Nevertheless, the new Inheritance

4 BFH, decision of 5 October 2011 – II R 9/11.

5 BVerfG, decision of 17 December 2014 – 1 BvL 21/12.

and Gift Tax Act is due to come into force retroactively, with effect as of 1 July 2016. The reform proposal leaves many things unchanged related to the tax privileges for business assets, however, some amendments exceed the requirements of the German Federal Constitutional Court. For both individuals and family-owned enterprises, structuring of asset succession might be more difficult in the future.

According to the proposal, the relief models are almost unchanged. In contrast to previous options, the person or company subject to taxation can choose freely between the two models. The provision for assets allowed preferential tax treatment also remains unchanged. In contrast to former policy, in the future there shall be a fundamental tax liability for items of property that are part of passive non-operating assets. These shall be fully taxable at the regular rate, as far as the value of passive non-operating assets exceeds 10 per cent of the total company assets (the 'contamination clause'). In an extreme case, if the passive non-operating assets equal 90 per cent of the value of the whole company, the remaining 10 per cent of the tax-privileged assets is excluded from all relief to avoid any misuse. 'New passive non-operating assets' (i.e., those assets that were contributed to the business assets within a period of two years before the relevant transfer) are still completely excluded from any form of relief. In the future, 'new capital' shall also be excluded from relief from the outset.

In contrast to previous standards, relief can no longer be claimed independently from the value of the acquired business assets. According to the 'ablation model', the extent of relief is reduced by 1 per cent of each €750,000 in company value, if the value of the total business assets exceeds €26 million. The result is that there is no longer any relief for acquirers of approximately €90 million. The taxable person can alternatively use the 'examination of the need for relief'. This proposal focuses on the acquirer as a person and examines his or her assets. Out of his or her assets, the acquirer is required to lay out up to 50 per cent of the taxes due on the acquired business assets. If 50 per cent is not sufficient, an exemption from inheritance tax will be considered upon request. Finally, another noteworthy point is the establishment of an advance deduction for family companies whose articles of association contain clauses typical for such family companies. However, it is only applicable if the provisions in the articles of association were already incorporated two years before the relevant transfer and if these are not revoked for 20 years thereafter. Thereby, it is highly recommended that family companies examine their articles of association and incorporate the appropriate clauses as soon as possible, if they are not already in place.

iii Tax treatment of trusts

Trusts are generally not recognised in Germany (see Section IV.iii, *infra*). Trusts can, however, trigger inheritance and gift tax in several ways; the establishment of a trust by residents (see Section II.i, *supra*) or of a trust comprising assets located in Germany is considered to be a transfer of assets that is taxable according to the Inheritance and Gift Tax Act. Distributions to beneficiaries during the trust period or on the trust's dissolution may trigger income tax and gift tax as well, if the beneficiary is a German resident or if German situs assets are distributed. The relationship between gift tax on the one hand and income tax on the other with regard to trust distributions has not yet been clarified by the courts.

In addition, corporate tax can be applied if income is received by a foreign trust from German sources. The worldwide income of a foreign trust may be subject to corporate tax if the trust's management is in Germany and if certain other conditions are met; for example, if the effective management of a trust is vested with a trustee resident in Germany.

Undistributed income received by a foreign trust can be attributed to the settlor or the beneficiaries if they are German residents. In this case, it can be subject to the settlor's or the beneficiary's personal income tax.

iv CFC rules in Germany – Section 7-14 of the Foreign Tax Act

Taxation in Germany generally cannot be avoided by establishing a foreign entity in a low-tax country. The German rules for the taxation of controlled foreign companies (CFCs) meanwhile have an extensive scope of application. The CFC rules are settled in Section 7-14 of the Foreign Tax Act (AStG).

These CFC rules extend the unlimited tax liability of residents to certain undistributed income of foreign corporations. The income may be attributed to domestic shareholders. The additional taxation under the CFC rules generally requires a substantial shareholding of German residents of more than 50 per cent of the corporation's shares (in certain cases, 1 per cent may suffice). The foreign corporation has to be an intermediate company, which receives passive or tainted income instead of income from its own business activities. Passive income is defined negatively by a list of active income in Section 8 of the AStG. Cumulatively, this passive income has to be subject to low tax rates of less than 25 per cent. Income that meets both criteria is added to a resident individual's income, to the extent to which the individual holds shares in the corporation. The taxable person can choose whether the taxes paid on income received from an intermediate company in a foreign country will be deducted from the amount subject to the additional taxation in Germany or whether the foreign taxes shall be credited against the additional taxes levied in Germany. In most cases, the second alternative is advantageous for the taxable person.

A foreign corporation is not, however, supposed to be an intermediate company if, *inter alia*, its effective place of management or statutory seat is located in a Member State of the EU or the European Economic Area and if the corporation carries out substantial economic activities.

III SUCCESSION

i Wills

According to Section 2064 *et seq.* and 2229 *et seq.* of the German Civil Code, there are two valid forms of wills: the holographic and the public will. The holographic will has to be handwritten, dated and signed by the testator. The public will has to be signed before and certified by a notary public. Neither form of will requires a witness.

A testator can also enter into a contract of succession with another person or a joint will with his or her spouse or civil partner. A contract of succession must be signed before and certified by a notary public; a handwritten contract does not meet the formal requirements.

By making a will, an individual can choose his or her heirs and state what share each heir receives. Additionally, an individual can make a legacy; that is, a person can be empowered to make a claim against the heirs, without being an heir him or herself. This claim can be for an amount of money, a share of the deceased's estate, an item or anything else.

Wills made in a foreign jurisdiction can be valid in Germany. Germany recognises the HCCH Convention on the Conflicts of Laws Relating to the Form of Testamentary Dispositions 1961. A will is valid if it complies with the law of the state where the testator made the will, the state of the testator's nationality or residence, or – in the case of real estate – the location of the assets. Foreign grants and probates are not recognised. An heir must ask the competent probate court to issue a German certificate of inheritance.

ii Intestacy and forced heirship regime

If an individual dies intestate, intestacy rules apply. Under the intestacy rules, the deceased's estate is distributed among his or her relatives and spouse or civil partner in accordance with a strict order of succession. Children and their descendants constitute the first category, followed by parents and their descendants, grandparents and their descendants, and great-grandparents and their descendants. Relatives within a particular category inherit in equal shares (succession *per stirpes*). Where German law applies, the surviving spouse or civil partner also has a right of inheritance, determined by the matrimonial regime. Within a community of accrued gains, the surviving spouse or civil partner gets at least 50 per cent of the estate. If the deceased and his or her spouse or civil partner chose separation of property or community of property as their matrimonial regime, the surviving spouse or civil partner receives at least 25 per cent of the inheritance.

There is a forced heirship regime under which the descendants, the spouse or civil partner and the parents of the deceased are entitled to make a claim for a compulsory share of the deceased's estate, if they are excluded from the testator's will or if the share granted to them is less than their compulsory share. A relative's compulsory share generally amounts to 50 per cent of the value of that relative's share on intestacy. It is a monetary claim and not a claim for a share of the estate. The compulsory share comprises all assets governed by German succession law (regardless of the beneficiary's residence). Therefore, the forced heirship regime can be avoided by buying assets that are situated abroad and that German succession law does not govern – for example, foreign real estate. Besides, a forced heir can renounce his or her right to his or her compulsory share during the testator's lifetime by signing a contract with the testator before a notary public. If the testator has died, a forced heir can also refrain from claiming his or her compulsory share.

iii Conflict of laws rules

Under the previous German conflict of laws rules, the applicable succession law was that of the deceased's nationality. If the deceased was a foreign national, German succession law applied only if the law of the deceased's nationality provided for a reference back to Germany (*renvoi*). This could be the case if the deceased was domiciled in Germany, if the deceased's habitual abode was in Germany or if the deceased held property or assets in Germany on the date of his or her death.

For successions as of 17 August 2015, new conflict of laws rules apply because of the European Union's Succession Regulation. They are valid in all EU Member States except Denmark, Ireland and the United Kingdom. According to the Regulation, the deceased's habitual abode at the time of his or her death instead of his or her nationality is relevant for the question of which succession law is applicable. If it is obvious that the deceased had a closer relationship to another state, that state's law will apply under certain circumstances. There is, however, the opportunity to opt for the succession law of an individual's nationality through a will, a joint will or by conclusion of an agreement regarding succession.

In addition, provisions on legal jurisdiction, recognition and enforcement of decisions and authentic instruments and on the European Certificate of Succession are part of the Regulation. As a general rule, the jurisdiction will be determined by the habitual abode at the time of the individual's death.

IV WEALTH STRUCTURING & REGULATION

i Commonly used structures: corporations and partnerships

Two structures are commonly used in Germany to hold assets: corporations and partnerships.

A corporation is subject to German corporate tax on its worldwide income if its effective place of management or statutory seat is located in Germany. In addition to corporate tax, a trade tax is also levied. Corporate tax, including a solidarity surcharge (see Section II.i, *supra*), and trade tax together equal a tax rate of about 29 per cent. A participation exemption may apply, however, for dividends and capital gains. Profits distributed to shareholders of the corporation are subject to income tax at a flat rate of 25 per cent plus the solidarity surcharge.

A foreign corporation with income from German sources might be subject to German corporate tax. If a foreign corporation has a branch in Germany that constitutes a permanent establishment, the corporation will be subject to German corporate tax and trade tax on all income effectively connected to this permanent establishment.

Partnerships are fiscally transparent in Germany for income tax purposes. The partners are subject to income tax at their individual tax rates plus the solidarity surcharge. If the partnership is engaged in trade or business, the partnership itself is subject to trade tax. Trade tax levied from the partnership is (to a large extent) credited against the income tax of the partners if they are individuals.

ii Foundations

Foundations in Germany can be established either as charitable foundations or as family foundations. Charitable foundations are tax-privileged. Recognition as a charitable foundation requires that the foundation's activities be dedicated to the altruistic advancement of the general public in material, spiritual or moral respects. These purposes must be pursued altruistically, exclusively and directly. A charitable foundation may, however, use one-third of its income for the maintenance of the founder and his or her family. The formation of a charitable foundation neither triggers any inheritance or gift tax, nor transfer tax if real property is transferred gratuitously to the foundation. A charitable foundation is released from almost every current form of taxation, especially corporate tax and trade tax.

In contrast, a family foundation is not tax-privileged. It is conducted for the personal benefit and the advancement of one or more families. The formation of a family foundation and later donations to the foundation generally trigger inheritance and gift tax. The current taxation of a family foundation generally complies with the taxation of other legal persons. A family foundation can, however, receive income not only from trade or business but any type of income. In addition, only family foundations are liable for a substitute inheritance tax. This special tax accrues every 30 years. Moreover, distributions to beneficiaries are subject to income tax. The liquidation of a family foundation leads to an acquisition of assets on the level of the beneficiaries. This acquisition is treated as a lifetime gift. Therefore, it is liable to gift tax. Income tax may be triggered as well. The classification of the tax bracket depends on the degree of relationship between the founder and the beneficiary.

In contrast to German family foundations, foreign family foundations are not liable for the substitute inheritance tax. However, the undistributed income of a foreign family foundation may be added to the personal income of the founder or the beneficiaries if they are resident for tax purposes in Germany. This does not apply to family foundations that are resident in a Member State of the EU or the European Economic Area, if it is assured that the foundation's property is legally and actually separated from the beneficiaries' property and that a treaty regarding mutual administrative assistance exists between Germany and the state in which the foundation has its residence. These conditions have to be satisfied cumulatively.

iii Trusts

Neither domestic nor foreign trusts are recognised in Germany. Germany does not have its own trust law. Germany did not ratify the HCCH Convention on the Law applicable to Trusts and on their Recognition 1985. Therefore, German property law does not recognise the transfer of assets located in Germany to a trust. In these circumstances, the terms of a trust are interpreted in accordance with German law for civil law and tax purposes.

Where assets governed by foreign property law have been transferred to an irrevocable trust effectively formed under foreign trust law, the trust can shelter these assets from the settlor's or beneficiary's creditors. German courts generally do not recognise claims against trust assets on the dissolution of a marriage or partnership after 10 years from the date of the transfer.

Foreign trusts are disadvantaged in terms of tax issues when they are established or when distributions to beneficiaries are made (see Section II.iii, *supra*).

V CONCLUSIONS & OUTLOOK

The tax and legal conditions for succession in both private assets and family-owned enterprises are advantageous in Germany at the moment. Many individuals make use of the exemptions the current Inheritance and Gift Tax Act offers for the transfer of business assets and other types of assets. These exemptions may be changed by the legal authorities in the foreseeable future.

Succession law, on the other hand, is (at least within the EU) more flexible since 2015, when the European Union's Succession Regulation became effective.

Usually, corporations and partnerships are used to structure assets and transfer them to the next generation. Family foundations and charitable foundations may be considered the proper structure from time to time. Trusts, however, are not recognised in Germany. In comparison with corporations and foundations, they are disadvantaged if beneficiaries of a foreign trust have their permanent home or their habitual abode in Germany.

Appendix 1

ABOUT THE AUTHORS

ANDREAS RICHTER

P+P Pöllath + Partners

Dr Andreas Richter, LLM, is a partner and a member of the management board at P+P Pöllath + Partners. He has outstanding experience in business and wealth succession, estate planning, legal and tax structuring of private wealth and family offices, corporate governance for family-owned businesses, expatriation taxation and charities, as well as in trust and foundation law. Some of Germany's leading family offices, family businesses and foundations, as well as their peers abroad, form the client base for Andreas's work as a legal and tax adviser. Clients in common law jurisdictions often engage Andreas due to his background in English law (BA Hons, Trinity College, Cambridge) and US law (LLM, Yale Law School). He is listed in domestic and international rankings as one of the leading lawyers in his practice areas. Among others, *Who's Who Legal: Private Client 2015* lists Andreas Richter as the only German lawyer among the 15 'Most Highly Regarded Individuals' worldwide.

Andreas is the managing director of the Berlin Tax Policy Forum and chairman of the executive board of the postgraduate programme 'Business Succession, Inheritance Law & Asset Management' at the University of Muenster/Westphalia. He serves as a member on boards of family offices, foundations and family businesses and acts as executor.

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Dr Anna Katharina Gollan LLM is admitted as attorney-at-law and specialist tax lawyer. Her thesis was awarded the W Rainer Walz prize of Bucerius Law School. As a counsel at P+P Pöllath + Partners, she focuses on legal and tax advice with regard to inheritance law, succession planning, foundation law and non-profit law. Dr Gollan is an adjunct lecturer for non-profit and foundation law as part of the postgraduate programme 'Business Succession, Inheritance Law & Asset Management' at the University of Münster. She is a member of the Inheritance Law Committee of the German Bar Association (Deutscher Anwaltverein). She has authored several publications in her practice areas.

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