

# A level playing field?

GERMAN RULES THAT PROVIDE LOWER INHERITANCE-TAX RELIEF FOR PERSONS WITH LIMITED TAX LIABILITY HAVE BEEN FOUND TO VIOLATE ONE OF THE FUNDAMENTAL FREEDOMS OF THE SINGLE MARKET, DR ANDREAS RICHTER AND STEPHAN HAMACHER EXPLAIN

THE GERMAN *Inheritance Tax Act (ITA)* distinguishes between the taxation of persons with unlimited and limited tax liability. Persons with limited tax liability are granted significantly lower relief of the taxable basis than taxpayers with unlimited liability.

The question of whether this differentiation is in accordance with the free movement of capital – one of the four freedoms of the EU single market – has been considered by the European Court of Justice (CJEU) and German courts.

## VIOLATION OF THE FREE MOVEMENT OF CAPITAL

In the *Mattner* case of 2010,<sup>1</sup> the CJEU considered this difference in treatment to be an infringement of the free movement of capital. According to *Welte*,<sup>2</sup> this judgment applies even if the heir is living in a third country and not within an EU member state.

## WHAT THIS MEANS IN PRACTICE

According to *Mattner* and *Welte*, the same relief should be granted to taxpayers with limited tax liability as to persons with unlimited tax liability. For taxpayers with limited liability, inheritance tax is only due on the estate within Germany, so this greater relief would often lead to a total exemption from inheritance tax in Germany. To close this tax gap, the German legislature implemented an option for unlimited taxation for persons with limited tax liability. However, it is still unclear if this amendment has solved the issue; a case pending in the CJEU will decide.

Choosing unlimited taxation means, on the one hand, that the same relief is granted as for other taxpayers with unlimited liability. On the other hand, it also means that those who have chosen unlimited taxation have to pay German inheritance tax not only on the estate within Germany, but also on the estate all around the world, as unlimited taxpayers must do. So, even if this option is available, in most cases it will not be advantageous for heirs because it will lead to much greater inheritance-tax exposure in Germany.

In 2014, the fiscal court of Düsseldorf in Germany again called for the CJEU to decide if providing the option of unlimited tax liability was sufficient to remedy the violation of the free movement of capital.<sup>3</sup> This case is still pending in the CJEU.<sup>4</sup> Although the CJEU's decision cannot be predicted, there seems to be a couple of aspects indicating that the amendment is not sufficient to remedy the infringement.

Furthermore, the statutory right to opt for unlimited taxation according to the ITA only applies if the decedent or heir has their residence within the EU. At least one German fiscal court has applied the *Mattner* and *Welte* decisions directly to a case where the conditions for the right to opt in were not fulfilled.<sup>5</sup>

## CONCLUSION

The German legislature's amendment, giving persons with limited tax liability the option to choose unlimited tax liability, may not have settled conclusively the matter of the infringement of the free movement of capital.

It is also worth noting that, in 2014, the German Federal Constitutional Court declared certain parts of the ITA valid only until the end of June 2016. The court considered the tax relief for company estates to be an infringement of the German Constitution and called for the legislature to react. Besides implementing a new inheritance tax law in accordance with the German Constitution, it looks like the German legislator does not plan to revisit the amendments made as a consequence of *Mattner* and *Welte*.

- 1 C-510/08
- 2 C-181/12
- 3 4 K 488/14 Erb
- 4 C-479/14
- 5 11 K 3629/13

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## SUCCESSION IN EASTERN EUROPE

In a *STEP Journal* web exclusive, Richard Wernick presents an overview of Ukraine's inheritance and tax laws. 'Ukraine does not have separate inheritance tax or gift tax. The receipt of property – either inherited or received as a gift – is, however, subject to personal income tax,' says Richard. Find out more at [www.step.org/journal/web-exclusive-ukraine-summary-practitioners](http://www.step.org/journal/web-exclusive-ukraine-summary-practitioners)