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Inheritance Tax: Limit Corporate Privileges and Spread Tax Burden

By Stefan Bach

After the inheritance tax ruling by the German Federal Constitutional Court, legislators will have to limit the wide-ranging exemptions on company assets. In recent years, they have exempted half of all assets subject to inheritance tax. In particular, large transfers consisting mainly of corporate assets benefit from the favorable conditions. In 2012 and 2013, over half of all transfers of five million euros or more were tax exempt, and over 90 percent of transfers of 20 million euros or more. Revoking these company privileges would increase annual inheritance tax revenue from the current five billion euros to 13 billion euros in the medium term at present tax rates.

The extensive exemption regulations are not required in larger companies to prevent job losses in the event of business succession and are sometimes even counterproductive. Allowances or deductions should be limited to required operating assets and be offset against other transferred assets or against the assets of the beneficiary. Tax burdens on corporate assets should be deferred or annuitized with no specific conditions over long periods in order to allow the corporate successor to pay them off using current revenues. Furthermore, other liabilities could be given priority over the tax claim or it could be pegged to the commercial success of the company. This would avoid complicated means testing. In addition, further tax benefits should be reduced or revoked, such as tax exemption of the family home or tax exemption for donations.

In December 2014, the German Federal Constitutional Court ruled that inheritance tax exemptions on corporate assets were in part unconstitutional.¹ Although these benefits should generally be permitted, some individual regulations are disproportionate and therefore unconstitutional. In particular, large companies were criticized for receiving exemptions without being subject to any means testing and because no checks were made to ensure there were no job losses at companies with up to 20 employees. The court also criticized widespread exemptions for non-core administrative assets. Legislators must now submit a new regulation by mid-2016. In the meantime, the current rules will apply.

Wide-Ranging Exemptions for Corporate Assets ...

The inheritance and gift tax (see Box 1) was last fundamentally reformed in 2009. A ruling by the Federal Constitutional Court in 2006 resulted in legislators developing new assessment procedures to eliminate the undervaluation of real estate and business assets. At the same time, this reform introduced far-reaching exemptions for transfers of corporate assets, provided that the taxpayer continued to run the business and no job losses resulted (Sections 13a and 13b of the German Inheritance and Gift Tax Act (*Erbschafts- und Schenkungsteuergesetz, ErbStG*)). This was intended to ensure jobs were retained after corporate succession.

Use of this tax break for corporate assets has increased dramatically in recent years (see Table 1). According to inheritance tax statistics,² asset transfers totaling 278 bil-

¹ Federal Constitutional Court judgment of December 17, 2014, 1 BvL 21/12. See D. Eisele, "Erbschaft- und schenkungsteuerliche Privilegierung des Unternehmensvermögens in Teilen verfassungswidrig," Judgment passed by the Federal Constitutional Court from December 17, 2014 - 1 BvL 21/12. NWB 4/2015.

² Federal Statistical Office, "Erbschaft- und Schenkungsteuer" (2014). This analysis is based on special analysis by the Federal Statistical Office; see also German Bundestag, printed paper 18/1516, May 23, 2014: 23 ff., and a letter from the Federal Ministry of Finance to Bundestag member, Cansel Kiziltepe dated December 15, 2014. The data in Tables 1 and 2 refer to all cases assessed for taxation, including those that have a taxable income of zero due to tax exemptions.

Box 1

Principals of Inheritance and Gift Tax

German inheritance and gift tax is levied on gratuitous transfers of assets by reason of death (inheritance or legacy) and by gifts *inter vivos*. The tax base is the capital gain of the acquirer, i. e., the beneficiary of the inheritance or gift. All transferred assets such as real estate, business assets, and equity, cash and financial assets as well as any other personal assets (e. g., household items, collections, etc., as long as they exceed specific allowances) are subject to inheritance and gift tax. Liabilities on assets and liabilities arising from transferred assets or restrictions on donations may be deducted.

Specific tax exemptions and reliefs are regulated by Sections 13–13c of the the German Inheritance and Gift Tax Act (*Erbschafts- und Schenkungsteuergesetz, ErbStG*). Among other things, household effects and other movable items of private assets are exempted up to a certain amount, depending on the tax class of the taxpayer. Donations to churches, non-profit or charitable organizations, and political parties are exempt from tax. There is tax relief on the acquisition of real estate or collections if their preservation is in the public interest due to their significance for art, history, or science.

If certain conditions are met, 85 or even 100 percent of corporate assets are tax exempt (Sections 13a and 13b of the *ErbStG*), in particular to ensure the continuation of a company and that the majority of the wage bill.¹ These regulations apply to assets consisting of agricultural land and forestry, sole proprietorships and joint partnerships, as well as to substantial holdings in incorporated companies.² This is to ensure jobs are retained after business succession. There are two scenarios for the tax breaks:

- The generally assessed "regulation exemption" allows 85 percent of a company's assets to be tax free if administrative assets³ are less than 50 percent of total operating assets, the business continues operating for five years after acquisition, and the total wage bill over these five years is no less than 400 percent of the initial wage bill.⁴

¹ See also Scientific Advisory Board at the Federal Ministry of Finance, Die Begünstigung des Unternehmensvermögens in der Erbschaftsteuer, report dated November 2011.

² The required ownership interest is at least 25 percent, but several shareholders may form a pool in order to jointly qualify for the ownership interest, Section 13b, para. 1, no. 3 of the *ErbStG*.

³ Administrative assets include, in particular, non-operating real estate, financial assets, cash, valuable collections, etc., Section 13b para 2 of the *ErbStG*.

⁴ If assets are sold within five years of them being transferred, this results in a pro rata loss of the exemption allowance. The same applies in

An additional (withdrawable) allowance of 150,000 euros is deducted from non-exempt company assets.⁵ The remaining taxable share of company assets is subject to the lowest rate of tax class I, irrespective of the family relationship.⁶

- Corporate assets may be completely exempted from inheritance tax on request ("exemption option," Section 13a, para. 8 of the *ErbStG*). For this to occur, administrative assets may not amount to more than ten percent of total corporate assets. Furthermore, the business must continue operating for seven years after acquisition and, during this period, the wage bill must equate to 700 percent of the initial wage bill.

Companies with up to 20 employees are exempt from compliance with wage bill regulations.

One problem in assessing businesses are restrictions placed on the shareholder's interest which are frequently agreed in the company's articles of association or shareholder agreements. This mainly concerns resale restrictions, book value clauses, severance clauses, or reinvestment stipulations.⁷ These restrictions reduce the value of an individual's interest in favor of the company as a whole and are therefore not explicitly taken into consideration for the tax assessment (Section 9, para. 2, and para. 3, sentence 2 of the German Valuation Law (*Bewertungsgesetz, BewG*). This should be taken into account in the valuation of assets and may require separate taxation of the company or of the retained reserves respectively.

For real estate, there is a valuation discount of ten percent for real estate leased for residential purposes and tax exemption on inheritance of the family home for spouses, partners, and children or grandchildren (the latter only if the living area does not exceed 200 m²), provided that they live there.

Personal allowances and the applicable inheritance tax rate vary according to the family relationship of the acquirer to the

the case of excess withdrawals.

⁵ The 150,000 euro allowance is reduced if the non-tax-exempt assets exceed 150,000 euros. The allowance is reduced by 50 percent of the excess amount. This means that business assets to a total value of one million euros may be transferred completely tax free.

⁶ According to Section 13b, para. 2 of the *ErbStG*, administrative assets include non-operating real estate, financial assets, cash, valuable collections, etc.

⁷ B. Welling, "Erbschaftsteuer auf dem Prüfstand – Bewertungsrecht als Stein des Anstoßes," ifo Schnelldienst 17 (2014): 19–21.

deceased or donor. Here, the taxpayers are classified in three tax brackets. Close relatives have high allowances and lower tax rates (see Table 1).

The personal allowances apply to any acquisition. If the same person is due several acquisitions within a ten-year period, these are added together and taxed jointly (Section 14 of the *ErbStG*). In return, inheritance tax is deducted from the entire inheritance tax burden on all prior acquisitions included. The personal allowances can therefore be reused every ten years for gifts. This means parents can transfer tax-free assets worth 800,000 euros to each child every ten years because the allowances apply to each parent and each child separately.

In addition to the personal allowances, spouses or partners, children, and step-children receive a specific non-taxable maintenance allowance (Section 17 of the *ErbStG*) for each inheritance (not for gifts). This allowance is 256,000 euros for spouses or partners and is staggered according to the age of the children (52,000 euros for children up to five years and up to 10,300 euros for those aged 21 to 27 years). This non-taxable allowance on benefits is reduced by the net present value of the taxpayer's pensions or benefits exempt from inheritance tax (e.g., widows or orphans' pensions).

After all allowances have been deducted, the taxable acquisition is subject to the inheritance tax rate (see Table 2). The tax rate is progressive and varies according to tax class. The tax rates shown are based on the total amount of the taxable acquisition. To avoid being placed in a high marginal tax rate when the taxable acquisition slightly exceeds a single tax bracket, the tax burden is adjusted so that the marginal tax rate is limited to 50 percent (at tax rates up to 30 percent) and 75 percent (at tax rates above 30 percent) (Section 19, para. 3 of the *ErbStG*).⁸ Provided that corporate assets are included in taxable acquisitions, these are always levied at the lower rates of tax class I, irrespective of the family relationship (Section 19a of the *ErbStG*).

⁸ For example, the taxable acquisition totals 80,000 euros and is allocated to tax class I. At a tax rate of 11 percent, the initial tax burden would be 8,800 euros. On an acquisition of 75,000 euros, the tax burden is 5,250 euros (tax rate of seven percent). The burden on the excess 5,000 euros is therefore 3,500 euros or 71 percent. By adjusting the tax burden in accordance with Section 19, para. 3 of the *ErbStG*, the tax burden on the excess 5,000 euros is limited to 50 percent (2,500 euros), resulting in a final tax burden of 7,750 euros.

Table 1

Tax classes and personal allowances of inheritance and gift tax, Section 15, 16 of the *ErbStG*

Tax class	Family relationship of the taxpayer to the deceased or donor	Personal allowance in euros
I	Spouse and life partner	500 000
	Children and stepchildren, children of deceased children and stepchildren	400 000
	Grandchildren and step grandchildren	200 000
	Parents and grandparents for acquisition by reason of death	100 000
II	Parents and grandparents for gifts <i>inter vivos</i> , siblings and their children, stepparents, parents-in-law, children-in-law, divorced spouse and life partner	20 000
III	Other acquirers	20 000

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Table 2

Inheritance and gift tax rates, Section 19 of the *ErbStG*

In percent

Taxable acquisition up to ... euros	Rate tax class I	Rate tax class II	Rate class III
75 000	7	15	
300 000	11	20	30
600 000	15	25	
6 million	19	30	
13 million	23	35	
26 million	27	40	50
More than 26 million	30	43	

To avoid a high marginal tax rate when the taxable acquisition slightly exceeds a single tax bracket, the tax burden is adjusted so that the marginal tax rate is limited to 50 percent (at tax rates up to 30 percent) and 75 percent (at tax rates above 30 percent) (Section 19, para. 3 of the *ErbStG*).

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Table 1

Taxable acquisitions, exemptions for corporate assets, and tax burden of inheritance and gift tax¹

In billion euros

	2009	2010	2011	2012	2013	2009-2013
Value of transferred assets (value larger 0)	37 463	40 680	53 969	74 245	71 692	278 049
therof:						
Agricultural and forestry assets.	870	435	559	640	772	3 275
Business assets (value larger 0) ²	6 712	7 607	17 591	29 837	23 132	84 878
Holdings in incorporated companies ³	1 439	2 628	3 221	8 229	10 502	26 019
Exemptions for transferred corporate assets (Sec. 13a <i>ErbStG</i>)	3 433	7 150	20 023	40 168	34 083	104 857
therof: gifts	2 506	4 814	15 611	36 435	30 370	89 736
Other tax exemptions (Sec. 13 <i>ErbStG</i>) ⁴	220	590	945	1 022	1 304	4 079
Taxable acquisition after deductions and allowances, including prior acquisitions ⁵	28 482	30 500	25 112	27 361	28 783	140 239
therof:						
Value of prior acquisitions ⁵ (Sec. 14 <i>ErbStG</i>)	10 298	13 266	9 045	11 866	11 825	56 301
Gross tax liability	6 020	7 269	5 829	6 428	6 632	32 178
Tax credits ⁶	-1 758	-2 686	-1 629	-2 244	-1 915	-10 231
Assessed tax liability	4 262	4 583	4 200	4 184	4 717	21 947
For information: Cash revenue of inheritance and gift tax	4 550	4 404	4 246	4 305	4 633	22 138

¹ Resident taxpayers.² Sole proprietorships and joint partnerships.³ Available only for automated cases.⁴ Especially for household effects and other movable items, real estate, collections, charitable donations.⁵ Acquisitions from the same person within a ten-year period which are added together.⁶ Especially for prior acquisitions.

Sources: Federal Statistical Office, special analysis of the inheritance and gift tax statistics, revenue statistics.

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lion euros were recorded in assessed tax cases from 2009 to 2013. Of this figure, corporate assets in the amount of 105 billion euros were transferred tax free and 90 billion euros of this sum was transferred as gifts. The associated loss of tax revenue for this period is estimated at 25 to 30 billion euros.³ Inheritance tax revenues, which have fluctuated between four and five billion euros per annum in recent years, would have been more than double that.

Reported annual data refer to the year in which the relevant tax cases were initially assessed. Most of the underlying inheritances or gifts are one to three years old. This explains why expanded tax benefits from 2009 do not become evident until 2011. In 2012 and 2013, half

of all tax-assessed assets were transferred tax free.⁴ Presumably the “exemption option” was used frequently, allowing such businesses to be transferred completely tax free. This is illustrated by a comparison of the extent of tax benefits with the value of transferred business assets.⁵

The sharp increase in the volume of tax breaks on corporate assets is probably also due to anticipatory effects linked to possible limitations resulting from the judgment of the Federal Constitutional Court. This suggests a high share of gifts, which is also indicated by the decline in 2013. According to estimates of all personal and family-related business assets, annual transfers of

³ According to calculations by the Federal Statistical Office, the shortfall due to tax breaks for corporate assets from 2009 to 2012 was 19.1 billion euros (letter from the Federal Ministry of Finance to the Federal Constitutional Court dated June 6, 2014). Based on tax exemptions totaling 70.8 billion euros in the same period, there is an implicit marginal burden of 27 percent. Applying this marginal burden to tax exemptions in 2013 totaling 34.1 billion euros results in an additional tax shortfall for this year of 9.2 billion euros, and tax losses of 28.3 billion euros for the entire period from 2009 to 2013.

⁴ The total annual volume of inheritances in Germany is estimated to be at least 200 billion euros, see C. Schinke, “Inheritance in Germany 1911 to 2009: A Mortality Multiplier Approach,” SOEPpapers on Multidisciplinary Panel Data Research 462 (2012). According to these data, more than 90 percent of the inheritance tax base of around 16 billion euros per annum (taxable acquisition after deductions and allowances and with no prior acquisitions. See Table 1) was transferred tax free.

⁵ However, the shares in limited companies are underreported since they are only available for automated cases.

Box 2

Estimates of Personal and Family-Related Business Assets and Possible Business Transfers in the Coming Years

Due to the medium-sized business landscape of the German economy, a significant part of overall economic business assets are owned by families. Private individuals and families also own large interests in a number of major companies. According to estimates by *manager magazin* the 500 richest Germans in 2014 (individuals or families) owned assets of 611 billion euros.¹ This value, however, is likely to have been influenced by dynamic capital market valuation in recent years. The total wealth of the 500 richest Germans from 2010 to 2013 is estimated at approximately 500 billion euros. There are various risks in terms of the reliability of these estimates. Indeed, absent from the list are the high assets worth tens to hundreds of millions of euros earned by many SMEs and smaller major companies. Therefore, the total value of personal and family-related corporate wealth including the many medium-sized companies in Germany is likely to be much higher.

These figures use estimates on total assets owned by the richest 0.1 percent of households in Germany (40,000 households), based on data from the Household Finance and Consumption Survey (HFCS), tasked by the central banks of the Eurosystem, and the list of "The World's billionaires", published in the US economic magazine, *Forbes*.² The top concentration of wealth is interpolated with the Pareto

distribution here. The wealthiest 0.1 percent of households in 2011 starts at a net wealth of 11 million euros per household and represents total net wealth of 1,600 billion euros.³ Similar estimates based on the Socio-Economic Panel (SOEP) study in combination with the *Forbes* list for 2012 indicate total assets for the richest 0.1 percent of households valued at between 1,200 and 1,700 billion euros.⁴ Assuming that 75 percent of these assets are corporate assets (sole proprietorship, interests in joint partnerships, and substantial interests in incorporated companies)⁵ and that these assets will be passed to the next generation every 40 years on average, the potential transfer volume of corporate assets amounts to approximately 25 to 30 billion euros per year. According to current tax legislation, a large portion of that is likely to be tax free.

In this calculation, only the assets of the richest 0.1 percent of households with a net wealth of 11 million euros per household are taken into account. Even in households with less wealth, a considerable proportion is likely to be corporate assets, part of which could also be transferred tax free.

¹ "Die 500 reichsten Deutschen," *manager magazin Spezial* (2014); Wikipedia, s.v. "Liste der 500 reichsten Deutschen" (2015), last modified February 3, 2015.

² P. Vermeulen, "How fat is the top tail of the wealth distribution?," European Central Bank, Working Paper Series 1692.

³ It is assumed here that the distribution of assets among the richest one percent of households with net assets of two million euros follows the Pareto distribution. Estimates by Vermeulen, "wealth distribution," 27 ff. indicate that the inclusion of observations from the *Forbes* list gives a Pareto coefficient of 1.37 with a standard error of 0.02.

⁴ M. M. Grabka and C. Westermeier, "Große Unsicherheit beim Anteil der Top-Vermögenden in Deutschland," *DIW Wochenbericht*, no. 7 (2015).

⁵ S. Bach and M. Beznoska, "Aufkommens- und Verteilungswirkungen einer Wiederbelebung der Vermögensteuer," *Politikberatung kompakt*, no. 68 (DIW Berlin, 2012): 58 ff.

corporate assets totaling 25 to 30 billion euros are expected in the medium term (see Box 2).

Assuming that assets of this magnitude may be transferred tax free in the next few years, this would lead to potential tax losses of seven to eight billion euros per annum, based on applicable statutory tax rates.⁶ Inheritance tax revenue from the current five billion euros per annum might increase by two and a half times in the medium term if tax rates remain constant.

However, tax benefits might continue to be applied until the new rules come into effect in mid-2016. Consequently, further tax losses on a similar scale are like-

ly in 2014 and 2015. After the forthcoming reform, the anticipation effects should in itself mitigate inheritance tax revenue.

... Lead to Low Tax Burdens on Substantial Assets

Since there is no limit on the tax breaks for corporate assets, they can also be applied to shares in large enterprises. These shares are often in the two to three-digit million range, sometimes even billions. In 2012 und 2013, over half of transfers amounting to five million euros or more were tax exempt (see Table 2). The tax-free shares increase as the transfers rise since they consist primarily of corporate assets. Over 90 percent of transfers of 20 million euros or more during the ob-

⁶ A marginal tax burden of additional assessable corporate assets of 27 percent is assumed here. See footnote 3.

reservation period were tax exempt. In 2012, transferred assets in this bracket totaled 33 billion euros, 95 percent of which was transferred tax free. Tax-free deductions in this group come to a total of 131 million euros per taxpayer. At the maximum tax rate of 30 percent for corporate assets, this results in a tax benefit of 40 million euros in each case. In 2013, fewer assets worth 20 million euros or more were transferred, but there were a higher number of cases in the lower brackets.

This results in low effective inheritance tax burdens for large or very large transfers. In contrast, transfers by the “normal” wealthy are taxed at a rate of 11 or 15 percent if they exceed the beneficiary’s personal allowance (see Box 1). In the case of transfers to distant relatives, friends, or other persons, the personal allowance in tax class III is only 20,000 euros with an initial tax rate of 30 percent and a top tax rate of 50 percent. Accordingly, the effective tax burdens are higher in these cases.

Tax Exemptions Not Required for Large Enterprises

The inheritance tax is supposed to progressively burden the accretion of larger assets lacking effort and thus improve equal opportunities in a meritocracy and limit the concentration of wealth. Granting tax concessions for very large assets, too, contradicts this approach. Therefore, such tax breaks must be legitimized for reasons of public interest, as called for by the Federal Constitutional Court.

In the case of multi-million euro business assets beyond small and medium-sized enterprises (SMEs), extensive tax breaks are not required to secure jobs during corporate succession.⁷ Obviously, larger firms may continue to be run by external acquirers. A massive tax break for business continuation is also questionable insofar as family members are not necessarily the more successful entrepreneurs, even if the family character and commitment is an important element in family businesses.⁸ Furthermore, the tax benefits tend to lead to overinvestment in the company. The lock-up periods and payroll provisions stipulated in exemption regulations may prevent meaningful restructuring and reorganization of en-

terprises. This may in turn burden the development of enterprise in the longer term. After all, tax exemptions on corporate assets are open to abuse and costly to administer for both taxpayers and tax authorities. They give strong incentives for taxpayers to invest other taxable assets in the business. To counter this effect, complicated rules must be applied to administrative assets.

Overall, the extensive exemption regulations are not required at least in larger companies to prevent job losses during corporate succession and are sometimes even counterproductive. They should be urgently scaled back, as called for by the Federal Constitutional Court.

Tax Exemptions only for SMEs and on Operating Assets

The legitimate core of tax exemptions on corporate assets is liquidity and funding problems for larger inheritance tax payments.⁹ These can burden, in particular, owner-managed SMEs. Borrowing options are usually limited here and the company may not bring in outside shareholders, so here, tax allowances or deductions on taxable assets are justified. However, they should be limited to operating assets and capped, for example, at one to two million euros. Even this represents a considerable privilege compared with the tax burden imposed on transfers of non-exempt assets of this magnitude.

Tax benefits should be restricted to the company’s “administrative assets,”¹⁰ as stipulated by the Federal Constitutional Court, i.e., assets not necessarily required to run the company. In addition, other transferred assets¹¹ and other assets owned by the beneficiary could be credited, and, in the case of gifts, other assets owned by the donor. Since, in these cases, there are liquid assets to finance the tax burden, without having to draw on the company’s operating capital. However, this would require assessing the beneficiary’s wealth, and, in the case of gifts, the wealth of the donor.

⁷ Scientific Advisory Board at the Federal Ministry of Finance, *Die Begünstigung des Unternehmensvermögens in der Erbschaftsteuer*, report dated November 2011; German Council of Economic Experts, *Die Finanzkrise meistern - Wachstumskräfte stärken*, Annual Report 2008/9, para. 366 ff.

⁸ See V. Grossmann and H. Strulik, “Should continued family firms face lower taxes than other estates?,” *Journal of Public Economics* 94 (2010): 87-101; and empirical studies for the US in F. Pérez-González, “Inherited control and firm performance,” *American Economic Review* 96 (2006): 1559-1588; B. Villalonga and R. Amit, “How do family ownership, control and management affect firm value?,” *Journal of Financial Economics* 80 (2006): 385-417; M. Bennedsen et al., “Inside the family firm: The role of families in succession decisions and performance,” *Quarterly Journal of Economics* 122 (2007): 647-691.

⁹ See Scientific Advisory Board, *Begünstigung*; German Council of Economic Experts, *Finanzkrise*.

¹⁰ Administrative assets include, in particular, non-operating real estate, financial assets, cash, valuable collections, etc.

¹¹ See also analyses by H. Houben and R. Maiterth, “Endangering of Businesses by the German Inheritance Tax? – An Empirical Analysis,” *Business Research* 4 (2011): 32-46; R. Maiterth, “Empirische Erkenntnisse zur Unternehmensgefährdung durch die ErbSt.” Notes relating to the pending decision of the Federal Constitutional Court on inheritance tax, *Der Betrieb* dated October 10, 2014, issue 41 (2014); S. Bach, H. Houben, R. Maiterth, and R. Ochmann, “Aufkommens- und Verteilungswirkungen von Reformalternativen für die Erbschaft- und Schenkungsteuer,” *Politikberatung kompakt*, no. 83 (DIW Berlin, 2014).

Table 2

Taxable acquisitions, deductions and tax burden of inheritance and gift tax¹

Acquisitions before deductions ²	Acquisitions before deductions ³		Deductions ^{3, 4}			Personal allowance	Assessed tax liability	Effective tax burden ⁵
	taxpayer	billion euros		as percent of acquisitions	1 000 euros per taxpayer	billion euros		percent
2012								
below 0	529	-10 367	-5	0	-9	34	,	,
0	-	-	-5	-	.	20	,	,
0-5 000	3 623	8	1	16	0	137	1	7.5
5 000-10 000	4 244	31	2	8	1	122	2	5.1
10 000-50 000	55 666	1 655	96	6	2	1 436	125	7.6
50 000-100 000	32 126	2 265	188	8	6	1 078	295	13.0
100 000-200 000	24 096	3 393	346	10	14	1 426	498	14.7
200 000-300 000	11 408	2 770	390	14	34	1 309	323	11.7
300 000-500 000	13 160	5 179	941	18	72	2 817	401	7.7
500 000-2,5 mill.	16 251	14 765	4 756	32	293	4 637	1 259	8.5
2,5 mill.-5 mill.	1 147	3 898	1 865	48	1 626	386	366	9.4
5 mill.-10 mill.	468	3 241	2 031	63	4 340	160	242	7.5
10 mill.-20 mill.	200	2 808	2 108	75	10 539	62	166	5.9
20 mill. and more	242	32 979	31 500	96	130 167	62	493	1.5
Total	163 160	62 624	44 214	71	270 984	13 685	4 184	6.7
2013								
below 0	474	-129	-30	23	-63	35	,	,
0	-	-	0	-	.	29	,	,
0-5 000	5 583	8	3	38	1	195	1	7.1
5 000-10 000	3 711	27	3	10	1	154	1	5.0
10 000-50 000	54 875	1 652	95	6	2	1 543	122	7.4
50 000-100 000	32 207	2 269	190	8	6	1 081	294	13.0
100 000-200 000	24 334	3 414	375	11	15	1 470	495	14.5
200 000-300 000	11 523	2 797	409	15	36	1 315	332	11.9
300 000-500 000	14 002	5 483	1 046	19	75	2 954	439	8.0
500 000-2,5 mill.	18 522	17 420	6 278	36	339	5 267	1 407	8.1
2,5 mill.-5 mill.	1 593	5 567	3 210	58	2 015	464	437	7.8
5 mill.-10 mill.	722	5 044	3 467	69	4 802	228	340	6.7
10 mill.-20 mill.	357	4 750	3 924	83	10 993	151	205	4.3
20 mill. and more	356	22 060	19 992	91	56 159	91	630	2.9
Total	168 259	70 363	38 962	55	231 562	14 977	4 717	6.7

1 Resident taxpayers.

2 Only first tax assessments

3 Only automated cases for acquisitions by reason of death.

4 Deductions of tax exemptions according to Section 13 ErbStG (especially for household effects and other movable items, real estate, collections, charitable donations), tax exemptions for corporate assets according to Section 13a ErbStG, exemption for real estate leased for residential purposes according to Section 13c ErbStG, sum of deductible restrictions on transfers, incidental acquisition costs, and exempted transfers by double taxation agreements.

5 Assessed tax liability divided by acquisitions before deductions.

Sources: Federal Statistical Office, special analysis of the inheritance and gift tax statistics, 2012 and 2013.

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Extending Deferred Payment and Annuitization on Tax Liability

Tax burdens of up to 30 percent are likely to be a significant drain on liquidity for corporate successors, which may force them to sell the company or company shares. The family-owned small and medium-sized enterprises of the “Mittelstand” are a cornerstone of the German economy. Acquisitions by foreign investors are fraught with risk. Foreign acquirers, such as financial investors, are sometimes not interested in the long-term success

of the company. This may cause economic disadvantages in the long term.

Tax-related liquidity and financing burdens can be considerably curbed through extended deferral arrangements.¹² After allowances and deductions, tax burdens on corporate assets should be deferred or annuitized over long periods with no specific conditions to allow corpo-

¹² Scientific Advisory Board, Begünstigung, 37 ff.; German Council of Economic Experts, Finanzkrise.

rate successors to pay them off using current revenues.¹³ This is currently the case for “substitute inheritance tax” on the assets of foundations which is charged every 30 years and can be annuitized over 30 years.¹⁴ Even with a maximum tax rate of 30 percent, the tax burden would only be equivalent to one percent per annum spread over 30 years, somewhat more due to compound interest. If the extra revenue from restricting companies’ privileges were used to reduce the tax rate, the burden could be even lower. The extra revenue would be raised only step by step, however, if deferral or annuitization arrangements were applied to the tax liability.

So as not to restrict a company’s funding options and its ability to weather a crisis, other liabilities may be given priority over the tax claim, or may be pegged to the economic success of the company. This would make the tax authorities into a kind of silent partner of the company until the tax liability is amortized.

These liquidity support measures would not hinder family succession in medium-sized and large enterprises and, at the same time, prevent huge tax benefits for business successors. This would eradicate the need for complicated and non-transparent means testing which would otherwise be required for a continuation of the existing tax breaks for large companies, in accordance with the judgment of the Federal Constitutional Court. Furthermore, incentives to shift private assets into companies would be reduced which would partially ease the complicated regulations on administrative assets.

Keep Inheritance Tax and Broaden Tax Bases

Inheritance tax is the last remaining tax on “the rich” in the German tax system. For close relatives, it only burdens the transfer of large assets. Indeed, the currently low revenue of approximately five billion euros per year could easily be replaced by an increase in the top rate of personal income tax, corporate income tax, or capital income tax.¹⁵ Compared to these taxes or to a recurrent wealth taxation inheritance tax is considered by many economists and tax experts to be the economically more

favorable version.¹⁶ Since it is levied only when the assets are passed on, which generally happens only in old age, it may be less relevant for economic decisions during the active economic activities carried out in younger years. Inheritance tax only affects behavior when the assets are to be inherited or gifted. This is not the case when assets are accumulated or held for the proprietor’s own use, such as retirement or risk prevention, children’s education, prestige or power, and there are no specific bequest motives.

The burden on beneficiaries of high inflows lacking effort increases the acceptance of this form of asset taxation, since it takes into account “meritocratic” ideas and equal opportunities between members of individual generations.¹⁷ The increase in income and wealth concentration in the upper levels of the distribution¹⁸ also argues in favor of preserving or even expanding inheritance tax because, due to the increasing “dualization” of income tax since the late 1990s, high and very high corporate and capital income is hardly being taxed progressively at all, as it is no longer subject to the personal income tax rate.

For these reasons, international organizations such as the OECD and the IMF recommend shoring up property-related taxes such as inheritance tax and reducing current taxes on earned income.¹⁹ But it must be remembered that, when corporate and capital assets are high, inheritance incentives and family succession both frequently play a role. Inheritance tax is accounted for in tax planning and can trigger avoidance reactions including relocation of residency, especially since inheritance tax is no longer levied in a number of OECD countries and current net wealth taxes have been abolished in most countries.²⁰ This argues in favor of limiting the tax burden.

¹³ Section 28 of the ErbStG currently states that, on request, inheritance tax on corporate assets may be deferred for up to ten years. However, proof is required that this is necessary to maintain the company.

¹⁴ Section 24 of the ErbStG. The applicable interest rate of 5.5 percent should, however, be approximated to currently much lower interest rates on government debt.

¹⁵ See the effects on revenue of possible reforms to these taxes, Finanzpolitische Kommission der Heinrich-Böll-Stiftung, “Nachhaltig aus der Schuldenkrise – für eine finanzpolitische Zeitenwende,” *Wirtschaft und Soziales*, vol. 14, (Heinrich-Böll-Stiftung, 2014): 85 ff.

¹⁶ See J. K. Brunner, “Die Erbschaftsteuer – Bestandteil eines optimalen Steuersystems?,” *Perspektiven der Wirtschaftspolitik* 15 (2014): 199-218; W. Kopczuk, “Taxation of intergenerational transfers and wealth,” in *Handbook of Public Economics* 5, eds. A. J. Auerbach et al., (North Holland, 2013): 329-390; T. Piketty and E. Saez, “Rethinking Capital and Wealth Taxation” (working paper, September 17, 2013); R. Boadway, E. Chamberlain, and C. Emmerson, “Taxation of Wealth and Wealth Transfers,” in *Institute for Fiscal Studies, Dimensions of Tax Design: The Mirrlees Review* (Oxford: Oxford University Press, 2010): 737-824; H. Cremer and P. Pestieau, “Wealth and wealth transfer taxation: a survey” (working paper, July 2009, revised in November of 2009).

¹⁷ See Piketty and Saez, Rethinking; A. Oberhauser, “Erbschaft- und Schenkungsteuern,” *Handbuch der Finanzwissenschaft*, 3rd ed., vol. II (Tübingen: Mohr, 1980): 487-508.

¹⁸ S. Bach, “Einkommens- und Vermögensverteilung in Deutschland: Trends und Perspektiven,” *Wirtschaftsdienst* 10 (2014) and M. M. Grabka and C. Westermeier, “Große Unsicherheit beim Anteil der Top-Vermögenden in Deutschland,” *DIW Wochenbericht*, no. 7 (2015).

¹⁹ OECD, “Divided We Stand: Why Inequality Keeps Rising” (OECD Publishing, 2011); International Monetary Fund (IMF), *Taxing Times*. Fiscal Monitor (October 2013); OECD, *Economic Surveys Germany*, 18f.

²⁰ Scientific Advisory Board, *Begünstigung*; M. Förster, A. Llana-Nozal, and V. Nafilyan, “Trends in Top Incomes and their Taxation in OECD Countries,” OECD Social, Employment and Migration Working Papers, no. 159 (2011): 56 ff.

In addition to limiting companies' privileges, other tax breaks on inheritance tax could be reduced or abolished, such as the valuation discount of ten percent for real estate leased for residential purposes, full tax exemption of the family home when it continues to be used by close relatives, or tax exemptions on donations to churches, non-profit or charitable organizations, and political parties. Furthermore, the period of aggregation with previous transfers could be extended from the current ten years in order to restrict multiple use of personal allowances. Finally, irrespective of decedent or donor, personal allowances might only be granted once in a lifetime. In turn, the extra revenue could be used to increase personal tax allowances, particularly for spouses, partners, and children. This would eliminate the need to assess cases where there is no significant tax revenue and also counteract latent reservations against inheritance tax by the middle classes.

The federal states are entitled to inheritance tax revenues. Since it is mainly generated in the city-states of Berlin, Hamburg, and Bremen, and in the prosperous regions of western Germany, inheritance tax revenue is strongly redistributed across the states as a result of fiscal equalization.²¹ This reduces the willingness of the wealthier states to agree to inheritance tax reforms that would have a greater impact on high assets. Consequently, during the upcoming reform of German fiscal federalism, inheritance tax revenue should be transferred to the federal government and compensate those states with tax sources that are distributed more evenly across the country.²²

Conclusions

The Federal Constitutional Court has determined that the far-reaching inheritance tax exemptions for corporate assets are partly unconstitutional and has required legislators to submit new regulations by mid-2016. The significance of these tax breaks has increased greatly. In 2012 and 2013, half of all assets assessed for inheritance tax were transferred tax free, mostly as gifts. In the medium term, annual transfers of corporate assets worth 25 to 30 billion euros are expected. If these were to remain tax exempt, it would lead to tax losses at the current statutory tax rate of between seven and eight billion euros per year. If these company privileges were re-

voked, this would increase annual inheritance tax revenue to 13 billion euros in the medium term if current tax rates were applied.

Tax breaks for corporate assets are unlimited, so they apply to million or even billion-dollar transfers. In 2012 and 2013, more than half of transfers of five million euros or more were tax exempt. The tax-free shares increase as the transfers rise since they consist primarily of corporate assets. Over 90 percent of transfers of 20 million euros or more in these two years were tax exempt.

For larger companies, the extensive exemption regulations are not required to prevent job losses during business succession and are sometimes even counterproductive. Allowances or deductions should be limited to required operating assets. Other transferred assets and other assets owned by the beneficiary could also be credited, and, in the case of gifts, other assets owned by the donor as well.

After allowances and deductions, tax burdens on corporate assets should be deferred or annuitized over long periods with no specific conditions in order to allow corporate successors to pay them off using current revenues. However, additional tax revenue would then be raised only step by step.

Furthermore, other liabilities could be given priority over the tax claim or it could be pegged to the commercial success of the company. As a result, liquidity problems resulting from high inheritance tax payments would be avoided and the tax authorities would become a kind of silent partner of the company until the tax liability is paid off. This would eradicate the need for complicated and non-transparent means testing which would, in accordance with the judgment by the Federal Constitutional Court, otherwise be required for a continuation of the existing tax breaks for large companies.

In addition to restricting company privileges, further tax benefits should be reduced or abolished, such as privileges for rented residential property, tax exemption for the family home, and tax exemptions on donations. Furthermore, the multiple use of personal allowances could be limited by extending the ten-year period for aggregating transfers or permitting personal allowances to be applied only once in a lifetime. In return, personal tax allowances could be raised, particularly for spouses, partners, and children. This would avoid the need to assess cases where there is no significant tax revenue and also counteract latent reservations against inheritance tax by the middle classes.

²¹ S. Bach and T. Mudrack, "Reichensteuer-Erhöhen: Durch Finanzausgleich profitieren auch arme Bundesländer," DIW Wochenbericht, no. 36 (2013).

²² See German Council of Economic Experts, "Mehr Vertrauen in Marktprozesse," Annual Report 2014 (15), Tz. 624, who also points out that the local accretion of tax revenue is not appropriate.



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