

# German Inheritance Law and Taxes

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## 1. Introduction

The death of a person not only affects the personal and family lives of the people concerned but often also raises tax issues.

In Germany, all estates are taxed pursuant to the “Erbschaftssteuer- und Schenkungssteuergesetz (ErbStG)” (Inheritance and Gift Tax Act). Although this is federal legislation, the states (Länder) are entitled to the revenue generated by the tax.

This article gives an overview of German inheritance tax law. Since March 2010, the Inheritance Tax Act has undergone a number of radical changes. The changes which mostly concern the tax classes and the tax free threshold amount only affect cases where deceased died after 31 December 2009.

Any reference to German inheritance tax law in this article refers to the law in Germany that is currently applicable. This article also highlights some of the differences between the current law and cases in which the old law is still applicable.

## 2. Tax Liability

A beneficiary of an estate is generally liable for inheritance tax.

German law divides tax liability into the following three categories:

- unlimited tax liability;
- limited tax liability; and
- extended limited tax liability.

### 2.1. Unlimited Tax Liability

Pursuant to section 2 (1) ErbStG, the whole estate is subject to German inheritance tax if the deceased was resident in, or the beneficiary is resident in Germany.

A “resident” is defined in section 2 (1) (a) to (d) ErbStG to mean:

- 2.1.1. someone who has a permanent residence or normally resides in Germany. Even if the person’s principal place of residence is not in Germany, he or she may arguably be regarded as a resident in Germany if a so-called “small

permanent residence” exists, e.g. a small furnished room which is used as accommodation for stays in Germany;

- 2.1.2. someone who does not have a permanent residence in Germany but is a German citizen and has not lived outside of Germany for more than five years before becoming a beneficiary of a taxable estate; or
- 2.1.3. an employee of the Foreign Office who does not have a permanent residence in Germany and does not normally reside in Germany (e. g. consular personnel and their families).

## 2.2. Limited Tax Liability

Limited tax liability applies when none of the people involved in the taxable transaction is a “resident” as defined by section 2(1) ErbStG, but the estate or dealings of the estate can be shown to have a “special connection” with Germany. Real property situated in Germany and business assets of companies in Germany fall within this category. In such a case, only the estate actually situated in Germany and which has this connection, is subject to tax and not the whole estate.

It is noteworthy that pure financial assets in German bank accounts or portfolios of investment are not included under this category.

## 2.3. Extended Limited Tax Liability

Extended limited tax liability arises when neither the deceased nor the beneficiary are residents in Germany, but the deceased used to reside in Germany and still has substantial economic interests in Germany (e. g. if the deceased held a majority of the shares in a German company).

In order to fall under this tax category, the deceased:

- 2.3.1. must have had a permanent residence or resided outside of Germany in a country with lower tax rates for at least five but no more than ten years before his death;
- 2.3.2. must have been a German citizen; and
- 2.3.3. must have fallen into the unlimited tax liability category for at least five years before his or her emigration from Germany.

## 3. **Taxable Acquisition and Time When the Tax Liability Arises**

When someone inherits an asset from an estate, two questions arise; namely what part of the inheritance is in fact taxable, and at what point of time does the liability arise.

This law relating to the taxation of inheritances is not only applicable to the transfer by reason of death, but also to gifts made while the deceased was still alive and also to gifts made for particular purposes. However, the latter two clauses are not dealt with in this article.

According to section 3 ErbStG, inheritances of estate assets include:

- 3.1. inheritances which result from statutory succession or testamentary disposition;
- 3.2. inheritances which result from entitlement to a compulsory portion (in Germany, the testator's relatives can claim a fixed statutory portion of the estate against a beneficiary. The compulsory portion is equivalent to one-half of the person's entitlement under statutory succession);
- 3.3. direct bequests;
- 3.4. inheritances pursuant to an inheritance contract;
- 3.5. gifts upon death; and
- 3.6. compensation for a waiver or renunciation of an inheritance right.

Pursuant to section 9 ErbStG, tax liability generally arises at the time of death of the deceased. In the case of an inheritance contract, tax liability arises once the contractual obligations have been asserted. In the case of a waiver or renunciation of a right to inherit, tax liability arises on the execution or making of the waiver or renunciation. In the case of an inheritance which results from entitlement to a compulsory portion, tax liability arises at the time of enforcement.

#### 4. **Determination of the Value of the Taxable Acquisition**

Pursuant to section 10 (1) (1) ErbStG, the capital gain of the beneficiary is taxable. The basis for the valuation is the actual financial gain by the beneficiary from the inheritance, not the value of the beneficiary's estate. The key date for the valuation is also the time of the death of the deceased.

In order to calculate the capital gain, the gross value of the estate is determined and then the estate liabilities are deducted from that amount. Estate liabilities include any debts of the deceased, the value of any bequests, testamentary charges and claims for statutory portions as well as estate costs (e.g. funeral expenses, costs for the determination of the estate value etc.). The inheritance tax liability itself is not a liability of the estate.

#### 5. **Tax Classes**

German inheritance tax law creates three tax classes of beneficiaries. The relationship between the beneficiary and the deceased determines the tax class to which the beneficiary belongs (s. 15 ErbStG). A different tax exempt amount and tax rate applies to each tax class.

5.1. The following people are members of the first tax class:

- spouse;
- children and step-children;

- issue of the children and stepchildren (e. g. grandchildren, great-grandchildren and step-grandchildren); and
- parents and grandparents.

5.2. The following people are members of the second tax class:

- siblings;
- nieces and nephews;
- step-parents;
- parents-in-law, sons-in-law and daughters-in-law; and
- former spouses.

5.3. All other beneficiaries are members of the third tax class. For this reason also the surviving partner of a non-marital relationship or of a life partnership which has been registered pursuant to the LPG is member of the third tax class.

## 6. General Tax Exempted Amounts

### 6.1. Residents

Every beneficiary has a right to a personal tax exempt amount which varies according to the relationship of the beneficiary to the deceased, which tax class the beneficiary is a member of (section 16 ErbStG). Inheritance tax only applies to the estate which is over the tax free threshold amount.

If the deceased at the time of death, or the beneficiary at the time of acquisition, is a resident as defined in section 2 ErbStG and the tax applies after 1 January 2009, the following tax exempt thresholds apply:

<b>Relationship</b>	<b>Tax Free Amount</b>
Spouses and registered life partners	€500,000
children/step-children (or their issue if the children/step-children predecease)	€400,000
children of the still living children	€200,000
all other members of the first tax class	€100,000
members of the second and third tax class	€20,000

In the case of a transfer by reason of death before 1 January 2009 the following tax exempt amounts apply:

Relationship	Tax Free Amount
Spouses	€307,000
children/step-children (or their issue if the children/step-children predecease)	€205,000
children of the still living children	€51,200
all other members of the first tax class	€51,200
members of the second tax class	€10,300
members of the third tax class (also registered life partners or partners)	€5,200

#### 6.2. Non-residents

If neither the deceased nor the beneficiary are residents then a tax exempt amount of €2,000 applies in so far as the assets are situated in Germany as defined in section 121 Bewertungsgesetz (BewG) (Assessment Act). This includes real property situated in Germany as well as mortgages, charges over land, mortgage loans etc. in so far as these are secured by real property situated in Germany.

It is again noteworthy that pure financial assets such as portfolios of investment are not domestic assets for the purposes of the Assessment Act.

#### 7. **Maintenance Exemption**

Pursuant to the LPG, spouses, partners, registered life partners and children of the deceased receive a special maintenance exemption in addition to the general tax exempt amount. The maintenance exemption for a spouse, registered life partner or the partner is currently €256,000.

The maintenance exemption for children ranges according to age from €52,000 (for children up to 5 years of age) to €10,300 (for children between 20 and 27 years of age). The law allows for a reduction of the maintenance exemption amounts in certain circumstances.

#### 8. **Tax Free Estate Assets**

No inheritance tax is payable on certain estate assets (s. 13 ErbStG).

Members of the first tax class do not pay inheritance tax on household effects, personal effects and clothes up to a value of €41,000, or on other additional moveable assets up to a value of €12,000.

Members of the second and third tax class only receive an exemption of up to a total amount of €12,000 for the effects and assets previously referred to.

A home is exempt from taxation, if the beneficiary continues to reside in the home him- or herself. For spouses, registered life partners and partners, the exemption applies irrespective

of the size of the real property; for children the exemption only applies if the size of the living space is not more than 200 sqm.

Since the tax reform in 2008, the entire value of other real property in the estate is taxable.

**9. Tax Rates**

Tax rates are determined by the following criteria:

- 9.1. which tax class applies to the beneficiary; and
- 9.2. the net value of the estate (i.e. the value of the inheritance less the tax free amount).

Currently the following tax rates apply to the acquisition of estate assets:

Taxable Amount in €	Tax Rate/Tax Class		
	First	Second	Third
€75,0000	7%	15%	30%
€300,000	11%	20%	30%
€600,000	15%	25%	30%
€6,000,000	19%	30%	30%
€13,000,000	23%	35%	50%
€26,000,000	27%	40%	50%
over €26,000,000	30%	50%	50%

The higher tax rate applies even if the taxable amount is only €1.00 over the threshold amount. This can lead to situations where the additional value is eaten up by the higher tax rate. In these circumstances, the hardship provision of section 19(3) ErbStG applies. This section limits the additional tax to the additional value of the estate.

For cases of transfer by reason of death between 1 January 2009 and 31 December 2009, the following tax rates apply:

Taxable Amount in €	Tax Rate/Tax Class		
	First	Second	Third
€75,0000	7%	30%	30%
€300,000	11%	30%	30%
€600,000	15%	30%	30%
€6,000,000	19%	30%	30%
€13,000,000	23%	50%	50%
€26,000,000	27%	50%	50%
over €26,000,000	30%	50%	50%

For cases of transfer by reason of death prior 31 December 2008, the following tax rates apply:

Taxable Amount in €	Tax Rate/Tax Class		
	First	Second	Third
€52,0000	7%	12%	17%
€256,000	11%	17%	23%
€512,000	15%	22%	29%
€5,113,000	19%	27%	35%
€12,783,000	23%	32%	41%
€25,565,000	27%	37%	47%
over €25,565,000	30%	40%	50%

**10. Zugewinnausgleich – Entitlement to Value Increase in Joint Assets**

In Germany, there is a special form of ownership between spouses called “Zugewinnngemeinschaft”. Under this form of ownership, the husband’s and the wife’s assets at the time of marriage are not shared, but they have equal entitlement to any financial gain or increase in the value of these assets above the CPI rate. If the spouses lived under a “Zugewinnngemeinschaft”, then a claim to entitlement to the relevant financial gain arises on the death of one of the spouses. This claim is not considered an estate asset and is therefore tax free.

**11. Multiple Beneficiaries**

If there is more than one beneficiary then the taxation rate applicable to each individual is determined by the share of the estate he or she receives.

**12. Taxation of Capital Gains**

If a beneficiary inherits real property or securities, stocks and/or bonds from the deceased and these are sold then income tax may be payable on the capital gain in addition to the inheritance tax.

Capital gains on privately owned assets are generally tax free under German law. However, capital gain on inherited assets is only tax free once certain time limits from the date of acquisition of the assets have expired. If the real property or securities are sold before expiration of the relevant time limits then the acquisition of the estate asset is deemed to be a “speculative transaction” and any capital gain is subject to income tax.

In relation to real property, the time limit is ten years, and in relation to securities, a time limit of one year from the date of acquisition of the estate assets, applies.

**13. Duty of Disclosure**

Upon receiving an inheritance, various obligations to disclose information to the taxation office apply. If someone acquires an estate asset, he or she has a duty to inform the taxation office of the acquisition within three months.

The final definition calculation of the tax liability is made by the competent tax authority which sends an assessment notification to all beneficiaries concerned.

#### 14. Tax Returns

Persuant to section 31 ErbStG, every beneficiary is obliged to file an inheritance tax return. According to the statutory provisions, the tax return must include, among other things, a list of assets belonging to the estate.

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#### Disclaimer

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