

GERMANY

Treatment of business assets for German inheritance and gift tax purposes



Andreas Richter, LLM
P+P Pöllath + Partners
Berlin

The German Inheritance and Gift Tax Law has been reformed as of January 1 2009. Some of the most notable changes relate to the valuation system: all transferred assets now have to be taxed on the basis of their true market value. As compensation, the Inheritance and Gift Tax Law provides for an extensive preferential treatment of business assets.

Qualified assets

Besides business assets and agricultural and forestry property, shares in corporations also qualify for preferential treatment in case of a shareholding of more than 25%. Minority shareholders have the possibility of pooling their shares to pass the 25% test. A sufficient pooling agreement must include binding provisions which oblige the shareholders to exercise their voting rights unitarily and to uniformly dispose of the shares only.

Where business assets generally qualify for preferential tax treatment, basic business property relief and an optional business property relief are available. According to the basic relief, 85% of the business assets will not be part of the tax base while 15% of the business assets will be taxed immediately. There is an additional tax allowance for a transfer of business assets amounting to a maximum of €150,000 (\$215,000). If the taxpayer chooses optional relief, 100% of the business assets will not be part of the tax base.

Special requirements

Business property may, however, only benefit from the basic relief if it does not contain more than 50% of so-called passive non-operative assets (leased commercial property, minority shareholdings of 25% or less, securities and cultural property, for example). The optional relief is only available if the business property consists of no more than 10% of non-operative assets. Where the 50% and 10% requirements, respectively, are satisfied, passive non-operative assets may benefit from business property relief as well, but only if at the time of the transfer the respective assets have been part of the transferred business for two years.

Guidelines on the law's application published by the German Tax Administration have confirmed that cash as well as savings accounts and fixed deposits do not qualify as non-operative assets for tax purposes. Therefore, the transfer of liquid assets without triggering inheritance or gift tax may be enabled where such assets belong to a business.

A special focus should be placed on the fact that the threshold of 10% for assets classified as non-operative

for tax purposes only applies to the transferred entity, whereas the relevant threshold for subsidiaries at a lower level remains 50%, even if the taxpayer opts for total exemption from inheritance or gift tax (optional relief). By executing respective reorganisations, it should frequently be possible to benefit from total exemption from inheritance or gift tax in order to transfer assets to the next generation.

The business property relief is intended to preserve the workplaces at the transferred businesses. Therefore, for basic relief the total sum of wages and salaries paid during the five years following the transfer must be at least 400% of the historical average of the total wages during the last five years preceding the transfer. To benefit from optional relief, the total sum of wages and salaries after seven years must be 700% of the historical average of the total wages. Where at the end of the applicable period the company's total sum of wages and salaries does not reach the relevant threshold, a corresponding percentage of the allowed tax deduction is lost.

IT SHOULD FREQUENTLY BE POSSIBLE TO BENEFIT FROM TOTAL EXEMPTION FROM INHERITANCE OR GIFT TAX IN ORDER TO TRANSFER ASSETS TO THE NEXT GENERATION

GERMANY

Smaller businesses with 20 or fewer employees or an historical average of salaries and wages of €0 are not subject to these rules. However, the tax administration intends to also apply the provision regarding the minimum sum of salaries to such parent or holding companies which have less than 20 employees, but whose subsidiaries have engaged 20 or more employees. Consequently, tax planning to avoid the application of the minimum sum of salaries provision by transferring shares to a holding company without any employees of its own may entail a considerable risk of litigation. There may still be an opportunity to avoid the application of the

IN ORDER TO BENEFIT FROM BASIC RELIEF THE TRANSFeree MUST HOLD ON TO THE BUSINESS ASSETS FOR AT LEAST FIVE YEARS

minimum sum of salaries provision resulting from the fact that only subsidiaries (including partnerships) with participations of a minimum of 25% should be considered. Furthermore, employees of subsidiaries

located in a state outside the European Union and the European Economic Area and the wages earned by these employees are disregarded for means of the application of the minimum sum of salaries provision.

Moreover, in order to benefit from basic relief the transferee must hold on to the business assets for at least five years. On the event of a sale or abandonment of a business within five years after the transfer, the transferee partly loses the business property relief. In the case of optional relief, the compulsory holding period is extended from five years to seven years. Several residuary clauses cover other events which have the same harmful effect as a sale or abandonment of the transferred business, for example the sale of essential assets or significant withdrawals. An exemption is made if the sale of an independent division of the business or of essential assets is not aimed at the retrenchment of the business and if the proceeds of the sale are reinvested in business assets which do not qualify as non-operative. Where no exemption applies, the reduction of the business property relief depends on the time that has passed after the transfer up until the harmful event.

Rich opportunities

Overall, the German Inheritance and Gift Tax Law offers numerous possibilities transferring preferentially treated business assets to the next generation. Though the barriers for a preferential tax treatment are high, nonetheless a business may be transferred entirely free of German inheritance or gift tax.