THE PRIVATE WEALTH AND PRIVATE CLIENT REVIEW

TENTH EDITION

Editor
John Riches

THE LAWREVIEWS

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PREFACE

After the past unprecedented 24 months, it is now time to look forward to the post-pandemic world and consider the developments that will likely affect high-net-worth individuals. While (at the time of writing) life begins to resume, the after-effects of the pandemic will reach into the next decade and possibly beyond. The main political question of the day is 'Who will pay for the costs of the pandemic?' As the retail and hospitality industries were forced to close, there was a severe reduction in capacity in construction and manufacturing and high unemployment rates threatened, and governments intervened to provide stimulus packages to all areas of the economy.

The latest reports indicate that the pandemic had cost the UK government £372 billion as at 31 March 2021. [1]To put this in perspective, the total tax revenue that the UK government collected for tax year 2019–2020 was £636.7 billion.[2] Therefore, the Covid-19 bill constitutes almost 60 per cent of total tax revenue, or almost 14 per cent of the UK's GDP for 2019, and there are likely to be more costs to come.

On the other side of the Atlantic, Harvard economists David Cutler and Lawrence Summers estimate the pandemic will cost the United States at least US$16 trillion if the pandemic is largely over by autumn 2021.[3] That would comprise roughly 75 per cent of the nation's 2019 GDP, which was £21.43 trillion. Over in Europe, Germany's government estimated, in December 2020, that the pandemic would cost the country €1.3 trillion, almost 33 per cent of the country's 2019 GDP.[4]

For the rest of the 2020s, the aim for governments will be to generate higher revenues to pay off this borrowing, while continuing to stimulate the economy through fiscal interventions such as keeping interest rates low and government spending. Generating higher revenues will pose a challenge, as the pandemic has worsened inequality and had the greatest impact on individuals with low incomes.[5] Meanwhile, many high-net-worth individuals have benefited financially from the pandemic.[6] Not since the end of the Second World War have the tongues of rumour wagged so much or so loudly on the subject of wealth taxes.

1 https://www.nao.org.uk/covid-19/cost-tracker/.

2 https://www.nao.org.uk/work-in-progress/the-management-of-debt-owed-to-hmrc/

3 https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7604733/.

4 https://www.dw.com/en/coronavirus-germany-faces-13-trillion-covid-bill/a-56103251.

5 https://www.ft.com/content/cd075d91-fafa-47c8-a295-85bbd7a36b50.

6 https://www.ft.com/content/747a76dd-f018-4d0d-a9f3-4069bf2f5a93.

As the introduction to the UK's Wealth Tax Commission[7] Report[8] points out, the concept of a one-off levy during a time of financial crisis is not a novel one in many countries, including the UK. In 1981, during recession, Conservative Prime Minister Margaret Thatcher's government introduced a tax on banks, which raised about £400 million. In 1997, Labour Prime Minister Tony Blair's government imposed a tax on privatised utility companies, and raised £5 billion.

The OECD report on Wealth Taxes notes that in 1990, 12 countries had wealth taxes, but since then many countries have repealed the tax and now only four countries currently tax the net wealth of their residents annually.[9] Only three European countries currently have a general wealth tax, being Norway, Spain and Switzerland. The Norwegian tax is on net wealth where a resident owns more than 5 million kroner in worldwide assets. The Swiss tax is levied on worldwide assets, with the exception of immovable property abroad. The tax rates vary from canton to canton. The Spanish wealth tax progresses from 0.2 to 3.75 per cent where the individual holds assets above €700,000. Individuals living in Madrid are exempt from the tax.

Argentina was the first country to implement a wealth tax in response to the pandemic at the end of 2020 in the Solidarity and Extraordinary Contribution of Great Fortunes Law. The levy is a one-off, payable by those whose assets total 200 million pesos. The rate of the tax is progressive, with Argentinian assets taxed up to 3.5 per cent and worldwide assets taxed up to 5.25 per cent. The tax has raised roughly 223 billion pesos. This amounts to about half a per cent of Argentina's GDP[10] and 75 per cent of the government's target amount of the tax to be raised.

All taxes are wealth taxes to some degree, be they income tax, capital gains tax, value added tax, inheritance tax or corporation tax. However, these taxes are taxes on transfers of wealth, on dispositions of wealth and on accumulations of wealth rather than a tax on all the assets an individual holds on a particular date.

So if governments are to bring in wealth taxes, what might they look like? The UK Wealth Tax Report advocates a one-off wealth tax as being more effective than an annual one.[11] A one-off wealth tax is much harder for taxpayers to avoid as the date of assessment of the individual's wealth can be announced at the same time as the tax itself. Furthermore, a one-off tax does not distort taxpayers' behaviour or disincentivise taxpayers from working, investing or even being resident in the country. The report recommends that it should be possible to pay the tax in instalments to assist those who hold mainly illiquid assets, such as residential property, from having to sell in order to pay the tax. It also recommends that the tax should be levied on individuals' net wealth, that is, after deduction of debts and liabilities, and that jointly held assets should be apportioned between owners. The report then goes on to estimate that such a tax on the net assets of UK residents above £500,000 could, at 1 per cent per annum for five years, raise £260 billion. If levied on net assets above £2 million, it could raise £80 billion.

7 Although the title makes the Commission sound official, it was not a government report but rather one in which the London School of Economics played a central role.

8 https://www.wealthandpolicy.com/wp/WealthTaxFinalReport.pdf.

9 https://www.oecd.org/tax/tax-policy/role-and-design-of-net-wealth-taxes-in-the-OECD-summary.pdf.

10 https://www.bloomberg.com/news/articles/2021-05-03/argentina-wealth-tax-fought-by-millionaires-raises-2-4-billion.

11 https://www.wealthandpolicy.com/wp/WealthTaxFinalReport.pdf.

Meanwhile, a European study developed in partnership with the Karl Renner Institute and the Austrian Federal Chamber of Labour advocates a pan-European wealth tax as well.[12] The argument for a pan-European tax is that it would be much harder for individuals to avoid, unless they became resident outside of Europe altogether. Within the 22 European countries, the richest 1 per cent of individuals hold 32 per cent of European wealth whereas the poorest 50 per cent of individuals hold 4.5 per cent between them. The report finds that a 2 per cent tax on individuals who hold net assets above €1 million would only tax 3 per cent of the population and would likely raise revenues in the region of €192 billion, accounting for some evasion. A very progressive tax rate with a rate of 10 per cent above assets of €500 million could raise in the region of €357 billion, which equates to 3 per cent of European GDP.

In the United States, there is a similar wealth disparity. The richest 10 per cent of Americans hold just under 70 per cent of US wealth.[13] The *Financial Times* reported in February 2021 that a one-off 5 per cent tax on the richest 10 per cent would raise US$4 trillion, amounting to 19 per cent of the US's GDP. Democrat Elizabeth Warren advocates for an 'ultra-millionaire tax' at 2 per cent above US$50 million and 6 per cent above US$1 billion. It is estimated that this would bring in revenues of US$3.75 trillion over 10 years.[14]

As well as introducing a new wealth tax, there are also calls for changes to existing taxes. The OECD recently published a study on inheritance taxation in OECD countries, which notes that the inheritance tax bases in many countries have been narrowed due to exemptions and reliefs.[15] Making estate and gift taxes more rigorous would not only raise revenue but also reduce wealth inequality through intra-generational transfers. The report also notes that, with many countries having ageing populations, there is a disparity between wealthy older generations and poorer younger generations. On average, inheritance tax revenues equate to only 0.5 per cent of the total tax revenues in most OECD countries, with only Belgium, France, Japan and South Korea collecting 1 per cent of total tax revenues from inheritance taxes.[16]

Within the 38 member countries of the OECD, 24 tax assets that are passed on the death of the owner. Interestingly, the majority of these countries tax on the basis of the value the recipient receives. Only four countries, being the US, the UK, South Korea and Denmark, tax on the basis of the value of the deceased's estate. US President Biden is attempting to push through a reduction in the lifetime gift and estate allowance from US$11.7 million to US $3.5 million, as well as to increase the top tax rate to 45 per cent up from 40 per cent.

The UK has no tax on outright lifetime gifts between individuals, but the threshold for gifts the deceased makes in the last seven years of life and through his or her estate is £325,000. However, many individuals can circumvent this through making lifetime gifts outside the seven-year window with no tax implications. However, the OECD report suggests that capturing lifetime gifts in the tax base, as well as reducing exemptions and reliefs, would make inheritance taxes more effective as well.

12 https://www.feps-europe.eu/attachments/publications/a%20european%20wealth%20tax_policy%20study.pdf.

13 https://www.ft.com/content/0952761a-f565-46be-a515-12659551169a.

14 https://elizabethwarren.com/plans/ultra-millionaire-tax,

15 OECD (2021), Inheritance Taxation in OECD Countries, OECD Tax Policy Studies, OECD Publishing, Paris, https://doi.org/10.1787/e2879a7d-en.

16 ibid, p. 5.

One separate non-pandemic rationale that has been advanced in the UK to support estate and gift tax reform is the theme of 'inter-generational fairness'. A report published by the All – Parliamentary Group in early 2020[17] advocated replacing the current UK donor-based tax regime with one based on a donee-based tax where every donee was given a lifetime exemption. Gifts in excess of that exemption would attract a 10 per cent flat tax rate. The preference for a donor-based system was in part fuelled by a desire to encourage donors to make gifts to their grandchildren as well as their children. It is unclear whether this approach will find favour with the government.

Meanwhile, despite the pandemic, transparency and automatic information exchange initiatives, which formed the main subject of my forewords in earlier years, have been progressing apace. Where high-net-worth individuals are taking advantage of technological advancements and easier remote working, and spending more time in different countries, they may become tax resident in multiple jurisdictions and, if not, at least reportable under measures such as those of the Financial Action Task Force, the Common Reporting Standard (CRS) and the sixth version of the EU Directive on administrative cooperation (DAC6). Indeed, the CRS FAQs were updated to advise financial institutions that where an individual's interests are split between multiple jurisdictions, the account can be 'reported to all Reportable jurisdictions where there is a residence address'.[18] In this case, the individual will be reported to more tax authorities and perhaps subject to a higher degree of scrutiny than before.

Individuals are already facing enquiries from tax authorities as a result of the information exchanged between different countries. Currently, many enquiries are merely requesting further information, but it may be that in the near future countries will begin to adapt and modulate taxation regimes on the strength of this information. The introduction of the DAC6 legislation across the European Union will also provide a plethora of information to tax authorities and governments about arrangements that are not currently caught by the CRS.

Finally, the US is currently pursuing a global minimum corporation tax rate, which was pitched at 21 per cent before dropping to 15 per cent. Given high budget deficits and the need for increased revenue, governments are going to be even more reluctant to allow multinational corporations to avoid paying taxes in the countries in which they achieved their revenue. The oft-maligned Amazon, for example, made a record €44 billion in Europe in 2020, and yet paid no tax as the Luxembourg headquarters made a €1.2 billion loss.[19]

However governments end up dealing with the large debts that have been created, the rate of change, be it to tax rules or to disclosure obligations, continues to increase exponentially. What is clear is the need to keep a clear view of the road ahead so that our high-net-worth individual clients and their structures can adapt to the changing landscape.

John Riches
RMW Law LLP
London
August 2021

17 https://www.step.org/system/files/media/files/2020-05/STEPReform_of_inheritance_tax_report_012020.pdf.

18 https://www.oecd.org/tax/exchange-of-tax-information/CRS-related-FAQs.pdf, Sections II-VII: Due Diligence Requirements, FAQ 3.

19 https://www.theguardian.com/technology/2021/may/04/amazon-sales-income-europe-corporation-tax-luxembourg.

Chapter 12

GERMANY

Andreas Richter and Katharina Hemmen[1]

I INTRODUCTION

Private wealth and private client law in Germany is 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 German civil and tax law.

In recent decades, private wealth and family-owned enterprises have been growing. Accordingly, private wealth and private client law in Germany 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 or a habitual abode 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.

With regard to income tax, there is a progressive tax rate ranging from 14 to 45 per cent. An additional solidarity surcharge of 5.5 per cent of the tax liability was generally levied until the end of 2020. This surcharge was intended to finance German reunification in 1990. As of 1 January 2021, the solidarity surcharge was completely abolished for 90 per cent of income tax payers. Currently, only high earners, investors who have exhausted their savings allowance, as well as limited liability companies and other corporations, are still subject to the solidarity surcharge.

As previously 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

1 Andreas Richter is a partner and Katharina Hemmen is a counsel at Poellath.

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 successor or donee (hereinafter both referred to as transferee) is liable for the tax on the value of the assets 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 deceased or donor (hereinafter both referred to as transferor) and the transferee, and on the value of the assets 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 a transfer of more than €6 million).

Unlimited tax liability is triggered if either the transferor or the transferee is resident in Germany, regardless of whether the assets received are effectively connected to Germany. If neither the transferor nor the transferee is resident, inheritance and gift tax is only due on certain assets 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 real estate 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. Furthermore, real estate tax is levied annually and is calculated on the basis of rates determined by the local authorities, and property values, which were last assessed in 1964 or 1935. However, the German Federal Constitutional Court found that these obsolete valuation methods are inconsistent with the constitutional principle of equality of taxation. In June 2019, the federal government therefore sent a draft to the German parliament that is supposed to change how the assessment of property values is conducted by local authorities from 1 January 2022 onwards. According to the draft, the federal states will have the possibility to regulate the property assessment individually by implementing their own assessment methods and criteria. This could lead to very different tax burdens in different parts of the country and could, in some parts of Germany, result in significant increases of the real estate tax burden in the future. The new real estate tax law is supposed to come into effect on 1 January 2025. Wealth tax has not been levied in Germany since 1997. Since then, there have already been numerous impulses in the political landscape for either reintroducing the tax or introducing a one-time wealth fee. Against the background of the federal elections in autumn 2021, the introduction of a wealth tax to combat the negative economic effects of the covid-19 pandemic is increasingly being discussed again and can also be found in some election programmes of political parties. Whether it will be introduced depends largely on the composition of the new federal government and the approval of the states. At least in the latter case, the hurdles seem to be too high at present due to the conservative right-wing composition of the Federal Council.

As a result of European directive requirements, a law was introduced by the end of 2019 obligating any person that markets, designs, organises or makes a cross-border tax

arrangement available for implementation or manages the implementation for third parties (intermediary) to disclose these to the respective tax authorities. In some cases, the reporting obligation may also be applicable to the relevant taxpayer of a cross-border tax arrangement.

ii Taxation of business assets under the Inheritance and Gift Tax Act

The inheritance tax law has been reformed several times, most recently in 2016. Exemptions of the Inheritance and Gift Tax Act for business assets are still widely available. The transferee may choose between a basic relief and an optional relief. According to the basic relief, 85 per cent of the business assets do not form part of the tax base and the remaining 15 per cent only are taxed. If the taxpayer chooses the optional relief, 100 per cent of the business assets are not considered part of the tax base. The relief is, however, conditional upon the continuing operation of the business for a certain amount of time (retention period) and the preservation of jobs. The retention period amounts to five years for the basic relief and seven years for the optional relief. Regarding the preservation of jobs, depending on the relief model chosen and the number of employees, after the retention period, the total payroll has to amount to at least 250 to 700 per cent of the payroll before the transfer.

Furthermore, business assets can only benefit from the relief insofar as they do not constitute passive non-operating assets. Passive non-operating assets are, generally speaking, leased real estate, minority shareholdings of 25 per cent or less, securities, certain movables like artwork, antique cars and yachts, and liquid funds if they exceed, after deduction of debt, 15 per cent of the business' total value.

The passive non-operating assets are fully taxable at the regular rate if their value exceeds 10 per cent of the total business assets (the contamination clause). In extreme cases, if the passive non-operating assets equal 90 per cent or more of the value of the whole business, the remaining potentially tax-privileged assets of up to 10 per cent are excluded from all relief, too, in order 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 completely excluded from any form of relief.

In contrast to before 1 July 2016, relief can no longer be claimed independently from the value of the business assets transferred. If the value of the assets exceeds €26 million, the transferee may choose between two relief models: an ablation model or an economic needs test. According to the ablation model, the extent of relief is reduced by 1 per cent for each €750,000 in company value exceeding €26 million. The result is that there is no longer any relief for acquisitions of approximately €90 million. The economic needs test, on the other hand, focuses on the transferee as a person and examines his or her assets. Out of his or her entire non-exempt assets after the transfer, the transferee is required to spend up to 50 per cent for the taxes due on the transferred business assets. Only if the 50 per cent of assets are not sufficient will an exemption from inheritance tax be considered upon request. Finally, it is noteworthy that the reform introduced the possibility of an advance deduction for family companies whose articles of association contain clauses typical for such family companies. However, this is only applicable if the provisions in the articles of association were already incorporated two years before the relevant transfer and if they are not revoked for 20 years thereafter. Therefore, it is highly recommended that family companies examine their articles of association and incorporate the appropriate clauses, if they are not in place already.

iii Tax treatment of trusts

Trusts are generally not recognised in Germany (see Section IV.iii). Trusts can, however, trigger inheritance and gift tax in several ways. The establishment of a trust by residents (see Section II.i) or of a trust comprising assets located in Germany is considered to be a transfer of assets that is taxable in accordance with 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 ultimately clarified by the courts.

In addition, corporate tax can be triggered 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 Controlled foreign company rules in Germany: Sections 7 to 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 Sections 7–14 of the Foreign Tax Act (AStG) and will be subject to comprehensive changes in the future. The EU's Anti-Tax Avoidance Directive (ATAD) obliges all Member States to implement a minimum standard for additional taxation in national tax law. In Germany, the draft law of the federal government for the implementation of the ATAD has been published, and the legislative procedure has thus been initiated. This draft will result in significant changes to the taxation of the addition of profits, only some of which are discussed here.

The 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). According to the government draft, this control concept is to be abolished and replaced by a shareholder-based control concept. 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. The government draft provides for an expansion of the active list here. Cumulatively, this passive income has to be subject to low tax rates of less than 25 per cent at present and also according to the government draft. 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.

Under the current regulation, a foreign corporation is not, however, supposed to be an intermediate company if, inter alia, its effective place of management or its statutory seat is

located in a Member State of the EU or the European Economic Area and if the corporation carries out 'actual' economic activities. The government draft provides for a tightening of this rule by basing it on 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 will 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 set up 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 subject to forced heirship rules. 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 himself 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. Additionally, formal requirements for a will are laid down in Article 27 of the EU Succession Regulation. 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 hypothetical 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 acquiring assets that are situated abroad and that German succession law does not govern. The 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 old conflict of laws rules in Germany, 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 EU Succession Regulation. They are valid in all EU Member States except Denmark and Ireland. The Regulation is not only applicable to cross-border inheritances within the EU, but also to cases with links to third countries (e.g., US citizens with their habitual abode in a Member State). 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 or 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.

The EU Succession Regulation is not applicable to trusts; hence, the respective national conflict of law regime applies.

IV WEALTH STRUCTURING AND REGULATION

i Commonly used structures

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. The corporate tax amounts to 15 per cent plus the solidarity surcharge (see Section II.i). In addition to corporate tax, a trade tax is also levied. The trade tax due depends on the rates determined by the local authorities. A participation exemption may apply, however, for dividends and capital gains. Profits distributed to shareholders of the corporation are subject to withholding 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

applicable). 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 are 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 a 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 real estate 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 subject to gift tax. Income tax may be triggered as well. The classification of the tax bracket depends on the relationship between the founder and the beneficiary.

In contrast to German family foundations, foreign family foundations are not liable to pay substitute inheritance tax. Further, according to a recent ruling of the German Federal Fiscal Court,[2] distributions from foreign family foundations to German resident beneficiaries are only subject to gift tax if they do not comply with the statutory purposes of the foundation or if the beneficiaries have an enforceable entitlement to distributions. However, the undistributed income of a foreign family foundation may be attributed to the personal income of the founder or the beneficiaries if they are resident for tax purposes in Germany (Section 15 AStG). This does not apply to family foundations that have their seat in a Member State of the EU or the European Economic Area if the foundation's assets are legally and effectively separated from the beneficiaries' property and a treaty regarding mutual administrative assistance exists between Germany and the state in which the foundation has its seat. These conditions have to be satisfied cumulatively.

Comprehensive changes are also expected in the law on foundations in the near future. In February 2021, the federal government passed the cabinet draft of a law on a fundamental reform of the foundation law. The two main objectives of the reform are to bundle the hitherto federally fragmented foundation law in a uniform and conclusive manner in the German Civil Code) and to establish a centrally managed foundation register.

2 II R 6/16.

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).

V OUTLOOK AND CONCLUSIONS

The German legal and tax system offers some flexibility for private wealth and estate planning. If structured appropriately, the taxpayer can take advantage of certain relief mechanisms for the succession in family-owned businesses. In particular, flexibility was gained when the EU Succession Regulation came into effect.

Usually, corporations and partnerships are used to structure assets and transfer them to the next generation. Family foundations and charitable foundations may be considered an alternative instrument in estate planning 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

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Dr Andreas Richter LLM is a partner at Poellath. 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 owing 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: Germany 2021* lists Andreas as one of the 'Most Highly Regarded Individuals' in the practice area 'Private Client'.

Andreas is the managing director of the Berlin Tax Policy Forum (Berliner Steuergespräche), chair of the executive board of the inheritance law and business succession postgraduate programme at the University of Muenster and a member of the International Academy of Estate and Trust Law. He serves as a member on boards of family offices, foundations and family businesses and acts as executor.

Andreas is the editor of the leading German compendium on foundations and trusts and related tax issues. He is also the author and editor of numerous other publications, commentaries and compendiums, in particular on family offices, foundation law, business succession and all tax-related matters.

KATHARINA HEMMEN

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Dr Katharina Hemmen LLM is admitted as an attorney-at-law and tax adviser. As a counsel at Poellath in Frankfurt, she focuses on legal and tax advice with regard to domestic and international tax law, inheritance law and succession planning, as well as trust and foundation law. She regularly speaks at conferences, such as those of the International Bar Association, on private client topics, and has been ranked as 'One to watch' in the Private Client Global Elite by *Legal Week*. She has authored many publications in her practice areas.

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