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No pro-rata reduction of tax-free allowance for non-resident beneficiaries

The ECJ has previously held that the German inheritance and gift tax option according to which a higher exempt amount is available where one beneficiary is resident does not fully resolve the conflict with EU law arising from the lower personal allowances for non-residents. In consequence and considering the relevant ECJ case law the Supreme Tax Court ruled in favour of a Swiss-resident widow and granted the full higher tax-free allowance for spouses of €500,000 irrespective of the total inheritance transferred which also included foreign property not subject to German tax.

German inheritance (and gift) tax personal allowances vary by degree of kinship between €500,000 (spouses) and €20,000 (unrelated persons). The allowance drops to €2,000 regardless of kinship in all cases where both testator (donor) and heir (beneficiary) are not resident in Germany (Sec. 16 sub-sec. 1 and 2 German Inheritance and Gift Tax Act). A Swiss-resident widow objected to this distinction in respect of her inheritance of a German property along with certain other Swiss assets from her deceased Swiss-resident husband. In 2010 the widow inherited German property of some €377,000 and also Swiss property of €5,200,000 and Swiss bank deposits and investments in Switzerland of €1,100,000. Initially the German tax office assessed the inheritance tax on the value of the German property by taking into account the lower personal allowance of €2,000 but then reversed its decision in light of the judgment of 17 October 2013 (C-181/12, *Welt*), in which the ECJ has held that the principle of freedom of capital movement prohibits the German system of granting higher personal allowances on capital transfers where at least one of the parties is resident. In its amended assessment, however, the tax office reduced the tax in part by granting the higher tax-free allowance for spouses only proportionally, i. e. in the ratio of the German property to the total assets inherited (including the Swiss assets). This treatment was now also rejected by the Supreme Tax Court. The higher tax free allowance must be granted in full and the inheritance of German property was thus tax free altogether.

The German tax administration in 2011 introduced in the Inheritance and Gift Tax Act an option for taxation as a resident. Nevertheless, the ECJ - in a subsequent judgment of 8 June 2016 (C-479/14, *Hünnebeck*) - held that the inheritance and gift tax option for taxation as a resident does not fully resolve the conflict with EU law from the lower personal allowances for non-residents.

Taking all this into account the Supreme Tax Court concluded that the higher tax-free allowance of €500,000 be available in full according to the strict wording of Sec. 16 sub-sec. 2 of the Inheritance and Gift Tax Act. A broader interpretation that the exemption must be granted on a pro rata basis is not justified. Any amendment to that effect would be a matter for the German legislator.

Note: In the course of the legislation to combat tax avoidance which the government introduced at the end of last year Sec. 16 sub-sec. 2 was indeed amended to the effect that the tax-free allowance be reduced by a partial amount to be determined in detail and thus taking into account to a certain extent the transfers abroad being not subject to German tax.

Supreme Tax Court judgment II R 53/14 of May 10, 2017 published on August 17, 2017

Schlagwörter

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