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ECJ: Restriction of partial inheritance tax exemption for letting of Canadian real property in breach of EU law

In a most recent decision, the European Court of Justice held that the German inheritance tax regime that distinguishes between assets located in the domestic territory, in a Member State of the European Union or in the EEA or, alternatively, in a third country, is a restriction on the free movement of capital and cannot be justified by overriding reasons relating to the public interest.

Background

In 2021 the Cologne Tax Court submitted to the European Court of Justice (ECJ) a request for a preliminary ruling on the inheritance tax valuation of a developed private property located in Canada. The reason for this is the different treatment of similar property either located in Germany, or in an EU Member State or in a state of the European Economic Area (EEA).

Pursuant to Section 13d of the German Inheritance and Gift Tax Act (IGTA) - which was Section 13c IGTA in the year under dispute - real property is assessed at only 90% of its value for inheritance tax purposes if the property in question is developed land that: (1) is rented out by the owner for residential purposes, (2) is located in a Member State of the EU or the EEA and (3) is not a business asset taxed preferentially pursuant to Section 13a IGTA. The purpose of the law is to create a (small) tax benefit for landlords renting out their private property to compensate them for not enjoying the same tax benefits as those enjoyed by the owners of commercial rental companies.

In the case pending before the tax court of Cologne the plaintiff is a German resident who in 2016 became the owner of developed land in Canada as his father's legatee. The plaintiff claims to be entitled to the tax benefit under Section 13c IGTA. The only requirement in the statutes which could possibly exclude the plaintiff from the tax benefit is the requirement that the property be in a Member State of the EU or the EEA, which is not fulfilled in the case of Canada.

The tax court thus asked the ECJ whether it is compatible with the free movement of capital (Art. 63 TFEU) that Germany limits the application of a provision for a 10% tax exemption included in its inheritance and gift tax law to real property located in a Member State of the EU or the EEA. According to the tax court it is questionable whether Germany can restrict the tax benefit to EU and EEA situations given that the free movement of capital also applies to third countries.

Decision of the ECJ

The ECJ shared the doubts of the Cologne Tax Court and - in contrast to the Opinion of the Advocate General - held that a national tax regime that distinguishes between assets located in the domestic territory, in a Member State of the European Union or in the EEA or, alternatively, in a third country, is as such a restriction on the free movement of capital and can only be compatible the free movement of capital if the difference in treatment concerns **situations that are not objectively comparable** or if it is **justified by overriding reasons relating to the public interest**. According to the ECJ, **both preconditions for justification are not met** in the case at hand.

The calculation of inheritance tax is directly linked to the market value of the assets included in the estate, with the result that there is objectively **no difference in situation** such as to justify unequal tax treatment so far as concerns the level of inheritance tax payable in relation to, respectively, an immovable property located in Germany, another Member State or a State which is party to the EEA Agreement and property located in a so called third country State (other than States which are party to the EEA Agreement).

No overriding reasons in the public interest:

The German Government believed the tax advantage provided for in Sec. 13c (1) and (3) of the IGTA to be justified by requirements related to the housing policy pursued by that Member State. That provision reduces the inheritance tax for which heirs of immovable property let for residential purposes are liable and thus reduces the tax burden which may compel them to sell such property. In addition, it favors the letting of housing by individuals over the letting of housing by large institutional investors. Thus, the tax advantage provided for by that provision is suitable for securing, in conjunction with other measures, the objective of enabling the population to gain access to affordable rented accommodation not only in Germany but also in other Member States and States which are party to the EEA Agreement, since access by the population to affordable rented accommodation is also a task of a European nature.

For the ECJ it is not apparent that Sec. 13c (1) and (3) IGTA, which draws a distinction according to whether immovable property let for residential purposes is located either within the national, EU or EEA territory or in the territory of a non-Member State other than a State which is a party to the EEA Agreement is suitable for securing, in a consistent and systematic manner, the attainment of the objective relied on by the German Government. Instead of focusing on places where there is a particularly acute shortage of housing, such as in large German cities, Sec. 13c IGTA applies generally, including in States which are party to the EEA Agreement, and disregards whether the immovable property is located in a rural or urban area. Moreover, all categories of immovable property let for residential purposes, from the most basic to the most luxurious, may be valued at 90% of their market value for the purposes of calculating inheritance tax.

Furthermore, it is not evident that the German legislation at issue requires heirs to retain their housing for a specified period and to use it for rental purposes, so that they may, after obtaining the tax advantage, sell that housing or use it as a second home. In those circumstances, the tax advantage cannot be justified by the objective of promoting and providing affordable rented accommodation in Member States and States which are party to the EEA Agreement.

Also, **the need to ensure the effectiveness of tax supervision cannot justify the restriction** on the free movement of capital brought about by the German legislation at issue. The German authorities are - at any time - in a position to ask the competent Canadian authorities for the information necessary to verify that the conditions laid down in Paragraph 13c IGTA are satisfied in order to grant the tax advantage at issue when the immovable property is located in Canada. In that regard, it is also apparent from the preliminary request that there are no difficulties in the context of that exchange of information.

Source:

ECJ, judgment of 12 October 2023 (**C?670/21**), *BA (Successions - Politique sociale de logement dans l'Union)*

Schlagwörter

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