

By PwC Deutschland | 08. Mai 2024

Income tax reduction due to inheritance tax charge only within 5-year preferential period

According to a decision of the Supreme Tax Court, the 5-year preferential period in Section 35b sentence 1 of the German Income Tax Act starts at the time the inheritance tax arises, which is generally upon the death of the testator. This also applies if it was not possible to claim the tax reduction in due time by reasons for which the taxpayer could not be held responsible.

Background

The plaintiff is the sole heir of W, who died in 2010 and whose estate included two investments in limited partnerships. Because the ascertainment of the heirs took almost six years through several instances and due to staff shortages at the probate court, a certificate of inheritance was only issued on 2 March 2016 which identified the plaintiff as the sole heir. A guardian of the estate was appointed, and the plaintiff was prevented from disposing of the estate until the certificate of inheritance was issued. The plaintiff finally sold the KG shares as of 1 January 2017 and realized a capital gain upon disposal.

In his income tax return for 2017, the plaintiff claimed tax relief in accordance with Section 35b Income Tax Act (ITA) for these sales which the tax office refused. The appeal before the tax court of first instance was rejected.

Decision

The Supreme Tax Court upheld the view of the tax office. The tax reduction in accordance with Section 35b ITA provides that income that was "subject to inheritance tax" in the assessment year or in the previous four assessment periods as a transfer of value passing on death was to be included in the taxable income but taxed at a reduced rate. This was not the case here, as about six years had passed between the death of W and the sale of the KG shares.

Income is "subject to inheritance tax" at the time at which the inheritance tax for the corresponding transfer of assets arises in accordance with Section 38 of the German Fiscal Code and in conjunction with Section 9 of the German Inheritance and Gift Tax Act. In the case of transfers of value passing on death the tax occurs upon the death of the testator. This material tax claim is separate from the tax assessment itself.

According to the Supreme Tax Court, nothing to the contrary can be concluded from the legislative records. Furthermore, only the reference to the time at which the inheritance tax arises ensures that the extent of a possible double burden can be determined within the preferential period. This is also evident in the case of dispute, in which it should have been determined at the time of the inheritance to what extent taxable hidden reserves existed and if they were also subject to inheritance tax. The more time has passed, the greater the difficulties which may arise in this respect.

In the opinion of the Supreme Tax Court, it is not unconstitutional if, due to the limitation of the preferential period to five years, inheritance tax is charged on the transfer of the KG-shares and later income tax is levied upon the sale of the investments. The principle of equal treatment is not violated, nor is any constitutional maximum burden exceeded, for the following reason. While income tax takes the increase in the ability to pay into account, inheritance tax refers to the gratuitous transfer of assets. These two types of tax therefore affect "different levels".

Reference:

Supreme Tax Court, decision of 28 November 2023 (X R 20/21), published on 2 May 2024.

Schlagwörter

inheritance tax, preferential taxation