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Inheritance Tax Gift Tax Act: Increases in the value of shares in a corporation

In its decision of 6 June 2025 (II B 43/24 (AdV)) the Supreme Tax Court held that, upon summary examination, it was seriously doubtful whether contributions made by a shareholder to the capital reserve of a limited liability company (GmbH) lead to a taxable increase in the value of the shares of the co-shareholders within the meaning of Section 7(8) Sentence 1 of the Inheritance Tax and Gift Tax Act (“IHTGTA”) if the shareholders agree that the contributions are to be allocated to the contributing shareholder.

Background

X-GmbH was founded by shareholders A, B, and C with the intent of distributing net profits based on shareholdings. In 2010, A transferred part of his shares to D, and in 2013, both A and B transferred shares to the appellant. In 2014, the shareholders amended the profit distribution model to reflect financial contributions made toward the company's investments rather than mere ownership percentages. Adjustments to their articles of association stipulated that profits were to be shared proportionally based on the financing ratios and contributions made toward acquiring shares. This redefinition focused on participation in financing rather than equity shares, essentially tying a shareholder's right to profits to their financial input into the relevant profit-making company.

In the years under review, X GmbH acquired shares in Z-AG. These acquisitions were financed by all the shareholders with the exception of the appellant. The amounts paid were transferred to the capital reserve of X-GmbH by resolution of the shareholders and reported individually in the annual financial statements under the balance sheet item 'Capital reserve' and allocated to the respective shareholders in the amounts paid by them. No further alteration was made to the articles of association.

The tax office took the view that the payments into the capital reserves of X GmbH constituted gifts to the appellant under Section 7 (8) Sentence 1 of the Inheritance Tax and IHTGTA and issued assessments. The appellant appealed against the assessments and made an application to suspend enforcement of the assessments, arguing that since the disparate contributions of the shareholders had been specifically allocated to specific individuals this had not led to an increase in the value of the shares held by the other shareholders of X-GmbH. The appellant's appeal and enforcement-suspension application to the local tax court was rejected.

Decision

The Supreme Tax Court allowed the appeal, holding that there were serious doubts concerning the legality of the contested gift tax assessments.

An application for the suspension of enforcement should be granted if there are significant doubts about the legality of the relevant administrative act.Serious doubts as to the legality of a contested administrative act already exist if, in addition to those circumstances which support the legality of the administrative act, circumstances come to light upon summary examination which give rise to uncertainty in the assessment of the legal issues or facts relevant to the decision. In the summary examination required for a suspension of enforcement, the decision is made on the basis of the facts presented by the parties and as they appear in the files. For a suspension of enforcement application to be granted, it is not necessary for the reasons demonstrating unlawfulness to outweigh those demonstrating legality in terms of probability of success.

Under **Section 7(8) Sentence 1 IHTGTA**, where a natural person, who directly or indirectly participates in a corporation, benefits from an increase in the value of shares in that corporation due to a payment by another person (donor) to the corporation, the increase in value can constitute a gift. The provision creates a

fictitious gift by the transferor to the (co-)shareholder whose share in the company increases in value as a result of the transfer.

Under **Section 7(8) Sentence 1 IHTGTA** the gift arises from the increase in value of shares in a corporation that occurs as a result of the donor's payment to the corporation. Such an increase in value exists if the fair market value of the beneficiary's share, after the payment, exceeds the fair market value before the payment. Whether an increase in value exists must be determined in each individual case. The burden of proof for the occurrence of the increase in value as a tax-triggering event lies with the tax office.

A non-proportional contribution by a shareholder to the capital reserve of his corporation is generally capable of leading to a taxable increase in value within the meaning of **Section 7(8) sentence 1 IHTGTA**. This is because such a contribution also increases the value of the shares of the other shareholders, who did not make a contribution, by the amount corresponding to the contribution value in relation to the respective shareholding of the shareholder. However, such an increase in the value of the shares of the co-shareholders within the meaning of **Section 7(8) Sentence 1 IHTGTA** is to be excluded if the contributing shareholder is granted additional rights in connection with his contribution. This may, for example, be an improvement in his share of profits, additional shares in the company or a distribution of assets that differs from the shares in the event of subsequent liquidation. The same applies if additional agreements are made between the shareholders or with the company which ensure that the contributions of the contributing shareholder do not lead to a final transfer of assets in favour of the co-shareholders. The same applies if the contribution of the contributing shareholder is allocated to the company via a contractually agreed, personal capital reserve.

According to these standards, the Court found that there were serious doubts as to whether the transfer of the amounts paid by the other shareholders into the capital reserve of X-GmbH led to an increase in the value of the applicant's shares within the meaning of **Section 7(8) sentence 1 IHTGTA.**

Based on the contents of the file and the submissions of the parties involved, it could be assumed on summary examination that the shareholders of X-GmbH allocated the amounts paid into the company's capital reserve to the individual shareholders. In the event of liquidation or dissolution of the capital reserve, the amounts paid should therefore only be attributable to the shareholders who originally made the payment. The other shareholders could therefore not benefit from the payment made through their shareholding. In the years 2018 and 2019, shareholders' resolutions specifically made a personal allocation of the capital reserve in favour of A. Furthermore, the annual financial statements for the years 2013 to 2019 allocated individual amounts in the capital reserve to the shareholders. In this respect, the approval of the annual financial statements amounts to a declaration of the binding effect of the balance sheet both in the relationship between the shareholders and the company and in the relationship between the shareholders themselves. Upon summary examination, the allocation of payments to the capital reserve in the balance sheets for the years in dispute, broken down by amount and person, and the resulting disproportionate repayment claims of the shareholders in relation to the capital reserve are to be regarded as legally binding agreements as of the respective balance sheet date.

A summary examination of the instructions issued by the tax authorities would also give rise doubt. According to **Regulation 7.5 (11) Sentence 13 of the 2019 IHTGT Regulations**, payments made by individual shareholders should not result in a taxable increase in the value of co-shareholders' shares pursuant to **Section 7 (8) Sentence 1 IHTGTA,** provided that 'additional agreements' exist on the reporting date which guarantee the contributing shareholder that their payment will not result in a definitive transfer of assets to the co-shareholders. The same applies if the contribution is recognised as a capital reserve bound by 'contractual obligations' in favour of the contributing shareholder (**Regulation 7.5 (11), Sentence 14, Alternative 2, 2019 IHTGT Regulations**). The wording of these provisions suggests that an agreement between shareholders outside the articles of association may also be sufficient to prevent a shareholder's contribution from increasing the value of other shareholders' shares in the company. Based on this interpretation of the administrative instruction, it cannot be ruled out from the outset that the applicant will be successful in appealing against the contested gift tax assessments, even on the basis of the instructions issued by the tax authorities. This is because taxpayers have a legal right to be taxed in accordance with the general administrative instructions, a right that must also be observed by the tax courts. The tax authorities are prohibited from refusing to apply administrative instructions in individual cases that are clearly covered by their wording without valid reasons within the scope of their discretionary power.

Source

Supreme Tax Court decision of 6 June 2025, II B 43/24 (AdV)

Schlagwörter

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