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Inheritance tax exemption for family home not revoked if compelling reasons prevent own use

According to a decision of the Supreme Tax Court, the inheritance tax exemption granted to the surviving spouse upon acquisition of the family home must not be revoked retroactively if its continued use for own residential purposes is impossible or unreasonable due to health reasons. The same applies to the tax exemption granted to children as heirs, the BFH said in another judgment from the same date.

Background

Section 13 (1) No. 4b Inheritance Tax and Gift Tax Act exempts from inheritance tax, the transfer on death of the family home (or a co-ownership in it) to the surviving spouse or life partner. The property must be designated immediately to the heir "for his own use for his own residential purposes". The tax exemption will be revoked retroactively if the acquirer (i. e. the heir) no longer uses the family home for his own residential purposes within a ten-year period following the inheritance and where it cannot be shown that there are compelling reasons preventing the heir from "using it for his own residential purposes".

After the death of her husband, the plaintiff inherited the jointly occupied family home and had remained in it for just under two years. She then moved to a condominium to avoid further detriments to her health. The plaintiff unsuccessfully asserted to the tax office and to the Tax Court of Muenster that she had left the house she formerly shared with her husband upon medical advice due to the emotions that the house conveyed to her and her depressions, both of which had worsened after the death of her husband. For this purpose, she produced from her doctor a medical report according to which the environment of the formerly jointly occupied house was expected to cause severe mental damage.

The tax office took the view that the exemption nevertheless be revoked with retroactive effect.

Court decisions

The **Muenster tax court** did confirm the retroactive revocation of the tax exemption as there had been no compelling enough reasons for abandoning the self-use of the home. The tax court took a rather restrictive view and held that "compelling reasons" are only those which make it impossible for the transferee to run a household in general and not only in the inherited family home.

The **Supreme Tax Court** took a different view and referred the case back to the court of first instance. The term "compelling reasons" is to be interpreted in a wider sense and contrary to the view shared by the Muenster tax court.

The term "compelling" is defined as to comprise not only cases where the continuing use of the house is impossible, but also in circumstances where the on-going use of the family home is an unreasonable burden or an undue hardship. Such a situation of hardship could also be found if the heir, as in the case of dispute, had to expect a considerable impairment of her state of health if she remained in the family home.

The Muenster tax court must now - if need be, with the help of a medical appraisal - check in more detail the severity of the condition of the plaintiff and the expected development and prospects of her disease.

Should the medical bulletin answer the question of ongoing hardship in the affirmative, the Supreme Tax Court went on to say that neither the abandonment of the ownership of the family home (the plaintiff had sold the house after she purchased the condominium) nor the demolition of the building will lead to a revocation of the erstwhile tax exemption.

Source:

Supreme Tax Court, decision of 1 December 2021 (case ref. II R 1/21) published on 4 August 2022.

Note:

On 1 December 2021 (case ref. II R 18/20, published on 7 July 2022) the Supreme Tax Court has ruled in a similar way: *“The heir does not forfeit the inheritance tax exemption for a family home if his own use of the family home is impossible or unreasonable for him for health reasons.”*

The plaintiff had initially occupied the single-family house inherited from her father but moved out after seven years. The house was subsequently demolished. She claimed, among other things, that in view of her state of health (disc prolapses, impairment of the hip which was inoperable due to a generalized anxiety disorder) she had hardly been able to move around the house on her own and had therefore moved to another ground floor apartment.

Keywords

inheritance tax exemption, spousal residence exemption