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By PwC Deutschland | 20 October 2023

Update: Extended unlimited gift tax liability constitutional and in accordance with EU law

According to a decision of the Supreme Tax Court the so called “extended unlimited gift tax liability” does not violate the constitutional principle of equality and the freedom of movement of capital under EU law. The German gift tax arises if the donor is a resident at the time the gift is made, or the acquirer is a resident at the time the tax arises. If this is the case, the tax is levied for the total amount of assets received, irrespective of whether these are of domestic or foreign origin.

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German concept of “extended unlimited gift tax liability”

Pursuant to Sec. 2 (1) No. 1 of the Inheritance and Gift Tax Act (IGTA) a tax liability arises if the donor is a German resident at the time the gift is made or if the acquirer is a German resident at the time the tax arises; the obligation to pay gift tax is for the entire amount of assets received as gift. German nationals who have not resided abroad permanently for more than five years without having had a domicile in Germany are considered as residents in the aforementioned sense (“extended unlimited tax liability”).

Background

In December 2011 the plaintiff acquired a plot of land located in Switzerland from his mother by way of a publicly notarized contract in return for the creation of a lifetime right of use under Swiss law which fell short of the value of the land. The plaintiff and his mother, who were both German nationals, had given up their residences in the Federal Republic of Germany prior to the transfer and had moved to Switzerland in November 2011.

After the plaintiff's mother died in February 2013, the plaintiff, as her sole heir, notified the tax office of the acquisition of the property by way of a gift as part of the inheritance tax proceedings. The tax office assessed gift tax on the value of the property. The plaintiff claimed that this was in violation of both the German Constitutional Law and EU law. The lower tax court rejected the appeal.

Decision of the Supreme Tax Court (STC)

The STC agreed with the decision of the lower court and rejected the appeal as unfounded. Gifts are only subject to gift tax if the donor is a resident at the time the gift is made, or if the acquirer is a resident at the time the tax arises. If this is the case, the entire accrual of assets is subject to gift tax, irrespective of whether the assets are domestic or foreign assets.

No violation of fundamental constitutional rights

The involvement of German citizens residing abroad into the concept of unlimited tax liability is part of determining the taxable assets and thus the amount subject to tax. To achieve this the legislator is given a wide scope of discretion and flexibility in determining the amount subject to tax. In this respect, the specific provision of Section 2 (1) no. 1 sentence 2 (b) ITGA was found by the STC to be appropriate and not arbitrary.

The extended unlimited gift tax liability also does not suffer from a structural enforcement deficit and shortcomings in collecting the tax and thus it was held by the STC not to contravene the principle of equality as laid down in Article 3 (1) of the Basic Law.

No violation of EU principles

The STC pointed out that the legal situation has already been clarified by ECJ case law, and the court saw no need to obtain a preliminary ruling in this respect under Article 267 TFEU.

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In the past the European Court of Justice (ECJ) has ruled that a Dutch regulation, under which the transfer of an estate of a national of a Member State who died within ten years of transferring his residence abroad is taxed as if that national had remained resident in the same Member State, does not constitute a restriction on the **free movement of capital** (ECJ, decision of 23 February 2006 C-513/03 *van Hilten - van der Heijden;* para. 45). In the judgment *van Hilten - van der Heijden*, the ECJ essentially relied on the fact that the Dutch law applicable at the time foresaw a wide-ranging option for a tax credit for foreign inheritance or gift tax paid. Such a credit option also exists in the present case.

Furthermore, and according to the case law of the ECJ, the Member States enjoy a certain autonomy in this area and are therefore not obliged to adapt their own tax systems to the different systems of tax of the other Member States in order, inter alia, to eliminate the double taxation arising from the exercise in parallel by those Member States of their fiscal sovereignty (ECJ, decision of 12 February 2009 C-67/08 *Block*; para. 31).

Finally, the disputed German regulation also does not contravene the **Agreement for Free Movement of Persons** between the EU and Switzerland. For that matter, it was neither submitted nor is it evident in the case of dispute that the move of the plaintiff or his mother to Switzerland was in connection with employment-related reasons. Although Art. 24 of Annex I also contains a provision for persons who are not in employment, it only deals with the right to a residence permit, which is not relevant for the question of the extended unlimited gift tax liability.

Update (20 October 2023)

In the meantime, a constitutional complaint has been filed against the ruling (pending under file no. 1 BvR 325/23 at the Constitutional Court).

Source

Supreme Tax Court, decision of 12 October 2022 (II R 5/20), published on 12 January 2023.

Keywords

gift tax, unlimited tax liability