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No income tax on sale of inherited property after acquisition of shares from co-heirs

In a case of the sale of property belonging to the estate of an association of co-heirs the Supreme Tax Court held that the acquisition for consideration of a joint shareholding is not equivalent to the direct pro rata acquisition of the inherited assets themselves. With this most recent judgment the Supreme Tax Court abandons its previous case law on the matter.

Background

Sec. 23 Income Tax Act (ITA) deals with the taxation of private sales. In general, capital gains from the sales of privately held property are exempt from income tax if the property was held for more than ten years when sold. According to German law, an association of co-heirs is automatically formed after someone dies and if there are several heirs who have been determined by law or by testamentary disposition. The members of such an association thus become joint owners of assets without having consciously decided to do so. Such was the situation in the case of dispute.

The plaintiff complained against the taxation of the capital gain resulting from a private sale of previously inherited property. The plaintiff had inherited 52 % of an estate and was a member of an association of co-heirs consisting of altogether three heirs. The remaining shares in the estate belonged to the two children of the deceased. The estate included real property. In an intermediate step via a third party the plaintiff purchased the children's shares and became the sole owner of the property, which he subsequently sold.

The tax office was of the opinion that the acquisition of the inheritance shares from the third party constituted a proportionate acquisition of 48% of the property by the plaintiff for consideration and held that the ultimate sale be subject to income tax since no more than ten years had passed between the acquisition of the inheritance shares and the ultimate sale of the property. The Munich Tax Court had dismissed the appeal brought by the plaintiff as unfounded. The Supreme Tax Court considered the complaint to be justified and reversed the decision of the court of first instance.

Decision

The requirements for a taxable private sale within the meaning of Section 23 (1) sentence 1 no. 1 ITA are not met. There is no identity between the asset acquired and the asset sold. Based on a notarial deed from 20 October 2017, the plaintiff acquired the inherited shares of the deceased's two children, i.e., the proportionate share in the association of co-heirs as joint owners. By notarized deed dated February 9, 2018 he sold the property.

In principle, the acquisition for consideration of a share in a joint participation (such as in the joint assets of the heirs) does not lead to the direct (pro rata) acquisition of particular assets from the joint assets. A joint ownership is not equivalent to the real estate itself and does not constitute a right subject to the provisions of civil law on real estate. This applies even if the joint assets only include real estate. Moreover, a joint ownership does not convey a tangible share and, consequently, no right of disposal for the individual to the property of the joint assets. It can therefore not be treated the same way as the property itself or a right equivalent to a property.

With its ruling the Supreme Tax Court changed its previous case law and also held against the opinion of the tax administration published by the Federal Ministry of Finance in a circular of 14 March 2006.

Supreme Tax Court, judgement of 26 September 2023 (IX R 13/22), published on 11 January 2024.

Keywords

heir, inheritance tax