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By PwC Deutschland | 18 March 2024

ECJ referral: Higher gift tax for foreign family foundation in conflict with EU law?

The Cologne Tax Court has expressed doubts as to whether a family foundation based in Liechtenstein may be denied the inheritance and gift tax privilege applicable to domestic family foundations and has referred this question to the European Court of Justice for a preliminary ruling.

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Background

Inheritance and gift tax is a tax levied on lifetime gifts and on transfers of value passing or intended to be passed on upon death. Progressive tax rates of 7% up to 50% and tax-free allowances between EUR 20,000 and EUR 500,000 apply, depending on the value and the tax bracket (tax class) which is applied based on the degree of the relationship between testator/donor and beneficiary.

In the case of dispute, a donor living in Germany had donated assets to the plaintiff, a so-called family foundation domiciled in Liechtenstein and established under Liechtenstein law. The beneficiaries of the foundation are the donor's children and grandchildren. With the gift tax return, the plaintiff requested the assessment of gift tax, considering a tax-free allowance of EUR 200,000 and the application of a tax rate of 19% according to tax class I.

The tax office assessed the gift tax without granting the tax class privilege by taking into account instead a tax-free amount of only EUR 20,000 and applying a tax rate of 30% according to tax class III.

Opinion of the Cologne Tax Court

In the opinion of the tax court the provision on the tax class privilege pursuant to Section 15 para. 2 of the Inheritance and Gift Tax Act (*Erbschaft- und Schenkungsteuergesetz*), according to which the tax rate shall be based on the relationship of the most distant beneficiary to the testator or donor in accordance with the foundation deed (and provided the foundation is established essentially in the interests of a family or certain families in Germany), should also be applied by extension to foreign foundations as it otherwise violates the fundamental freedom of capital movement.

Given these circumstances, the Cologne Tax Court decided to stay the proceedings and to **refer the following question to the European Court of Justice (ECJ) for a preliminary ruling:**

Is Article 40 of the Agreement on the European Economic Area (EEA Agreement) of 2 May 1992 to be interpreted as precluding national legislation of a Member State to levy inheritance and gift tax which applies the highest tax class III for the taxation of the transfer of assets to a foreign foundation, even if the foundation is established essentially in the interests of a family or certain families (family foundation)? Whereas in the corresponding case for a domestic family foundation the tax class is based on the relationship of the most distant beneficiary to the donor (founder) according to the foundation deed, which leads to the application of the more favorable tax classes I or II for the domestic family foundation.

Reference:

Cologne Tax Court, decision 7 K 217/21 of 30 November 2023 – published on 11 March 2024. The referral is pending before the ECJ under case C-142/24 *Familienstiftung*.

Keywords

family foundation, gift tax