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Business succession planning in Germany
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Publications

- "EuGH: Quellensteuer auf Dividenden an Gesellschaften im EU-Ausland", annotation to EuGH judgement of 18.06.2009, GWR 2009, issue 8, p. 209
- "Steuer- und Bilanzklauseln in M&A-Verträgen" - Schriftlicher Management-Lehrgang, Lektion 2 - Steuerklauseln im Unternehmenskaufvertrag, Euroforum Verlag, 1st and 2nd Edition 2009
- "BFH: Bankgeheimnis steht Kontrollmitteilungen nicht generell entgegen", annotation to BFH judgement of 09.12.2008, GWR 2009, issue 2, p. 49
- "Die wesentlichen Änderungen bei der Erbschaft- und Schenkungsteuer", Zeitschrift für Familien- und Erbrecht (ZFE), p. 89 (Sangen-Emden/Horn)
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- "Steuerrecht in der anwaltlichen Praxis", in: Heidel/Pauly (Editors), Chapters 1, 4 and 5. 2nd and 3rd Edition 2000 and 2002

Lectures

- "Law Firms and CSR - A Continental European Approach", IBA Conference Singapore 2007

Affiliations

- German Association of Business Tax (DUV)
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A. Overview of the German inheritance law

In general, German inheritance law applies for the entire estate in case of succession if the decedent was a German national at the time of his death. Furthermore, any person can choose German inheritance law by testamentary disposition for real property located in Germany.

I. Universal succession

In Germany the decedent's property and his debts automatically accrue to the successor(s) at the time of the decedent's death (see §1922 German Civil Code). The only requirement to become successor is that the he[1] survive the death of the decedent for at least one second.

If a successor disagrees with the inheritance (e.g. because debts exceed the assets), he has the possibility to renounce his right to succession. This is possible up to six weeks after the successor gained information about the death of the decedent and the cause of his inheritance. If the decedent only lived abroad or the successor was abroad at the time he was informed about the inheritance, the time limit is extended to six months.

II. Statutory succession of relatives

If the decedent has not made a will or any other testamentary disposition, the following legal succession rules apply:

1. Succession classes

Relatives are primarily divided into succession classes:

The **first class** consists of the descendants of the decedent. Children who were born out of wedlock also fall into this first category. Several descendants inherit in equal shares. A living descendant excludes those descendants from the inheritance who are related with the decedent through him (succession by family branches, see 2. below).

Parents of the decedent and their descendants belong to the **second class**. If only the two parents of the decedent are still alive they are the only successors who inherit the entire estate in equal shares. If one parent has already died, this parent's descendants take his place. If the late parent does not have any descendants, the surviving parent inherits solely. This system also applies in subsequent succession classes.

The grandparents of the decedent and their descendants compose the **third class** whereas the **fourth class** consists of the great-grandparents and their descendants. Great-great-grandparents and their descendants belong to the fifth and last succession class.

[1] For simplification purposes, persons are referred to only in the masculine form. This is meant to include the female form as well.

It is important to recognise that members of a subsequent class are not entitled to succession if members of a previous succession class are still alive.

2. Succession by family branches

Of course there can be more than one relative in one class. Then another system applies – the succession by family branches. One branch consists of all descendants who are related to the decedent through one and the same person. Within one succession class the estate is not distributed equally to the existing persons but equally to the family branches. If a descendant of the decedent is still alive and has descendants himself, his existence excludes his descendants from the inheritance. If a descendant of the decedent died but still has descendants of his own, they follow into his right of succession.

III. Statutory succession of spouses

Most of the German married couples live in the statutory matrimonial property regime which consists of joint ownership of the increase in capital value of the assets which accrues during the period of marriage. Upon the end of the statutory matrimonial property regime (e.g. through divorce) such increase in capital value has to be equalized between the former spouses (*Zugewinnausgleich*). This is important because the statutory succession of spouses also depends on the applicable matrimonial property regime at the time of the inheritance.

1. General principle

First of all, the surviving spouse has a separate right to succession if the decedent and the surviving spouse lived in matrimony at the time of the inheritance.

The spouse is, besides heirs of the first succession class, entitled to 1/4 of the estate. Besides heirs of the second class or grandparents the spouse is entitled to 1/2 of the estate.

If there are no heirs of the first class, second class or grandparents the surviving spouse receives the entire estate.

These principles apply regardless of the applicable matrimonial property regime.

2. Matrimonial property regime

If the spouses lived in the statutory matrimonial property regime, the statutory inheritance of the surviving spouse is increased by 1/4 of the estate. This statutory increase of one quarter constitutes a lump sum equalisation of the increase in capital value of the assets. It avoids the difficulties of an exact equalisation which are likely to arise upon the death of one spouse.

If the spouses did not live in the statutory matrimonial property regime but in the regime of community of property (*Gütergemeinschaft*) or separation of property (*Gütertrennung*), this special lump sum equalisation does not apply.

In the regime of separation of property there is in principle no need to increase the inheritance if one of the spouses dies. Nevertheless the German Civil Code states that, if the decedent has one or two descendants, the spouse is entitled to the same part of inheritance as the descendants. This arrangement ensures that the inheritance of the surviving spouse is not less than the inheritance of a descendant.

In the system of community of property there are no special regulations.

The inheritance law for registered life partners is similar to the law for spouses.

Besides the inheritance, the surviving spouse may demand the household objects as well as the marriage presents.

IV. Statutory succession without relatives or spouse

If the decedent neither has relatives nor a spouse the state becomes the legal successor.

V. Estate planning

If a German decedent made a will the rules on statutory succession do not apply. Because of the private autonomy which is guaranteed by the German federal constitution, the freedom to draw a will cannot be excluded. Nevertheless the legislator is allowed to set boundaries to the freedom (see below under VI.)

1. The will

The most common form of a will is the entirely **hand written** and personally signed **will**.

The decedent may revoke the will at any time without any reason. A revocation can be effectuated by a revocation will, a subsequent will with different content or simply by destroying the will.

The advantage of a hand written will is that it can be made at any time and that costs do not arise. Nevertheless, the risk exists that the will is not found by the descendants or even lost or that it has not been created in a legally valid form. It is very important to observe the requirements of a valid will. If these requirements are not adhered to, the rules of statutory succession will apply which may differ a lot from the intention of the decedent. A hand written will requires in particular that the entire text is hand written by the decedent (who must be of age), that the decedent indicates place and date of setting up the will and that he signs the piece of paper with his full name.

Another form of a will is the **public will**. The decedent may declare the will in front of a notary public or he may give the notary public a written version of his last will in safekeeping. This form of a will excludes the risk of loss or forgery but it is triggers notary fees depending on the value of the estate. These fees can reach significant amounts. However, these fees typically include legal advice by the notary how to phrase the will in order to achieve the results desired by the decedent.

There are some **other forms of will** which were created to give consideration to special situations such as a will in front of three witnesses or at sea.

A special form of a will which is very important in Germany is the **joint will of spouses**. It is sufficient if one spouse writes down the will and the other one just signs it. The joint will consists of two testamentary dispositions. It is a mix between a will and a contract of inheritance (see 2. below). The regulations in the joint will are binding for both spouses if the dispositions are mutual (*wechselbezügliche Verfügungen*). This means that one spouse would not have made the disposition without the disposition of the other spouse. If one spouse dies, these mutual dispositions develop binding force.

2. The contract of inheritance

In some cases a will may not satisfy the needs of the decedent and even of the successors because of the possibility to revoke a will at any time. A binding commitment is required. This may be true in particular where the estate includes a business.

A typical case is a situation where children are only willing to work in the business of the parents if they can be sure that they will be the heirs of the business. In this case a will does not give the children sufficient certainty. A contract of inheritance is a bilateral or multilateral agreement by which one or more of the contractual parties make testamentary dispositions. It can only be concluded personally and in front of a notary public. Additionally the other party / parties has / have to accept the terms of the contract. A contract of inheritance may only contain appointments of heirs, the granting of legacies and the imposition of testamentary burdens. It can be revoked or cancelled only under restrictive conditions.

VI. Forced heirship rules

Under German law, the decedent is not able to exclude certain descendants completely from succession by will. To this effect, Germany has implemented forced heirship rules.

1. Statutory share (*Pflichtteil*)

If a descendant of the decedent, the spouse or, if there are no descendants, a parent of the decedent is excluded from succession by will or contract of inheritance, the German Civil Code grants him at least a minimum part of the decedent's estate. This rule also applies to registered life partners. The forced heirship gives the beneficiary a right to claim as his statutory share in the estate from the heirs a payment in the amount of 1/2 of the value of his statutory inheritance (*Pflichtteil*).

2. Increased testamentary share (*Pflichtteilsergänzungsanspruch*)

A similar rule applies if the person entitled to a forced heirship was appointed heir but received an inheritance of less than 1/2 of his statutory inheritance. The person is then entitled to claim the rest (up to the statutory share of 1/2 of his statutory inheritance) as compensation from the other heirs (*Pflichtteilsergänzungsanspruch*).

3. 10 years add-back of lifetime gifts

Another part of the German forced heirship rules that is important to recognize is the add-back of gifts made by the decedent to others in the 10 years prior to his death. Without this regulation the decedent would have the possibility to minimize the forced heirship compensation during his lifetime. Therefore, the value of the gift is in this case added back to the estate existing at the decedent's death. The statutory share thus increases. The difference between the values of the statutory share (with and without gift add-back) can be claimed as compensation payment from the heirs. The gift is irrelevant if at the time of succession 10 years have passed since the donation took place. Currently a new law is in the process of being introduced which reduces the add-back pro rata by 1/10 for each year that has passed since the year following the gift. This rule reduces the detrimental effects that lifetime gifts to one designated heir can have if the donor dies shortly before the 10 years' period elapses and other heirs claim their statutory share from him.

4. Deferral of payment for statutory share

Under special circumstances the possibility exists for an heir to claim a deferral of the payment of the statutory share to the beneficiaries. This provision was introduced to protect the heir who is at the same time debtor of the statutory share. Under current law, the heir may demand a deferral only, if he would be entitled to a statutory share himself. Furthermore the immediate fulfilment of the forced heirship claim must constitute an extraordinary hardship for the heir because of the composition of the estate assets. This is the case, for example, if the heir, in order to satisfy the claim for the statutory share, would have to sell his family home or an asset that constitutes the main source of income for himself and his family. Additionally the deferral must be reasonable in view of the interests of the beneficiary of the statutory share. There must be a weighing of interests. A decision about such deferral is passed by the competent probate court. The new law which is in the process of being introduced will slightly extend the possibility to claim a deferral of payment of the statutory share.

VII. Debts of the decedent

With the death of the decedent his property passes over to the successor as well as his debts. The liability of the successor is generally unlimited but there is the possibility to restrict the liability.

First of all the successor is liable for the obligations of the decedent which already came into existence before the death of the decedent. Furthermore the successor is liable for all obligations which arise out of the accrual of the inheritance such as forced heirship claims, legacies and testamentary burdens as

well as funeral expenses. There may also be costs for the administration of the estate which the successor has to bear.

Nevertheless the successor has the possibility to limit his liability to the value of the estate. An administration of estates (*Nachlassverwaltung*) is one possibility to restrict the liability. Another instrument is the opening of insolvency proceedings concerning the estate (*Nachlassinsolvenzverfahren*). This is mandatory if the heir realises that the estate is over indebted. If the value of the estate is not sufficient to execute an administration of the estate or insolvency proceedings, the successor may declare this which will also lead to a limitation of the liability.

VIII. Community of heirs (*Erbengemeinschaft*)

In many of the inheritance cases there will be more than one successor. Every single successor inherits a virtual part of the entire estate according to his portion of inheritance. A successor is allowed to dispose of his heritage as such but he is not allowed to dispose of individual assets of the estate. If the successors want to enter into legal transactions concerning individual assets with third parties they have to act jointly.

The community of heirs is designated to be liquidated shortly after the succession took place. If the decedent has not decided this in his will, the successors have to come to an agreement, how the assets are to be divided among several heirs. In many cases such division of assets among the heirs will lead to equalisation payments between the heirs.

Conclusion: The above short summary illustrates the complexity of German inheritance law and in particular the interdependency between statutory rules, testamentary dispositions and lifetime donations. In particular where businesses are part of the estate, it is, therefore, highly recommendable for the owner to enter into estate planning early enough and to retain competent legal as well as tax advice for the implementation of his will. Business owners should clearly not rely on German statutory inheritance law if the want to ensure the continuance of their business. Also, German partnership deeds and articles of association must be taken into account or changed when a will or an inheritance contract is drafted because deviating contractual succession provisions at company level may have significant consequences for all parties involved and even supersede testamentary dispositions.

B. German inheritance and gift tax

Lifetime gifts and inheritances are treated, in principle, equally under German tax law. German inheritance and gift tax law has been fundamentally reformed as of January 1, 2009 (see XI. below).

I. Main taxable events

1. Acquisitions of property by reason of death

The main taxable event under German inheritance and gift tax law is the acquisition of property by reason of death (mortis causa). Such taxable event includes inheritances as well as gifts, donations or legacies upon the death of the donor as well as benefits directly acquired by a third person due to a contract concluded by the decedent (such as life insurances). Also, the funding of a German foundation (*Stiftung*) or foreign trust by will of the decedent is regarded as acquisition of property by reason of death.[2]

Spouses are regularly joint owners of the increase in capital value of their assets which is generated in the period of marriage. Upon the end of the marriage such increase in capital value has to be equalised between the former spouses (*Zugewinnausgleich*). If a marriage is terminated by the death of one spouse, the equalised amount does not form part of the taxable property transfer for inheritance tax purposes. The same applies if the equalisation of the increase in capital value takes place due to contractual arrangements between spouses about the applicable matrimonial property regime.

2. Lifetime donations

The second important taxable event under German inheritance and gift tax law is the granting of lifetime gifts. Equal treatment as lifetime donations receive also transfers of property into a German foundation or a foreign trust during the lifetime of the donor or the property received by a beneficiary upon the dissolution of a foundation or a foreign trust.

3. Foundation property

In Germany the property of a German family foundation (*Familienstiftung*) or other German association founded in the interest of one or more families is subject to inheritance tax every 30 years from the first funding of the foundation or association (*Erbersatzsteuer*).

[2] It must be noted, however, that German law does not normally recognize a foreign trust as a separate legal entity.

II. Tax base

1. German resident parties

The tax base for German inheritance and gift tax consists of the entire property transferred if the decedent or the donor at the time of his death or execution of the gift is German resident or if the recipient is German resident at the time of the decedent's death or making the gift. If one of these parties is a legal person, it will be regarded a German resident, if the legal person has its corporate seat or place of management in Germany. A natural person is regarded German tax resident, if he has his domicile or habitual place of abode in Germany or if the person is German national without German domicile who has lived for not more than five years abroad.[3]

2. Other cases

In all other cases only German property is subject to German inheritance and gift tax. German property is specifically defined for this purpose and comprises among others real estate situated in Germany, German business property for which at least a permanent establishment or a permanent representative is maintained and shares in a corporation with corporate seat or place of management in Germany when the decedent or donor owns at least 10 % of the equity. Also, claims from silent partnerships or profit participating loans are regarded German property, if the debtor is a German tax resident.

III. Origination of the tax

German inheritance and gift tax is triggered by the death of the decedent or the fulfilment of the lifetime donation. If the granting of a benefit is subject to a condition precedent, the tax is triggered when the condition is fulfilled.

IV. Valuation of property

Basis for the evaluation of the taxable property is now the fair market value of each taxable asset. Special assessment methods apply to real property and business property.

The value of undeveloped real property is to be assessed based on surface area and standard land price. The market value of real property with buildings is to be calculated depending on the type of real estate based on a comparative value, gross rental or asset value method.

The tax value of business property should equal the fictitious sales price. If this value cannot be derived from third-party sales, it is to be assessed based on earnings capacity or another recognized evaluation method. In doing so, however, the tax value of the business property may not fall below its net asset value.

[3] Special provisions about the allocation of taxation rights in cross-border cases may be contained in the specific double tax treaties on inheritance and gift tax concluded between Germany and Denmark, Greece, Sweden, Switzerland, USA and Austria.

Details of a "simplified earnings capacity valuation method" have been included in the German valuation tax act which tax payers have the option of applying, if this method does not lead to obviously incorrect results. In it, the earnings capacity value is calculated based on the familiar methodology, meaning the sustained achievable annual earnings of the business multiplied by a capitalisation factor. Legal simplification rules apply for calculating the annual earnings and the capitalisation factor.

It should be noted that business property does not only include German self proprietorship enterprises and commercial partnerships but also shares with a minimum participation of more than 25 % in corporations with seat in the European Economic Area as well as German agricultural and forestry businesses.

Property listed on a stock exchange such as shares or investments certificates will be evaluated with the lowest price listed at the relevant date of succession or transfer.

V. Personal allowances

The following personal allowances are available in Germany

Tax Class	Transferee	Current Law
I	Spouses	EUR 500,000
	Children	EUR 400,000
	Grandchildren, great grandchildren	EUR 200,000
	Parents and grandparents in the case of succession	EUR 100,000
II	Parents and grandparents in the case of a gift, siblings, nieces and nephews, step children, children in-law…	EUR 20,000
III	Other	EUR 20,000
	Registered life partners	EUR 500,000

Additionally, tax exemptions on social security and pension benefits are granted in the case of an inheritance at EUR 256.000 for spouses and from EUR 10.300 to EUR 25.000 for children, depending on the age.

VI. Inheritance tax rates

The German inheritance and gift tax rates can be illustrated as follows:

Value of the acquisition subject to tax up to and including Euro…	Percentage rate in the tax class		
	I	II	III
75,000	7	30	30
300,000	11	30	30
600,000	15	30	30
6,000,000	19	30	30
13,000,000	23	50	50
26,000,000	27	50	50
in excess of 26,000,000	30	50	50

VII. Special tax exemptions

Special tax exemptions are granted for business property and for owner-occupied residential property (family home).

1. Tax exemption for business property

a) Standard tax exemption – 85 %

The law provides for a standard tax exemption of up to 85 % from the tax value of German business property.

In order to be able to benefit from the entire exemption of 85 % of the business value, among other things, the successor/donee may not sell or give up the business for a period of 7 years (**retention period**). This provision, that was introduced as of January 1, 2009, is a pro rata temporis rule, meaning that each year that the business continues to operate, the transferee is rewarded with a corresponding portion of the tax exemption. In the event of a detrimental disposition in the fifth year after the transfer, the successor/donee is allowed, for example, to keep 4/7 of the standard tax exemption.

Another pre-condition of the tax exemption is that the business pays to its employees during the 7 years after the business was transferred at least 650 % of the **total annual payroll** which has been the average total annual payroll during the last 5 fiscal years that ended prior to the transfer of the business (initial annual payroll – no indexing). If and to the extent to which this prerequisite cannot be met the transfer is subject to a pro-rated subsequent taxation upon expiration of the seven-year period.

Furthermore, the tax exemption is only granted if the "**administrative assets**" of the business do not add up to more than 50 % of the total net assets of the business. Administrative assets are, for

example, real estate leased to third parties, securities, shares in corporations if the shareholding is 25 % or less, as well as loan receivables. Apart from this, the tax exemption may only be claimed for administrative assets that had already been attributed to the business for two years prior to the taxation date.

Finally, so-called **excess withdrawals** taken from the transferred business are detrimental during the retention period. This means that the accumulated withdrawals from the business may only slightly exceed the accumulated profits during this period (up to EUR 150.000); otherwise the tax exemption will become inapplicable proportionately.

b) Optional tax exemption – 100 %

Alternatively, the taxpayer may irrevocably choose a different tax exemption subject to more stringent pre-conditions, which theoretically allows an entirely tax-exempt transfer of the preferred business property. The more stringent pre-conditions are a retention period of 10 years (also under a pro rata temporis rule), the total payroll must achieve 1,000 % of the initial annual payroll for a period of 10 years and the administrative assets' limit is set at 10 %.

To ensure that the conditions for the tax exemptions are adhered to, the law includes a disclosure requirement for the transferee. Any violation is punishable under criminal law.

2. Tax exemption for family home

What up until 2008 was only tax-exempt among spouses for transfers made during a person's lifetime, has now been extended to also include acquisitions by inheritance. Thus, an owner-occupied residential property (family home) situated within the European Economic Area and acquired as a result of an inheritance remains inheritance tax free for spouses and for registered life partners if the family home remains owner-occupied for another 10 years.

A similar tax exemption exists for family homes inherited by children of the decedent, however only to the extent that the living space does not exceed 200 square meters.

As far as real estate rented out for residential purposes is concerned, no tax exemption but only a discount of 10 % off the current market value is granted. Landlords of commercial real estate do not benefit from this kind of reduction in tax value.

VIII. Inheritance tax assessment and payment

In cases of succession by inheritance or the funding of a foreign trust mortis causa, the recipient is liable for the inheritance tax. In cases of lifetime gifts or the funding of a foreign trust by a living person, the recipient and the transferor are jointly liable for the tax.

The tax assessment procedure can be outlined as follows:

The recipient of the property transfer has to inform the tax authorities about the taxable event. In cases of lifetime transfers of property, also the transferor is obliged to inform the tax authorities. The tax authorities then typically request the filing of a tax return. They may address this request to any party of the property transfer regardless whether such party is liable for the resulting inheritance or gift tax or not. This means that a donor has to file a tax return when requested to do so even if he is in the case in question not the person liable for the gift tax towards the tax authorities.

The tax payment becomes due within four weeks after the tax authorities have issued an inheritance or gift tax assessment on the basis of the tax return filed.

IX. Successive transfers of property

Successive transfers of property by gift or inheritance from one person to the same recipient which occur within a period of 10 years are added together when the tax assessment for the second or any further transfer is processed. Such transfers are only subject to the personal and other allowances once and the tax rate is determined on the basis of the cumulative value of the transfers. Since the tax rate is progressive, such successive transfers can increase the total inheritance tax burden significantly.

X. Selected income tax consequences

For individual assets belonging to the private property which are acquired through donation or inheritance, the transferee has to continue in principle the book values of the transferor. To the extent the transferee has to make compensation payments to other heirs or beneficiaries or assumes liabilities, the transaction is considered as an acquisition for consideration under German income tax law. This generates acquisition cost for the acquirer and - to the extent applicable - a new basis for tax amortisation of the relevant assets. The beneficiary of the payment is deemed to have received corresponding revenue.

Individual business assets received as gift without consideration lead to a step-up in basis up to the market value for the donee. The donor is deemed to have realized a fictitious capital gain. However, where a business unit is transferred without consideration, the book values have to be continued for income tax purposes. To the extent the recipient has to pay compensation or if he assumes private liabilities of the donor in connection with the transfer, the transaction is deemed as acquisition for consideration for both, donor and donee.

XI. Selected effects of the recent German inheritance tax reform in practice

For taxable events occurring after December 31, 2008, the German inheritance and gift tax has been fundamentally reformed. The reform was triggered by a judgement of the German federal constitutional court of the year 2006. The judges established that there was unequal treatment of, among other things, the asset categories real estate and business property, the tax values of which where set at

disproportionately lower levels compared to other asset categories such as cash and securities. The inheritance and gift tax reform led to an increase in the tax value namely of real estate and business property but, at the same time, now provides for the special tax exemption for business property and the transfer of the family home. Moreover the personal allowances were significantly increased.

Selective effects of this inheritance and gift tax reform can be outlined as follows:

1. Transfer of business property

In particular when business property is transferred, calculations must be based on a case-by-case scenario. What can be said generally is that the full tax exemption of 85 % despite higher tax values of the assets will typically trigger a lower inheritance tax as compared to the preferential evaluation under the old law. In addition, the pro rata temporis solution now in place leads to a significant mitigation in the event of non-fulfilment of the tax exemption prerequisites during the retention period. This is illustrated in the following tables:

Mid-size company:
Succession/gift to son

Table 1: Sale of business
Assumptions:

- Total payroll percentage observed
- Administrative assets up to 50 %
- Fair market value of business: Euro 30 million

Figures in Euro	**Current law**		
	Son sells immediately	Son sells **during the 5th year**	Son sells after 7 years
Tax value of business	**30,000,000**	**30,000,000**	**30,000,000**
Tax exemption	**N/A**	**- 14,571,429**	**- 25,500,000**
Personal allowance	**- 400,000**	**- 400,000**	**- 400,000**
Taxable acquisition (rounded)	**29,600,000**	**15,029,000**	**4,100,000**
Tax rate	**30%**	**23%**	**19%**
Inheritance / gift tax	**8,880,000**	**3,456,670**	**779,000**

However, what remains unclear in this constellation is what the requirements are for the total payroll in the event that the business is sold during the retention period. The tax authorities intend to review both criteria (total payroll and disposition) separately and to recognise only the lower tax exemption triggered either by the sale or the non-fulfilment of the total payroll percentage.

Table 2: Non-achievement of total payroll percentage
Assumptions:

- Business is not sold
- Administrative assets up to 50 %
- Fair market value of business**: Euro 30 million**

Figures in EUR	**Current law**		
	Total payroll in 7 years 200 %	Total payroll in 7 years 500 %	Total payroll in 7 years 650 %
Tax value of business	**30,000,000**	**30,000,000**	**30,000,000**
Tax exemption	**- 7,846,154**	**- 19,615,385**	**- 25,500,000**
Personal allowance	**- 400,000**	**- 400,000**	**-400,000**
Taxable acquisition (rounded)	**21,754,000**	**9,985,000**	**4,100,000**
Tax rate	**27%**	**23%**	**19%**
Inheritance / gift tax	**5,873,580**	**2,296,550**	**779,000**

2. Administrative assets

In the event of a business transfer, even administrative assets enjoy tax privileges within the statutory quotas of 50 % or 10 %. Not preferred administrative assets held in private property can therefore generally benefit from the tax privilege when contributed into a domestic business. However, what needs to be considered in addition to income tax aspects is that these kinds of contributions can only have the desired effect for inheritance tax purposes if the administrative assets had already been attributable to the business for a period of two years prior to the taxation date. Such types of plans must, therefore, be developed with sufficient foresight.

3. Cash and cash equivalents

As the interpretation of the law stands today, cash, savings accounts and time deposit accounts are not deemed to be part of the detrimental administrative assets. Sizeable amounts of cash may, therefore, be transferred in a tax preferential manner to successors after having been contributed into

a corporation or a preferred business. However, subsequent withdrawal restrictions need to be observed (see VII 1. a) above) as well as general anti-abuse rules.

4. Third country shareholdings

Shareholdings in foreign companies outside of the European Economic Area are generally not preferred under German inheritance tax law. However, the possibility exists to contribute such foreign shareholdings into a German or an EEA corporation in which the decedent/donor holds shares of more than 25 %.The preferential provisions for business property apply to these kinds of indirect shareholdings. What must be considered, however, is that the investment in each of the contributed third country companies needs to be more than 25 % so that these shares are not considered detrimental administrative assets.

5. Rental property assets

A common model under the old inheritance tax law was to contribute rented real estate into a German limited partnership (*GmbH & Co. KG*) qualifying as a commercial entity so that it could be bequeathed or gifted as business property under the existing preferential tax rules. Typically, this model will no longer work under the new law, because real estate conveyed for use to third parties represents a detrimental administrative asset, which is no longer tax preferred.

6. Reserved usufruct

A usufruct encumbrance is deducted from the property value with its capitalised value. As a result, reserved usufructuary rights will probably gain in popularity under the new inheritance tax law.

Conclusion: German inheritance and gift tax law contains very complex provisions, in particular in respect of the transfer of business property. The tax burden can differ significantly depending on the personal circumstances of transferor and transferee, the composition of the estate and the structuring of the transfer. With tax rates up to 50 % of the fair market value of the property transferred in a taxable manner, competent German tax advice should be sought for any estate planning projects involving Germany.

Düsseldorf, October 2, 2009
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HEUKING KÜHN LÜER WOJTEK

Disclaimer: This Memorandum does not constitute legal advice. While the information contained in this Memorandum has been carefully researched, it only offers a partial reflection of the law and its developments at the date of preparation. It can be no substitute for individual advice appropriate to the facts of an individual case.

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