

The Constitutionality of the German Inheritance Tax Regime for Family Entrepreneurs

On December 17, 2014 the Federal Constitutional Court ruled that elements of the inheritance tax regime exempting successors of family-owned companies from paying inheritance tax are unconstitutional and ordered the government to revise and tighten the law by June 30, 2016.

At first this ruling may sound disastrous for family businesses in Germany. The truth though is: The court confirmed that the exemption of business assets from the provisions of inheritance law is principally in accordance with the constitution and essentially justified. Nevertheless, there is need for improvement. Below are a first overview and an initial political assessment of DIE FAMILIENUNTERNEHMER – ASU e.V.

1. Exemption Model Principally in Accordance with the Constitution and Justified

The judges of the Federal Constitutional Court confirm that it is correct to exempt business assets from the provisions of inheritance law. There is no doubt about the legitimacy of the purpose of the law from a constitutional law point of view. Particularly the 5- and 7-years periods during with the business and jobs need to be maintained, the preferential treatment of the acquisition of interests in partnerships and a tax exemption of up to 100 percent under the aforementioned conditions cannot be objected to.

2. Disproportionate Clauses for Micro-Businesses

However, the judges also see the disproportionate nature of the exemption clauses in the case of small-sized enterprises. As a result, companies employing fewer than 20 persons will have to prove they secure jobs in the future. Basically, this measure appears understandable since, so far, such small-sized companies do not have to fulfil any requirements to obtain an exemption. In practice, however, it will be quite difficult to provide proof since it is especially small-sized companies that are much more vulnerable to economic fluctuations or when technical upheavals occur.

3. Possible Needs-Related Examination for Major Enterprises

In the case of major family enterprises, the connection between workplaces and exemption shall only apply on a case-by-case basis in the framework of a needs-related examination. What exactly such an examination will look like remains to be determined and the size of the companies, which will be subject to such examinations, has not yet been agreed upon. In this respect, the legislator was given considerable leeway, a fact that will lead to some discussion.

4. Need for Improvement for the Deferral of Administrative Assets

Finally, the Constitutional Court demands further improvements with respect to the provisions regarding administrative assets and the susceptibility to tax avoidance. As family entrepreneurs we have always been fighting against the improper use of the so-called “Cash Companies”, a misuse that has thankfully been reduced by the legislator in the meantime. Where the Federal Constitutional Court determines further need for improvement, we will be ready to make our contribution. Free-riders must be excluded in order to make exemptions from the inheritance tax comply with the constitution in the first place.

5. Terms and Validity

The legislator is obliged to agree on new rules by June 30, 2016 at the latest. On the one hand, this will give it sufficient time to find a carefully thought-out and well-targeted adjustment. On the other hand, the deadline is sufficiently far away from the end of the legislative period, so that debates will not be heated up in the framework of an early stage of the electoral campaign. Although the previous right will remain applicable until new rules enter into force, extreme caution is necessary as the legislator may decide that the new rules enter into force with retroactive effect to December 17, 2014.

Political Assessment

The judgment clearly demonstrates that our work as an association has been worthwhile. It is in particular the intensive preparative work of our tax committee and its head, Joachim Schramm, together with our department manager in the field of politics and economy, Dr Paulus, as well as their attendance at the oral proceedings in Karlsruhe that have borne fruit. Their statements in court – more or less on the witness stand – have contributed to the judgment in a decisive manner. The wording of the judgement makes it expressly clear that particular protection must be offered to family businesses due to their unique characteristics.

For many of our members, the constitutional judges' requests for improvement are difficult to fulfil. We are already in direct contact with all relevant politicians responsible for tax matters in order to implement the new version of the inheritance law as carefully as possible.