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Germany: Law & Practice and Trends & Developments

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GERMANY

Law and Practice

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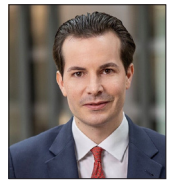

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1. Tax

1.1 Tax Regimes

German Income Taxation

Germany imposes a federal personal income tax on the worldwide income of resident individuals, under the Income Tax Act (ITA). Resident corporations, associations and certain segregated pools of assets are subject to federal corporate income tax, under the Corporate Income Tax Act (CITA). Both taxes are levied annually.

An individual who has a place of residence or a place of habitual abode in Germany has a worldwide income tax liability, pursuant to Section 1(1) of the ITA. While a place of residence is defined as the possession of a property with the intention to occupy (not necessarily on a full-time basis), a place of habitual abode is where the taxpayer remains for more than six months.

Non-resident individuals are subject to income tax from certain German sources specified in Section 49 of the ITA, especially on income derived from German real estate.

The following types of income are subject to income tax pursuant to Section 2(1) of the ITA:

- income from farming and forestry;
- business income;
- income from self-employment;
- employment income;
- income from capital assets;
- rental income; and
- other types of income listed in Section 22 of the ITA.

There are specific rules for each category, which regulate the types of expenses that may be deducted and the tax-free allowance available for those categories. Gains on the sale of privately held assets are subject to income tax under Section 22 of the ITA if they have been held for less than ten years in the case of real estate, or one year in the case of other assets.

In calculating the individual's taxable income, the income from each of the above categories is added together, and losses can be deducted. There are provisions by which losses can be carried backwards or forwards. A taxpayer can deduct special expenses such as pension contributions, health insurance, school fees and

charitable donations, and extraordinary expenses such as the costs of medical treatment (in each case up to a prescribed threshold). There are also tax reliefs for those with children, and rules that allow married couples and registered partnerships to be taxed jointly. A special tax regime applies to income from capital assets (Section 20 of the ITA), which is subject to withholding tax at a rate of 25% and is not subject to supplementary taxation at the taxpayer's usual rate.

The income tax rates for 2024 are as follows:

- the tax-free personal allowance includes income up to EUR11,604;
- the tax rate for income above EUR11,604 starts at 14% and increases up to 45% for income above EUR277,826; and
- in addition to income tax, a solidarity surcharge will be levied as a separate tax, at a rate of 5.5% of the definite income tax liability – this solidarity surcharge applies only for taxpayers with an income tax liability amounting to more than EUR18,130 (for a single person) and to income from capital assets.

Corporations and other types of legal entities listed in Section 1(1) of the CITA are subject to corporation tax on their worldwide profits if their place of management or registered office is in Germany. Non-resident legal entities are subject to corporate tax from certain German sources mentioned in Section 2 of the CITA in connection with Section 49 of the ITA.

Partnerships are not subject to corporation tax, but the partners are individually subject to income tax. A "check-the-box" system for certain partnerships was introduced in 2021, under which such partnerships may choose to be taxed as a corporation and for their partners to be taxed as shareholders of a corporation. Corporation tax is levied on a corporation's income, which is determined in accordance with the income schedules in Section 2(1) of the ITA, as mentioned above (the CITA refers comprehensively to provisions of the ITA that deal with determining the income). After the deduction of any available allowance, profits are subject to corporate tax at a rate of 15% (plus the solidarity surcharge of 5.5% of the corporate tax liability).

Exit Tax

If an individual of any nationality who has been resident or has had a place of habitual abode in Germany for at least seven out of the last 12 years emigrates, the unrealised gain on any shareholding in excess of 1% will be charged to income tax, according to Section 6 of the German Foreign Tax Act (FTA). However, the exit tax lapses with retroactive effect upon the re-establishment of German unlimited tax liability for a maximum period of 12 years ("temporary absence"). A limited tax deferral is possible in this case. The current exit taxation regime has applied since 1 January 2022. Following the amendment, the payment can now be made in seven interest-free instalments.

In 2023, the Federal Fiscal Court ruled in 2023 on a 2011 relocation case to Switzerland that applied the previous legislation, which did not provide for a permanent, interest-free tax deferral for relocations to non-EU/EEA countries, holding that such a tax deferral is applicable. Therefore, the Federal Fiscal Court is expected to rule in favour of a permanent, interest-free tax deferral in EU/EEA cases.

However, no adaptation of the current exit taxation is in sight. Moreover, the German tax authorities recently published a new decree

on the application of the exit tax: in the case of temporary absence, the exit tax only lapses with retroactive effect if Germany's right of taxation is directly re-established exactly at the time of departure.

If a German citizen who has been an income tax resident in Germany for at least five of the last ten years moves to a country that is classified as a low-tax jurisdiction while retaining significant economic interests in Germany, the individual will be subject to extended limited income tax liability for ten years. This means that the individual will be subject to German income tax on a more extensive list of German income sources than other non-residents. Furthermore, extended limited inheritance tax liability will apply for the same period. If the emigrant makes gifts or dies during this period, the class of assets that are treated as German assets (and therefore subject to inheritance tax even if the donor and donee are non-resident) is widened, pursuant to Section 4 of the FTA. This is in addition to the standard five-year inheritance tax shadow.

A further German exit tax may be triggered if, for example, a limited partner of a German GmbH & Co KG that does not qualify as a permanent establishment under the relevant double tax treaty terminates their German residence.

The rules imposing ongoing tax liabilities on emigrants are subject to the application of any relevant double tax treaty in Germany's wide treaty network.

German Gift and Inheritance Tax

General tax principles

Transfers at death and gratuitous transfers are subject to federal inheritance and gift tax under the Inheritance and Gift Tax Act (IGTA).

In Germany, the estate is not subject to inheritance tax, but the acquisition of the respective heir or legatee is; they are ultimately liable for tax on their individual share of the estate. Inheritance tax also depends on the family relationship between the decedent and the heirs.

Gift tax is levied on gratuitous transfers. Like inheritance tax, it is based on the concept of the accretion of wealth or enrichment. Only transfers that are not contingent on future events and that result in a present benefit to the transferee are taxable. While income tax employs factual criteria such as so-called economic ownership (beneficial ownership) in addition to legal criteria to identify taxable transfers, inheritance and gift tax takes a more formal approach. As a rule, a taxable transfer requires the transferee to obtain legal title to the property or at least an enforceable claim under private law.

Gift tax complements inheritance tax. Therefore, gratuitous transfers and transfers at death by an individual to the same recipient within ten years are aggregated into one transfer. Likewise, the same tax rates and tax-free allowances apply to gratuitous transfers and transfers at death.

There is an unlimited, extended unlimited, limited or extended limited gift or inheritance tax liability in Germany.

The (extended) unlimited inheritance and gift tax liability applies especially if the deceased/donor or the heir/legatee/donee has a residence or habitual abode in Germany or is a German citizen who left Germany for not more than five years (ten years in the case of Germany–USA).

In 2022, the Federal Fiscal Court ruled that the extended unlimited inheritance and gift tax liability does not violate the principle of equality,

the freedom to leave the country or the free movement of capital.

The limited inheritance and gift tax liability is applicable if a person who lives abroad has, for example, an interest in a German partnership with business assets, or holds a share of at least 10% in a German corporation (alone or with other closely related persons).

The extended limited inheritance and gift tax liability can be relevant for Germans who had unlimited income tax liability for at least five of the last ten years before leaving Germany.

After deducting the tax-free allowance, the tax rate applicable to the gift or inheritance is as follows.

- Gifts and inheritances of up to EUR75,000 are taxed at a rate of:
  (a) 7% in Tax Class I;
  (b) 15% in Tax Class II; and
  (c) 30% in Tax Class III.
- Gifts and inheritances between EUR75,000 and EUR300,000 are taxed at a rate of:
  (a) 11% in Tax Class I;
  (b) 20% in Tax Class II; and
  (c) 30% in Tax Class III.
- Gifts and inheritances between EUR300,001 and EUR600,000 are taxed at a rate of:
  (a) 15% in Tax Class I;
  (b) 25% in Tax Class II; and
  (c) 30% in Tax Class III.
- Gifts and inheritances between EUR600,001 and EUR6 million are taxed at a rate of:
  (a) 19% in Tax Class I;
  (b) 30% in Tax Class II; and
  (c) 30% in Tax Class III.
- Gifts and inheritances between EUR6 million and EUR13 million are taxed at a rate of:
  (a) 23% in Tax Class I;
  (b) 35% in Tax Class II; and
  (c) 50% in Tax Class III.
- Gifts and inheritances between EUR13 million and EUR26 million are taxed at a rate of:
  (a) 27% in Tax Class I;
  (b) 40% in Tax Class II; and
  (c) 50% in Tax Class III.
- Any gifts and inheritances of more than EUR26 million are taxed at a rate of:
  (a) 30% in Tax Class I;
  (b) 43% in Tax Class II; and
  (c) 50% in Tax Class III.

As soon as the respective amount is exceeded, the entire amount is subject to the relevant tax rate.

If neither the donor nor the donee has a place of residence or habitual abode in Germany, the tax-free allowances may be reduced by a partial amount. Pursuant to Section 16(2) of the IGTA, the tax-free amount is to be granted pro rata when only part of the acquisition is subject to the limited tax liability. Previous pecuniary benefits accrued by the same person within ten years must also be included in the calculation of the specific allowance.

Germany has double tax treaties that cover inheritance taxes with several other countries. Furthermore, Section 21 of the German Inheritance Tax Act provides for foreign estate taxes on foreign property to be credited against the German inheritance tax liability when the donor/decedent or the donee/heir has their residence or place of habitual abode in Germany or opts to be treated as being resident in Germany.

1.2 Exemptions

Tax-Free Allowances

Spouses, children and stepchildren, grandchildren, other descendants or (in the case of inher-

itance, upon death) parents or grandparents fall within Tax Class I, under which:

- spouses have a gift and inheritance tax allowance of EUR500,000;
- children or stepchildren have a gift and inheritance tax allowance of EUR400,000;
- grandchildren have a gift and inheritance tax allowance of EUR200,000; and
- other descendants, parents or grandparents have a gift and inheritance tax allowance of EUR100,000.

Tax Class II includes parents or grandparents (in the case of a lifetime gift), siblings, nieces or nephews, step-parents, sons- or daughters-in-law, mothers- or fathers-in-law and former spouses, all of which have an allowance of EUR20,000.

Other donees, such as trusts, fall within Tax Class III and have an allowance of EUR20,000. This allowance is granted once within ten years for the same donor and testator.

Tax Exemption Concerning Family Home

The family home can be transferred tax-free between living spouses without any restrictions. There is no inheritance tax on a transfer of the family home between spouses, and there is an exemption for the first 200 square metres of a family home transferred on death to the decedent's children. However, the tax on a transfer on death can be clawed back if the property is sold or let within ten years.

Transfer of Death Maintenance Allowances

In the case of a transfer on death, there are maintenance allowances of EUR256,000 for the surviving spouse and up to EUR52,000 (depending on the age of the child) per child aged 27 or younger. These maintenance allowances are reduced by the value of any maintenance payments that are not subject to inheritance tax (such as a widow's pension).

Transfer of Business Assets, Agricultural or Forestry Property and Capital Interests

Special treatment applies to business assets, agricultural or forestry property, and capital interests in corporations. Two levels of relief are available for the transfer of business assets, agricultural or forestry property and capital interests, each with different conditions attached.

Relief of 85%

This is subject to the conditions that:

- the donee retains the property for five years; and
- the total sum of salaries paid during that period is at least 400% of the annual average for the five years before the gift or inheritance (ie, previous employment levels must be largely maintained).

If there are more than five but fewer than ten employees, the total sum of salaries must be 250% of the annual average for the five years before; if there are more than ten but fewer than 15 employees, it must be 300%.

Relief of 100%

This is subject to the more stringent conditions that:

- the donee retains the property for seven years;
- the total sum of salaries paid during that period is at least 700% of the annual average for the seven years before the gift or inheritance (500% if there are more than five but fewer than ten employees, and 565% if there

are more than ten but fewer than 15 employees); and
- no more than 20% of the value is attributable to assets under administration.

Relief depending on value

This relief cannot be claimed independently of the value of the acquired business assets. A particularly complex tax system applies if the value of the acquired business assets exceeds EUR26 million (all acquired business assets of the deceased/donor within a ten-year period have to be taken into account). According to the "ablation model", the relief is reduced by 1% for each EUR750,000 that exceeds EUR26 million.

Above EUR90 million, the relief for business assets can no longer be claimed. If the value of the acquired assets exceeds EUR90 million or the transferee opts not to use the ablation model, they can only apply for an examination of need for relief (*Verschonungsbedarfsprüfung*). The transferee is not required to use "privileged" business assets, but they have to use 50% of the value of all other assets that they already own or that they acquire within a ten-year period to pay the regular rate on the privileged business assets.

They also have to use 50% of the value of the management assets that they already own or acquire within a ten-year period to pay the regular rate for business assets. The total rate for acquired assets that do not qualify as privileged business assets can be 80% or more. This makes tax planning complicated for entrepreneurs if the value of the privileged business assets exceeds EUR26 million.

Management assets

So-called management assets within the preferential business assets are fully taxable at the regular rate insofar as the value of such assets exceeds 10% of the acquired company's assets. The management assets will be calculated and totalled at the group company level (consolidated appraisal of management assets). Therefore, all management assets in the company and its subsidiaries will be taken into consideration and must be valued.

Special Tax Relief for Family Businesses

The maximum special tax relief for family businesses is an additional 30%. There are special requirements for the articles of incorporation that have to be fulfilled (for example, limitation on disposal and on distributions or withdrawals). These provisions have to be incorporated in the articles of incorporation two years before the relevant transfer, and have to remain unchanged and respected for the subsequent 20 years. Family businesses are therefore advised to examine their articles of incorporation and amend them if their provisions do not meet the special requirements of tax relief for family businesses.

Transfer of Real Estate Property and Art

In principle, a 10% tax relief for gifts and inheritances is available for personally held real estate that is let for residential purposes and that is located in Germany, the EU or the EEA. In 2023, the CJEU ruled that this provision violates the free movement of capital because properties in countries other than the EU/EEA are excluded from this relief. In the future, this relief will probably also be applicable to properties in non-EU/EEA countries that exchange inheritance and gift tax information with Germany.

There are also up to 100% reliefs for loss-making property or assets of artistic, historical or scientific importance, provided that the donee retains

the property for ten years and additional conditions are fulfilled.

1.3 Income Tax Planning

Tax Step-Up for Family Partnerships

Privately held real estate held for more than ten years can be transferred to asset management limited partnerships without triggering income tax. The transferred real estate receives a step-up in basis to its fair market value. The step-up allows an additional depreciation volume for income tax purposes, and it can be repeated after ten years.

1.4 Taxation of Real Estate Owned by Non-residents

The limited inheritance and gift tax liability is applicable when a non-resident and non-citizen directly owns real estate situated in Germany. The same applies to German real estate held via a partnership. However, a ruling of the German Fiscal Court held that a bequest of German real estate was not subject to limited inheritance tax liability. Following the ruling, the German legislature amended the IGTA to put domestic and foreign legatees on an equal footing.

Liabilities linked to the real estate may be deducted from the taxable acquisition. In the case of limited tax liability, debts and encumbrances are not deductible insofar as they are not economically related to assets that are subject to limited tax liability. Therefore, the Federal Fiscal Court ruled that claims arising from the compulsory portions were not deductible in case of limited inheritance tax liability. In 2021, the CJEU ruled that this provision violates the free movement of capital. The German legislature is therefore working on an amendment to the provision.

A pro rata deduction will probably be possible in the future. However, the transfer of foreign corporations holding German real estate is not subject to German inheritance and gift tax. Rental income derived from German real estate is generally subject to German income tax.

1.5 Stability of Tax Laws

The German transfer tax regime is currently in a rather stable phase. Germany elected a new federal parliament (*Bundestag*) at the end of 2021, with a government led by the Social Democratic Party. However, to date, no major changes in transfer taxes have been announced. Like many other countries, Germany is still facing the consequences of the war in Ukraine; hence, changes might be expected.

1.6 Transparency and Increased Global Reporting

Since July 2020, there has been a reporting obligation for cross-border tax arrangements in Germany. Moreover, the German Anti-Money Laundering Act was amended in 2017, implementing the respective EU Directive of May 2015 and introducing a German transparency register. German-registered commercial partnerships and legal persons governed by German private law, as well as German-based trustees, must report their beneficial owners or beneficiaries.

Following the implementation of the respective EU Directive of 30 May 2018, the information reported to the German transparency register has been publicly accessible since 1 January 2020.

2. Succession

2.1 Cultural Considerations in Succession Planning

The transfer of assets through generations is regularly performed with control rights in favour

of older generations, especially if minors or inexperienced persons are involved. The donor of such assets can retain a usufruct right (*Nießbrauch*) on the transferred assets, so that they can claim the emoluments of the assets after the transfer. The withholding of a usufruct right is an estate planning strategy that has been practised for hundreds of years.

The insertion of broad reclaim regulations in gift agreements or the appointment of executors (*Testamentsvollstrecker*) in last wills, as well as the establishment of binding partnership structures, are used to divide control and wealth.

2.2 International Planning

Advising high net worth individuals and their families has become an international matter; younger generations are not as deeply rooted in their native countries as former generations. Nowadays, family members frequently change their life circumstances in accordance with their study and business plans, and it is not rare for children of high net worth individuals who have spent several years abroad to be married to partners of other nationalities. Consequently, estate structuring requires the interaction of estate planning teams from different jurisdictions.

One of the major issues in this area concerns exit tax planning. The cross-border donation of business assets can trigger gift tax as well as an exit tax. Management holding partnerships are used in an effort to combat this tax burden.

2.3 Forced Heirship Laws

The German forced heirship regime depends on the applicable succession law. The EU Directive on succession has been applicable since 17 August 2015, meaning that in principle the succession law of the last habitual residence of the deceased applies. However, the testator has the right to opt for the laws of the testator's citizenship in the testator's last will. If the testator had their last domicile in Germany or was a German national and chooses the German law of succession, the German succession law is applicable for their entire estate.

In 2022, the German Federal Court ruled that German forced heirship law was applicable even through the testator, an English national, had chosen English law to govern their succession. Here, the last habitual residence of the testator was in Germany and hence German law of succession was generally applicable. According to the German Federal Court, the choice of English law was (partially) in violation of the German ordre public, since English law of succession does not provide for any kinds of forced heirship rights. Therefore, the choice of English law was (partially) invalid and, consequently, German forced heirship law was applied.

According to German succession law, descendants, spouses and parents may have a forced heirship right (*Pflichtteilsanspruch*) in the amount of 50% of their potential heirship share, according to the rules of intestate succession. The basis of the calculation is the estate at the time of death.

A so-called supplement statutory share (*Pflichtteilsergänzungsanspruch*) may also apply, since the testator shall not be able to avoid forced heirship rights by minimising their estate within a period of ten years before their death due to donations to third parties. For calculating the supplement statutory share, the value of the decedent's estate will be increased by the value of such donations. The donations will be fully taken into account within the first year prior to the decedent's death, and will be taken into

account by one tenth less for each further year prior to the decedent's death.

2.4 Marital Property

The German statutory matrimonial property regime is the regime of accrued gains (*Zugewinngemeinschaft*) if the spouses have not entered into a marital contract. The spouses are allowed to modify their statutory matrimonial property regime, or to choose the regime of community property (*Gütergemeinschaft*) or the regime of separation of property (*Gütertrennung*). However, the matrimonial property regime can only be modified or chosen by marital contract.

If the matrimonial regime of accrued gains applies, each spouse's assets remain the property of the respective spouse regardless of whether they were acquired before or during the marriage. In the case of divorce or the death of one of the spouses, or if the matrimonial regime is changed to the separation of property, the spouses must equalise their accrued gains that were obtained during the marriage. For the calculation of accrued gains, the period between the day of marriage and the day the matrimonial regime ends is decisive. According to that, the amount to be paid due to the equalisation has to be determined by comparing the initial assets (ie, the assets at the time the spouses entered into the marriage) with the final assets of each spouse (especially on the day the divorce petition was delivered to the respondent).

Gratuitous transfers from a spouse to a third party will be taken into account for the calculation, unless they were performed more than ten years ago or were performed with the other spouse's consent. Otherwise, such transfers will be added to the initial assets of the respective spouse.

2.5 Transfer of Property

In general, there are no differences between assets transferred during lifetime or at death. For income tax purposes, assets are also held with their updated historical acquisition costs after the transfer. Donees/heirs carry forward these historical costs, instead of the donor/decedent. The transfer itself usually does not trigger capital gains tax or exit taxes; therefore, no step-up occurs.

2.6 Transfer of Assets: Vehicle and Planning Mechanisms

The gift and inheritance tax-free allowances listed under Section 16 of the IGTA are available every ten years. If estate planning is started at an early stage of the donor's/testator's life, these tax-free allowances can be utilised multiple times as donations are made over several decades. If the donor decides to donate profitable assets such as shares or rented real estate, they can make a gift while retaining a usufruct right. However, this usufruct right is taken into consideration when determining the value of the transfer of assets.

Family limited partnerships (*Familien-KG*) are used as tax planning mechanisms, making the children of the donor/testator limited partners in this structure. The main benefit of such a structure is that the donor/testator can divide controlling rights to ease their children into the responsibilities of wealth management and limit their initial involvement in the operations of the structure, while at the same time retaining a large degree of control over the partnership structure. As limited partners, the children of the donor/testator have no ability to control, direct or otherwise influence the operations of the partnership structure.

Prenuptial and postnuptial agreements can also be a tax-efficient tool for transfers between spouses.

2.7 Transfer of Assets: Digital Assets

The digital estate is an interplay of inheritance law, fundamental rights, privacy and business practices of service providers. In Germany, there are only a few judicial verdicts in relation to the digital estate, so many legal issues are still unclear and somewhat controversial. There is no problem when the data is on a device such as a USB stick or a hard disk, as these objects are transferred by way of universal succession to the heirs.

A problem arises when the data is stored online – eg, on a cloud or in an online account. There is no agreement in the literature on whether digital assets should be included in the inheritance as they are personal assets; it is argued that accounts and data of a private nature are not inheritable. According to the prevailing opinion in the literature, the digital estate should be inheritable.

In a ruling in 2018, the German Supreme Court decided that the heirs are entitled to access the Facebook account of the deceased. The account would also be transferred to the heirs by way of universal succession. The Court stated that neither the secrecy of telecommunications nor the post-mortem personal right to privacy stands in the way of inheritance.

In a testamentary disposition, orders should also be made with regard to the digital assets. It should be noted, in particular, that the heirs must also be given access to the digital assets – for example, by deposition of the corresponding passwords.

3. Trusts, Foundations and Similar Entities

3.1 Types of Trusts, Foundations or Similar Entities

As the German civil law system does not acknowledge the concept of trusts in its own right, trusts are not an estate planning vehicle in Germany.

The private law foundation (*Stiftung bürgerlichen Rechts*) takes a prominent role in the German tax and estate planning regime. This is especially true for the family foundation (*Familienstiftung*), which is not its own legal form but rather a private benefit foundation focused on beneficiaries who are related to the founder of the foundation. In addition to the regular tax burden of a private benefit foundation, a back-up inheritance and gift tax is levied on the estate of the family foundation every 30 years, pursuant to Section 1(1) No 4 of the IGTA.

Another important structure for tax and estate planning is the limited partnership (*Kommanditgesellschaft*).

3.2 Recognition of Trusts

As stated in **3.1 Types of Trusts, Foundations or Similar Entities**, trusts are not an estate planning vehicle in Germany, as the German civil law system does not acknowledge the concept of trusts in its own right.

3.3 Tax Considerations: Fiduciary or Beneficiary Designation

Treatment of Trusts

Germany is not a member of the Hague Trust Convention and thus has not ratified the provisions thereof. The German treatment of trusts is typically determined by analogising the trust in question to some other legal arrangement

recognised under German law. The analogising procedure involves searching for "similar" or comparable legal structures that can be used for estate planning purposes in the German jurisdiction instead of a trust. The analogising procedure is mainly influenced by the specific trust structure.

Testamentary trusts

If German succession law applies to the decedent's estate, it is not possible to establish a trust mortis causa nor to bequeath parts of the estate to an existing trust. In such a case, especially when the testator has established a last will under foreign laws together with a testamentary trust, the trust arrangement will be regarded as German executorship, and the trustee will be regarded as executor and not as heir/legatee. The trust beneficiaries will be regularly treated as heirs/legatees.

Inter vivos trusts

Two different views are taken in Germany with respect to inter vivos trusts. According to one view, they are legal institutions similar to a contract for debt (*Schuldvertrag*), in which case the principles of the international law of contracts for debt pursuant to the EU Regulation on the law applicable to contractual obligations (Rome I) analogously apply to the contractual obligation (*schuldvertragliches Verpflichtungsgeschäft*). Thereby, an inter vivos trust could also be created by German nationals serving as settlors.

Another more restrictive view considers the trust to be a legal institution under corporate law, in which case the link will be the same as under international corporate law.

As the trustee's function in a trust is solely of a fiduciary nature with no own interest in the estate and the income of the trust, the mere appointment of a German citizen to serve as a trustee will, as a rule, have no tax consequences.

Place of business management in Germany

However, if the trustee conducts business in Germany, the place of business management (see Section 10 of the German Fiscal Code) might be in Germany. Consequently, the trust itself will be considered a corporation with unlimited tax liability according to Section 1(1) No 5 of the CITA; as a result, all worldwide income gained by the trust will be subject to German corporation tax. Similarly, unlimited tax liability will be established regarding gift and inheritance tax according to Section 2(1) No 1 lit d) of the IGTA (see Section 2(1) No 2 of the IGTA when a family foundation is concerned). Ultimately, if the place of business management is established outside Germany again, a taxable disjunction of trust assets can be triggered.

For tax purposes, whether the concrete trust is a fiduciary arrangement or a separate legal entity must be determined. The tax implications for beneficiaries are the following.

Trust as a separate legal entity

The creation of a testamentary trust triggers inheritance tax, pursuant to Section 3(1) No 1 of the IGTA. As manager of the trust assets, the trustee is obliged to file an inheritance notification with the German tax authorities, according to Section 30(1) of the IGTA in connection with Section 34(3) of the German Tax Procedure Act. In the creation of an inter vivos trust, the settlor and the trustee are obliged to file a gift notification.

In the case of distributions from the trust to the settlor and/or the beneficiaries, the persons concerned have to file income tax returns (regarding income pursuant to Section 20(1) No

9 of the ITA) and gift tax returns (regarding gifts pursuant to Section 7(1) No 9 of the IGTA). The trustee as asset manager is so obliged as well.

If the trust fulfils the prerequisites for the unlimited or limited corporate income tax liability pursuant to Section 1(1) or Section 2(1) of the CITA, the trustee is obliged to file a notification pursuant to Section 137 of the German Tax Procedure Act after trust creation, and has to file corporate income tax returns annually.

The new decree on the application of the FTA also addresses the income taxation of trusts. If the trust assets can be attributed to the persons behind the trust pursuant to general tax principles, the trust qualifies as transparent. The assessment is determined by assessing how the agreements are structured and how they are implemented in each individual case. If, according to the underlying agreements, the settlor can dissolve the trust at their free will and the assets are then distributed to the settlor, a transparent fiduciary agreement for German tax purposes can usually be assumed. Incidentally, ancillary agreements such as letters of wishes can also be included in the assessment.

Family Trusts Within the Meaning of Section 15 of the FTA (Special Tax Regime for Undistributed Income)

Scope of application

Section 15 of the FTA contains a special income tax regime for foreign so-called family foundations that are not subject to taxation of worldwide income and thus could be utilised to shelter income from taxation.

Foreign family foundation

A foreign family foundation is defined as an entity that has neither a registered office (*Satzungssitz*) nor a place of effective management in Germany, and was created to benefit the members of a family. The latter requirement is fulfilled if more than half of the foundation's property and income is set aside for the founder and/or their relatives (Section 15(2) of the FTA). In Section 15(1) of the FTA, a proportionate share of the foundation's income is included annually in the income of the settlor or of those beneficiaries and remaindermen who are German residents. Section 15(4) of the FTA extends this taxation mechanism to foreign "pools of assets" that were set up to benefit a family as required by Section 15(2) of the FTA.

Application to trusts

In a decision in 1992, the Federal Fiscal Court applied Section 15(4) to a Jersey trust, in which the trust's income was allocated to the settlor, who was still alive, and to a German resident; in a decision of 2 February 1994, the Federal Fiscal Court applied Section 15(4) to a US testamentary trust, in which the trust's income was allocated to the beneficiaries living in Germany. The court held that the trust had been created for the benefit of the settlor's wife and children, and was thus comparable to a family foundation and subject to the special taxation regime in Section 15 of the FTA. As a result, the trust's worldwide income was included in the settlor's income for the taxable year.

If a German resident becomes a discretionary beneficiary of a trust and is benefited by more than half of the trust's property and income (alone or together with other family members), the trust will qualify as a family foundation within the meaning of Section 15(2) of the FTA. Thus, its worldwide income will be allocated to the settlor if the settlor is resident in Germany and will therefore be subject to German taxation. If the German resident is only a beneficiary together with other (non-German) beneficiaries,

the beneficiary is exposed to taxation on the undistributed income on a pro rata basis.

Exemption for EU/EEA trusts

Section 15(6) of the FTA excludes family foundations that have their registered office or place of effective management in EU/EEA member countries from the special taxation regime, provided that the trust's property is extracted from the power of disposition of the settlor and their relatives, and that Germany and the respective state have entered into a certain exchange of information agreement.

Typically, the place of management of a trust is with the trustee. Nevertheless, when determining the place of management of a trust, one should also consider the rights and duties of a protector's committee, if one exists. It is a subject of debate whether Section 15(6) of the FTA is applicable to a trust that also has a registered office or place of management within the EU/EEA.

Tax consequences and taxation regime pursuant to Section 15 of the FTA

In accordance with the special taxation regime established by Section 15 of the FTA, which is applicable when the place of effective management of the trust is not located in Germany, property and (positive) income (negative income cannot be allocated to the settlor/beneficiary – see Section 15(7) sentence 2 of the FTA) of the family trust are attributed to the beneficiary on a pro rata basis if the beneficiary is a German resident. As long as the beneficiary is alive and the trust income accumulates to the trust, the trust income – as determined by German tax law – is added to the taxable income of the beneficiary on a pro rata basis. The beneficiary is entitled to a foreign tax credit with respect to foreign income taxes paid on the income by the trust (see Section 15(5) of the FTA). The trust income is included in the taxable income of the beneficiary in the taxable year in which the income arises, under general income tax rules on the level of the trust. Distributions of accumulated trust income that was subject to taxation in a prior year are not taxed a second time, pursuant to Section 20(1) No 9 of the ITA.

If the trust qualifies as a foreign family trust within the meaning of Section 15 of the FTA, and is not exempt under Section 15(6), its property and income are attributed to the beneficiary on a pro rata basis and added to their taxable German income.

According to Section 20(1) of the FTA, double tax treaties cannot prevent the allocation of income pursuant to Section 15(1) of the FTA. However, distributions of accumulated trust income that have been taxed under Section 15 will not be taxed a second time when distributed to the German beneficiaries, according to Section 20(1) No 9 of the ITA. Nevertheless, gift tax will arise in cases where the beneficiary has not made or cannot make use of the election right provided by Article 12 Section 3 of the US/German Estate and Gift Tax Treaty.

Trust distributions of income or capital to German residents

the distribution of income or capital of the trust to a German beneficiary may trigger income tax as well as gift tax.

German income taxation

Generally, distributions of foreign irrevocable trusts are subject to German income tax pursuant to Section 20(1) No 9 of the ITA. This is true for periodic or ad hoc distributions of trust income, and for distributions of trust property (repayment of capital). Only repayments at the

expense of the tax contribution account in terms of Section 27 of the CITA are not taxable.

Such distributions are taxed under the final flat-tax regime (withholding tax on capital gains) at a rate of 25% (plus solidarity surcharge and, if applicable, church tax) of the fair market value of the distributed assets. Under this law, not only income but also trust corpus is taxable income when distributed to a German beneficiary or remainderman.

A distribution from a foreign irrevocable trust to the German beneficiary or remainderman is not taxed under Section 20(1) No 9 of the ITA if the relevant income was already attributed to the German beneficiary under Section 15 of the FTA.

German gift tax

The distribution of trust property to the remaindermen also constitutes a taxable gift under Section 7(1) No 9 of the IGTA if the remainderman is a resident of Germany.

Section 7(1) No 9 of the IGTA applies to distributions upon the dissolution of testamentary and inter vivos trusts. It also applies to distributions of property from a trust that continues to exist, although the statutory language may imply otherwise. The wording of Section 7(1) No 9 sentence 2 of the IGTA is as follows: "Transfers upon the dissolution of a foreign pool of assets, having the purpose of segregating property, as well as transfers to intermediate beneficiaries during the existence of the pool of assets... are deemed to be a taxable gift."

The term "intermediate beneficiaries" (*Zwischenberechtigte*) is not legally defined. In a recent decision with regard to foreign family foundations, the Federal Fiscal Court has interpreted the concept of the intermediate beneficiary (Federal Fiscal Court, decision of 3 July 2019 – II R 6/16) to mean that an intermediate beneficiary is any person who, irrespective of a specific resolution on a distribution, is legally entitled to the assets tied up in the trust or foundation and/or the income generated by the entity, whether – according to German legal concepts – in the form of rights in rem or in the form of claims under the law of obligations. This means that not all recipients can be regarded as intermediate beneficiaries, but only those who are legally entitled to the grant, such as in a strict trust situation. This must apply to a trust in the same way as to a foreign family foundation.

Consequently, only those grants pursuant to Section 7(1) No 9 of the IGTA can be taxed when they are received by a beneficiary who has a legal claim to these grants from the outset. It is clear that the gift tax then arises on the actual receipt of trust income or trust property by the recipient of a discretionary trust. In Section 15(2) sentence 2 of the IGTA, family relationships are taken into account when determining the applicable tax rate. Depending on their proximity to the decedent or settlor, beneficiaries and remaindermen can qualify for Class I or Class III of the gift tax rate system. However, the determination of the tax rate class can pose difficulties if the trust property was contributed by different persons.

The Federal Fiscal Court has also ruled that distributions from a foreign foundation are only taxable as gifts under Section 7(1) No 1 of the IGTA if they clearly violate the purpose of the statutes. This is because a gratuitous transfer within the meaning of Section 7 of the IGTA can only be assumed if the distribution clearly exceeds the statutory purpose of the foreign foundation. Regarding the question of whether a distribution pursues the purpose of the articles of incorporation, there is a foundation-internal

assessment prerogative, which restricts an examination by the tax office and/or tax court accordingly.

The Federal Fiscal Court issued three more rulings in 2021 regarding the taxation of trusts. A trust is transparent for German tax purposes if the settlor still has power over the assets of the trust. In this case, the settlor is seen as the direct owner of the trust assets and hence the establishment of the trust is not subject to gift tax. If the settlor does not have power over the trust assets, the trust is considered to be opaque. The distributions from a foreign opaque trust to a German resident are generally subject to income tax and may simultaneously be subject to gift tax.

Double Taxation

As highlighted above, trust distributions can trigger income tax as well as gift tax simultaneously. Pursuant to Section 35b of the ITA, inheritance tax can be credited against German income tax if triggered by inheritance but not by donation. However, German tax law does not provide for a credit of the income tax paid by the beneficiary on the gift tax, nor vice versa.

in 2023, the Muenster Fiscal Court ruled that, in the event of dissolution of the trust, the distributions might be subject to income tax as well as gift tax. However, a step-up for income tax purposes was granted.

3.4 Exercising Control Over Irrevocable Planning Vehicles

Retaining a certain amount of control for a settlor of a private foundation is possible. Nevertheless, retaining too much control can lead to the settlement or foundation being treated as a sham or fiduciary structure, especially in trust cases or when foreign foundations are involved. This was also the topic of a 2021 Federal Fiscal Court decision on trusts.

4. Family Business Planning

4.1 Asset Protection

The most popular methods for asset protection are prenuptial and postnuptial agreements, family foundations and partnership structures.

Marriage Agreement

With a marriage agreement, it is also possible to transfer assets from one spouse to the other without incurring taxes, removing the assets from the reach of creditors by doing so.

Family Foundations

Assets that are transferred to a family foundation have left the property sphere of the founder and are attributed to the foundation itself. In order for this effect to occur, it is a prerequisite that the founder has actually given up control over these assets, which is, in turn, assumed by the entities of the foundation. It is also advisable for the founder to have no means of influencing the entities of the foundation with regard to this property. Assets that are successfully transferred are exempt from being accessed by any creditors of the founder.

Partnerships

Partnerships are often used (depending on the types of assets) to transfer wealth to the next generation but at the same time retain a degree of control over the gifted assets.

4.2 Succession Planning

See **2.6 Transfer of Assets: Vehicle and Planning Mechanisms** and **1.2 Exemptions**.

4.3 Transfer of Partial Interest

Fair market value is not adjusted for tax purposes: the partial interest will be valued with the current market value of the underlying assets. Nevertheless, whether a discount would be necessary is disputed within legal literature.

5. Wealth Disputes

5.1 Trends Driving Disputes

Probate arbitration and mediation are considered in solving wealth disputes, as an alternative to probate litigation.

An effective way to avoid long and costly probate disputes is to establish an arbitration clause in a last will. This clause is usually combined with a no-contest clause.

5.2 Mechanism for Compensation

There is no special mechanism for compensation in wealth disputes.

6. Roles and Responsibilities of Fiduciaries

6.1 Prevalence of Corporate Fiduciaries

The use of corporate fiduciaries is not prevalent in German law.

6.2 Fiduciary Liabilities

Piercing the veil of a trust or foundation is unusual. Nevertheless, if a trust or foundation is regarded as a mere fiduciary agreement, the veil can be pierced and income as well as capital of the trust will be attributed to the settlor or – in rarer cases – to the beneficiaries.

6.3 Fiduciary Regulation

The prudent investor rule is applicable to a fiduciary and also to an investment adviser.

6.4 Fiduciary Investment

There are only very few investment theories or standards in this field in the German jurisdiction. The Tax Court Munich (decision of 25 April 2016 – 7 K 1252/14) held that non-profit corporations are largely free to choose their investments. They may choose any form of investment that is economically reasonable, applying an ex ante perspective.

7. Citizenship and Residency

7.1 Requirements for Domicile, Residency and Citizenship

In general, German citizenship can be awarded automatically by law or upon the request of an individual by administrative act.

By law, German citizenship will be passed to children by way of kinship if one of the parents of the child is a German citizen. Another way of obtaining German citizenship is by way of adoption by at least one German citizen.

With certain prerequisites, citizenship can be acquired by administrative act if a person has immigrated lawfully to Germany and has had their habitual abode in Germany for longer than eight years. The same applies if an individual is willing to abandon their former citizenship and has a spouse or a registered partner with German citizenship. Alternatively, citizenship can be acquired if the individual has custody of a child who has German citizenship.

Former German nationals who were deprived of their citizenship by arbitrary expatriations

by the Nazi regime on political, racial and religious grounds between 1933 and 1945, and their descendants, may apply for naturalisation (without further requirements).

Tax Residency

German tax residency may be obtained by maintaining a dwelling in Germany or by staying in Germany and when the stay is not merely temporary (generally, a stay of six months without interruptions suffices).

7.2 Expeditious Citizenship

Citizens of the EU will be treated favourably in obtaining German citizenship as a result of the unity principle promoted by the EU.

On the one hand, they will not need to acquire a residence permit, but will be able to acquire it automatically if an application is filed with the responsible authorities. On the other hand, citizens of the EU are not required to drop their previous citizenship when obtaining German citizenship, thus gaining dual citizenship. Otherwise, EU citizens are held to the same standards as citizens of other countries.

8. Planning for Minors, Adults with Disabilities and Elders

8.1 Special Planning Mechanisms

A last will can be designed to focus especially on the needs of disabled children. In these cases, parents tend to consider specific provisions that ensure full support of the disabled child by state subsidy after their death, while keeping the estate itself untouched with regard to the day-to-day support of the child. This objective is reached by pairing a preliminary/posterior heirship (*Vor- und Nacherbschaft*) with an executorship.

8.2 Appointment of a Guardian

Appointing a guardian, conservator or similar party requires a court proceeding and ongoing supervision by the court. The district court as family court has the function to appoint guardians for minors (*Vormund*) or for adults with disabilities (*Betreuer*). The guardian is under supervision of the court and is especially obliged to file financial reports.

A reform that became effective on 1 January 2023 has strengthened the right to self-determination and the autonomy of people in need of support. Regarding the custodianship law, the reform highlights the care of the person and the rights of the ward. Moreover, stricter rules apply to the care of property of the ward: gratuitous transfers of interest in partnerships and corporations to minors are treated equally, which implies that even the transfer of shares in a corporation will generally require a family court approval. In addition, in health emergency situations, one spouse may represent the other spouse who is temporarily unable to manage their healthcare affairs due to unconsciousness or illness for a limited amount of time.

8.3 Elder Law

The social insurance system in Germany includes mandatory nursing care insurance, which provides coverage in the event of an individual becoming care-dependent. The coverage of this insurance is determined by the level of the individual's dependency on care.

German courts are increasingly dealing with maintenance issues, where parents demand maintenance payments from their children.

To avoid court-supervised care of a parent in the case of mental incapacity or the like, it is common to appoint a child as attorney-in-fact,

thus taking the necessary and provisionary steps in these cases (*Vorsorgevollmacht*) without court supervision. However, such a power of attorney can only be established if the principal is still fully capable of acting in their own right. In this context, problems may arise, particularly in the event of dementia. The power of attorney may be revoked at any time.

A living will (*Patientenverfügung*) is usually drawn up together with a power of attorney.

9. Planning for Non-traditional Families

9.1 Children

In German tax and civil law, children born out of wedlock and adopted children are treated in the same way as children born in marriage.

9.2 Same-Sex Marriage

Same-sex marriages have been recognised in Germany since 1 October 2017; previously, it was possible to enter into a so-called registered partnership (*eingetragene Lebenspartnerschaft*). It is possible to have a registered partnership that was made before this date retroactively converted into a marriage.

In addition, German registered partners are treated equally to other spouses regarding inheritance and gift taxation. Following a recent ruling of the Federal Constitutional Court of Germany, the same is true in the field of income taxation.

10. Charitable Planning

10.1 Charitable Giving

Due to the high reliefs under the German income, inheritance and gift tax regime, structuring non-profit organisations can be a good way to combine private clients' charitable interests with favourable tax planning.

Tax Reliefs

In general, tax reliefs are available for organisations that have tax-privileged purposes – ie, purposes that are in the public interest (defined as advancing the material, spiritual or ethical well-being of society), benevolent or religious. The statutory list of purposes in the public interest found in Section 52 of the German Fiscal Code is broad and includes:

- the advancement of science;
- art;
- caring for the young or elderly;
- education;
- conservation;
- social care;
- caring for victims of persecution;
- promoting international understanding;
- accident prevention;
- animal welfare;
- international development;
- consumer protection;
- promotion of equal rights; and
- sport.

The local tax office has jurisdiction to decide whether a particular organisation has tax-privileged purposes. If so, the organisation is exempt from most taxes (except insofar as it carries out a commercial activity not directly related to its tax-privileged purposes).

Tax Reliefs for Donors

Individuals can claim a tax deduction of up to 20% of their income in respect of gifts to tax-privileged organisations. In addition, an individual can deduct up to EUR1 million in any ten-year period in respect of contributions to the endowment of a tax-privileged foundation – ie, gifts of capital in respect of which the foundation may only distribute the income. A gift for tax-privileged purposes is free of inheritance tax.

These tax reliefs have historically only applied to donations to German organisations. However, in the case of Hein Persche v Finanzamt Lüdenscheid (C-318/07), the European Court of Justice held that the denial of an income tax deduction for a gift to a charity elsewhere in the EEA was contrary to the principle of free movement of capital under Article 56 of the EU Treaty. New legislation to allow the deduction of gifts to charities in other EEA member states for income and corporation tax purposes has therefore been passed.

However, such gifts continue to be subject to gift tax unless a mutual recognition arrangement is in place, the applicable double tax treaty provides otherwise or it is possible to structure the donation as a restricted gift, the use of which for exclusively charitable purposes is secured.

10.2 Common Charitable Structures

Structuring charitable organisations plays a significant role in German tax and estate planning. Charities can be set up in a variety of legal forms, including as foundations, corporations and associations.

Trends and Developments

Contributed by:
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Flick Gocke Schaumburg has seven offices in Germany, in Bonn, Frankfurt am Main, Hamburg, Berlin, Munich, Stuttgart and Düsseldorf. With more than 50 years' experience in the field, the firm combines outstanding expertise in German and international tax law with specialist know-how in other relevant areas of business law. Flick Gocke Schaumburg advises on national and international mergers and acquisitions, disposals, venture capital and private equity transactions, and complex restructurings; it also provides comprehensive advice to high net worth individuals, family-owned businesses, foundations and not-for-profit organisations on all tax and legal issues related to wealth management and succession. The firm's client roster is currently in excess of 2,000, including the majority of DAX-listed companies. In terms of tax crime and white-collar matters, Flick Gocke Schaumburg covers the entire spectrum, from risk assessments to representation in criminal proceedings.

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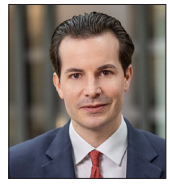

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Private Wealth in Germany: an Introduction

Gratuitous transfer of real estate: valuation changes

Three valuation methods are generally applicable for gratuitous transfers, depending on the type of the real estate:

- the sales comparison method (taking into consideration the recent sale of comparable properties in the area);
- the income capitalisation method (on the basis of the rental income earned in the building); and
- the cost method (adding the value of the land and the costs of the building).

In the past, the valuations regularly led to a lower value than the fair market value of the real property. However, the Annual Tax Act 2022 provided changes resulting in higher valuations and thus possibly increasing gift and inheritance tax on German real estate.

In contrast to this development, the Münster Tax Court decided in a recent ruling that a valuation discount may be applicable to a co-ownership share in a real property compared to full ownership. The valuation discount is subject to a well-founded appraisal. Moreover, the Higher Regional Court Hamm ruled in 2023 that a substantial discount (30% to 50%) is applicable to a co-ownership share in a real property held by a community of heirs.

Reform of real estate transfer tax (RETT)

A new version of the German RETT law is applicable to every transaction involving German real estate transfers as of 1 July 2021. The new law implements a lower threshold of interest in a real estate owning partnership or corporation triggering the RETT: 90% instead of the previous 95%. Furthermore, the holding period during which the RETT applies is extended to ten years (in contrast to the previous five years). Moreover, the general scope of application has been extended. These new provisions constitute an effective complication for taxpayers who wish to transfer interest in companies holding German real estate directly or indirectly.

Reform of property tax

Property tax was also reformed in 2021, following a ruling of the Federal Constitutional Court of April 2018. The reform includes a new valuation of real estate as of 1 January 2022, leading generally to an elevated property tax. Property

tax returns had to be submitted by the end of January 2023.

The law provides a new federal valuation model, with the option for the German states to implement their own valuation model. Several states have taken this option (Baden-Württemberg, Bavaria, Hamburg, Hesse and Lower Saxony). The disparities between the states complicate the preparation of tax returns for real estate located in different states of Germany. If, after the filing, any event was to change the value of the real estate, a simplified tax return must be submitted by 31 January of the next calendar year to describe the nature of the changes and the modified value. The application of the new property tax starts in 2025.

Introduction of a "check-the-box" election for certain partnerships

Corporations and other types of legal entities, such as foundations, are subject to corporate income tax on their worldwide profits if their place of management or registered office is in Germany. Partnerships are not subject to corporate income tax, but the partners are individually subject to income tax. However, a bill implementing a "check-the-box" system for certain partnerships was passed in 2021. These partnerships (with a commercial activity) may choose to be taxed as a corporation and their partners may be taxed as shareholders of a corporation. This option has applied since 1 January 2022.

Reform of the German law on partnerships

Case law and legal scholars have been amending the existing law on partnerships for decades; the bill, passed in June 2021, mainly aims to codify these developments. Moreover, civil law partnerships shall be able to apply to be entered in a partnership register. Some civil law partnerships are obliged to be registered in this partnership register, which leads to even more transparency obligations. Partnerships holding real estate or interests in companies have to be registered.

In addition, German company law applies to all partnerships registered in Germany, regardless of the place of their main activity. This allows German partnerships to move their main activity abroad. The new law came into force on 1 January 2024.

Reform of the foundation law

The creation of foundations, particularly charitable foundations, is common among wealthy individuals in Germany, also owing to the 2016 changes in the German gift and inheritance law. In some cases, these foundations are majority shareholders of enterprises with several thousand employees and thus dispose of considerable fortunes. More than 25,000 foundations exist in Germany.

A bill aimed at modernising German foundation law was passed in 2021, after various amendments. The bill includes a further harmonisation on the federal level (each German state still has its own foundation law), the recognition of the consumption foundation, possibilities to change the statutes, a possible merger of several foundations into a new foundation and a more liberal asset management. The new foundation law applies as of July 2023. Moreover, the foundation law of most German states has been amended as a consequence of the changes on the federal level.

Exit taxation

Germany has revised its exit tax regime on the basis of the European Anti-Tax Avoidance Direc-

tive, with the unlimited tax deferral in case of exit taxation for EU/EEA citizens within the EU/EEA area being abolished. Moreover, the required period of unlimited tax liability for the application of exit taxation has been reduced from ten years to seven years. In contrast to the former legislation, this calculation will not be based on the entire lifetime, but only on the last 12 years prior to the exit.

The exit tax lapses with retroactive effect upon the re-establishment of German unlimited tax liability for a maximum period of 12 years ("temporary absence"). A limited tax deferral is possible in this case. The current exit taxation regime has applied since 1 January 2022. Following the amendment, the payment can now be made in seven interest-free instalments.

In 2023, the Federal Fiscal Court ruled on a 2011 relocation case to Switzerland that applied the previous legislation, which did not provide for a permanent, interest-free tax deferral for relocations to non-EU/EEA countries, holding that such a tax deferral is applicable. Therefore, the Federal Fiscal Court is expected to rule in favour of a permanent, interest-free tax deferral in EU/EEA cases.

However, no adaption of the current exit taxation is in sight. Moreover, the German tax authorities recently published a new decree on the application of the exit tax: in the case of temporary absence, the exit tax only lapses with retroactive effect if Germany's right of taxation is directly re-established exactly at the time of departure. In cases with double taxation conventions in particular, it must be ensured that the double taxation convention (re)assigns the right of taxation to Germany directly upon the re-establishment of German unlimited tax liability.

German citizenship

Under Article 116(2) of the German Constitution, former German nationals who were deprived of their citizenship between 1933 and 1945 by arbitrary expatriations by the Nazi regime on political, racial and religious grounds, and their descendants, may apply for naturalisation. The number of such naturalisation applications was previously somewhat modest, but has increased significantly within the few last years. Requests from the United Kingdom, for example, have increased nearly tenfold – probably due to the results of the 2016 EU Referendum and a favourable ruling of Germany's Federal Constitutional Court on 20 May 2020.

Reform of the custodianship and guardianship law

The reform of the German custodianship and guardianship law came into effect on 1 January 2023, and strengthens the right to self-determination and the autonomy of people in need of support. Regarding the custodianship law, the reform highlights the care of the person and the rights of the ward. In addition, stricter rules apply to the care of property of the ward: gratuitous transfers of interest in partnerships and corporations to minors are treated equally, which implies that even the transfer of shares in a corporation will generally require a family court approval. Moreover, in health emergency situations, one spouse may represent the other spouse who is temporarily unable to manage their health care affairs due to unconsciousness or illness for a limited amount of time.

Taxation of trusts in Germany

Germany has always struggled with common law trusts. German civil law does not recognise trusts, since Germany is not a member of the Hague Trust Convention and has not ratified the provisions of the agreement. However, Ger-

man gift and inheritance tax law and income tax law do recognise trusts, even though they are described as a "pool of assets, governed by foreign laws and aiming on the binding of assets".

The taxation of trusts is rather severe in Germany, especially in the case of distributions from the trust to beneficiaries in Germany. However, the Federal Fiscal Court stated in July 2019 that, throughout the existence of a foreign foundation (and thus probably also of a trust), any distribution of trust principal or income to a beneficiary or remainderman in Germany who does not have a legal claim to the assets is not subject to German gift tax. The Bavarian tax authority confirmed the opinion expressed by the Federal Fiscal Court in a letter dated 5 March 2020.

The Federal Fiscal Court issued three more decisions in 2021 regarding the taxation of trusts. A trust is transparent for German tax purposes if the settlor still has power over the assets of the trust. In this case, the settlor is seen as the direct owner of the trust assets and hence the establishment of the trust is not subject to gift tax. If the settlor does not have power over the trust assets, the trust is considered to be opaque.

In 2023, the German tax authorities published a new decree on the application of the Foreign Tax Act, which, among other things, addresses the income taxation of trusts: if the trust assets can be attributed to the persons behind the trust pursuant to general tax principles, the trust qualifies as transparent. The assessment is determined according to how the agreements are structured and how they are implemented in each individual case. If, according to the underlying agreements, the settlor can dissolve the trust at their free will and the assets are then distributed to the settlor, a transparent fiduciary agreement for German tax purposes can usually be assumed. Incidentally, ancillary agreements such as letters of wishes can also be included in the assessment.

Distributions from a foreign opaque trust to a German resident are generally subject to income tax and may simultaneously be subject to gift tax. The income of an opaque trust that is not distributed to the beneficiaries may also be attributed to German resident beneficiaries for income tax purposes.

In 2023, the Muenster Fiscal Court ruled that distributions might be subject to income tax as well as gift tax in the event of dissolution of the trust. However, a step up for income tax purposes was granted.

Taxation of crypto-assets

The German Federal Finance Ministry released its guidelines regarding the taxation of crypto-assets in 2022, defining common terms such as mining, tokens, wallets and staking. According to the tax authorities, each transaction involving a crypto-asset of any kind may qualify as a taxable event, even if the transaction does not involve an exchange into fiat-money. The mere trading of crypto-assets (even in great volume) does not qualify as a commercial activity from a German tax perspective if such activity is conducted in the usual manner of private investors.

If crypto-assets are privately held, they can be sold income tax free after a holding period of more than one year. This is not the case for crypto-assets that qualify as commercial assets. If the sale of the crypto-assets is subject to German income tax, the gain is calculated on the basis of either the first-in-first-out method or the average method, at the taxpayer's discretion. Special activities like forging or mining crypto-

assets are always considered as commercial activities.

German limited inheritance tax liability in case of a real estate legacy

In 2022, the Federal Fiscal Court ruled that German real estate was not subject to limited inheritance tax liability if it was transferred by bequest. Generally, German real estate is subject to limited inheritance tax liability, especially if the beneficiary is appointed as heir. However, if the beneficiary was "only" a legatee and according to the applicable law of succession a legatee only acquires a claim against the heir to transfer the real estate, this claim was not subject to limited inheritance tax liability. This principle also applied if the real estate was later transferred to the legatee in order to fulfil the claim. The German legislature then amended the Inheritance and Gift Tax Act to put domestic and foreign legatees on an equal footing.

Application of German forced heirship law despite choice of English law of succession

In 2022, the German Federal Court ruled that German forced heirship law was applicable even though the testator, an English national, had chosen English law to govern his succession. The last habitual residence of the testator was in Germany and hence German law of succession was generally applicable. According to the German Federal Court, the choice of English law was (partially) in violation of the German ordre public since English law of succession does not provide for any kind of forced heirship rights. Therefore, the choice of English law was (partially) invalid and, consequently, German forced heirship law was applied.

Deductions of liabilities in case of limited inheritance tax liability

Generally, estate liabilities are deducted from the taxable acquisition. In the case of limited tax liability, debts and encumbrances are not deductible insofar as they are not economically related to assets that are subject to limited tax liability. Therefore, the Federal Fiscal Court ruled that claims arising from the compulsory portions were not deductible in the case of limited inheritance tax liability. In 2021, the CJEU ruled that this provision violates the free movement of capital. The German legislature is therefore working on an amendment to the above provision. A pro rata deduction will probably be possible in the future.

Tax relief of 10% for residential properties in non-EU/EEA countries

In principle, a 10% tax relief for gifts and inheritances is available for personally held real estate that is located in Germany, the EU or the EEA and let for residential purposes. In 2023, the CJEU ruled that this provision violates the free movement of capital because properties in countries other than the EU/EEA are excluded from this relief. In the future, this relief will probably also be applicable to properties in non-EU/EEA countries that exchange inheritance and gift tax information with Germany.

Double taxation convention with Sweden

Germany has entered into six double taxation conventions for inheritance and gift tax. The double taxation convention with Sweden came into effect in 1992. Sweden abolished its estate and gift tax in 2005. In 2023, the German Federal Fiscal Court ruled that a donor or decedent cannot be a resident of Sweden within the meaning of the double taxation convention because the country of residence is determined by the unlimited tax liability. Since Sweden

no longer has estate and gift tax, residency cannot be established in Sweden. Therefore, the convention does not offer protection even if the donor has their centre of life in Sweden and the donee is only resident in Sweden for tax purposes. The donor's residence in Germany is sufficient.

Extended unlimited inheritance and gift tax liability does not violate the Constitution or European law

The extended unlimited inheritance and gift tax liability applies if the deceased/donor or the heir/legatee/donee is a German citizen who left Germany for not more than five years (ten years in the case of Germany–USA). In 2022, the Federal Fiscal Court ruled that the extended unlimited inheritance and gift tax liability does not violate the principle of equality, the freedom to leave the country or the free movement of capital because the nationality of the parties involved establishes a sufficient link to Germany for tax purposes.

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