§ 1—Taxable Transactions

(1) Subject to the inheritance tax (gift tax) are
   1. the acquisition by way of death;
   2. gifts inter vivos;
   3. earmarked gifts;
   4. the assets of a foundation, provided it is substantially set up in the interest of a family or of certain families, and an association that is essentially focused on the tying up of assets in the interest of a family or certain families, at intervals of 30 years since the time as specified in § 9 para. 1 no. 4.

(2) Unless otherwise specified, the regulations of this act regarding acquisition by reason of death also apply to gifts and earmarked gifts; the regulations regarding gifts also apply to earmarked gifts inter vivos.

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A. Overview

1. What is subject to the German Inheritance Tax and Gift Tax is conclusively regulated in para. 1. Details are explained in §§3–8.

2. Transactions liable to tax that for the acquirer result in an accrual of assets by law or contract are acquisitions by way of death\(^1\) or gifts inter vivos.\(^2\) In practice, these are also for international practitioners of major relevance. As a rule, these acquisitions are based on the Civil Code. The former are stated in detail in § 3; the latter in § 7. Earmarked gifts,\(^3\) based on a corresponding disposition of the deceased or the donor, are explained in detail in § 8. The taxation of foundations and associations set up in the interest of a family is regulated in § 1 para. 1 no. 4. Attention is to be paid to particularities in the case of non-domestic foundations.

3. The differentiation between inheritance tax and gift tax has no practical significance. A clear distinction is achieved by the respective different taxable events (e.g., § 3 or § 7).

B. Transactions liable to tax pursuant to § 1 para. 1 no. 4—taxation of foundations and associations set up in the interest of a family

4. The rationale of the taxation of foundations (so-called “Stiftung”) and associations set up in the interest of a family is to prevent a final inheritance tax exemption for the assets tied therein.\(^4\) Therefore, an acquisition by the next generation, consisting of two children, is assumed at intervals of 30 years.

I. Foundations set up in the interest of a family

1. Civil law principles

5. A domestic foundation set up in the interest of a family is defined as a foundation, which represents the interest of a certain family or several certain families, or which is mainly set up in the interest of a family or several certain families. Foundations with legal capacity are regulated in the provisions of §§ 80 and the following of the Civil Code, as well as in the respective provisions for foundations of the German federal states. The formation of

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1 \(^1\) § 1 para. 1 no. 1.
2 \(^2\) § 1 para. 1 no. 2.
3 \(^3\) § 1 para. 1 no. 3.
4 \(^4\) Cf. Bundestag printed matter 7/1333, 3.
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foundations is based on an act of foundation, which includes the foundation’s purpose, its assets, and organization, and requires the recognition of the respective competent authorities. The beneficiaries of the foundation are only granted the administration and/or the usufruct. As a consequence, a disposition of the assets is excluded.

Foundations without legal capacity, as well as dependent foundations, have no own legal personality and thus do not come under § 1 para. 1 no. 4. If no beneficiaries are specified, an earmarked gift may exist.

2. In the interest of a family

The term family comprises all persons who are related with each other by marriage or family relationship.

Interests of a family or families consist of all possible asset-related interests. This also includes economic benefits resulting from the foundation’s assets, for example, the gratuitous making available of housing for use or the gratuitous use of services. Nonetheless, this requires a secure legal position of the family members in the charter of association.

Furthermore, the economic interests of the family’s beneficiaries must be substantial. In the view of the financial administration and the jurisdiction of the Federal Finance Court, it is sufficient if the foundation’s assets are available for use or the beneficiaries may receive earnings from the foundation. If the foundation’s charter of association contains several purposes, an overall assessment has to be made, whereupon it is to be paid particular attention to the influence of the family’s beneficiaries on the foundation’s management.

3. Intervals of 30 years

It is of decisive importance, whether or not the family’s beneficiaries had the possibility to use the foundation’s assets or to receive earnings from the foundation for the full period of 30 years. The substitutional inheritance tax is chargeable at intervals of 30 years after the first transfer of assets to the foundation or association.

5 Civil Code §§ 80, 81 para. 1.
6 Cf. § 8 for details.
8 Cf. fn. 13.
9 Cf. fn. 13.
10 § 1 para. 1 no. 4.
II. Associations set up in the interest of a family

An association with legal capacity is defined as a group of people established for realizing a common purpose based on a corporate statute on a lasting basis. Otherwise, it can be referred to the explanations for foundations set up in the interest of a family.11

III. Chargeability of tax

The substitutional inheritance tax for foundations and associations is raised on their existing assets on the valuation date. Services rendered to the beneficiaries are not deductible.12 Upon reversion, these services are tax-exempt for the beneficiaries, insofar as they are covered by the charter of association. The same applies to the burial costs of the deceased.13 The tax exemptions of § 13 para. 1 no. 1–3 and §§ 13a, 13c, 13d, § 28a are applicable. Consequently, the tax relief for business assets can be granted as well.

The assets, which are subject to the substitutional inheritance tax, are taxed as if transferred from parent to children. Consequently, a tax allowance of EUR 800,000 is granted in total.14 The substitutional inheritance tax is calculated according to the tax rate, which applies to the half of the assets that are subject to tax.15 The person liable to tax is the foundation or association.16 Thereby, the tax liability can be paid in equal amounts within a period of 30 years, based on an interest rate of 5.5%.17

IV. Formation and dissolution of the foundation

If the formation of a foundation occurs through a foundation agreement inter vivos,18 the tax is chargeable pursuant to § 9 para. 1 no. 2 at the time of the transfer of the assets; in the case of a formation through a disposition mortis causa,19 at the time of recognition by the respective competent authorities.20

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12 § 10 para. 7.
13 § 10 para. 5 no. 3.
14 § 15 para. 2 sent. 3 and § 16 para. 1 no. 2.
15 § 15 para. 2 sent. 3.
16 § 20 para. 1.
17 § 24.
18 § 7 para. 1 no. 8.
19 § 3 para. 2 no. 1.
20 § 9 para. 1 no. 1 subpara. c).
these cases, generally, tax class III is to be applied. The same occurs in the case of future endowments, which come under § 7 para. 1 no. 1.

Exceptions arise, in contrast to associations set up in the interest of a family, for foundations set up in the interest of a family, as in order to determine the tax class, the family relationship of the most distant beneficiary to the founder, according to the deed of foundation, is decisive.\textsuperscript{21} In this context, tax authorities also refer to future beneficiaries of the foundation.\textsuperscript{22}

The transfer of assets to a non-domestic foundation is only subject to the inheritance tax or the gift tax if, in accordance with the agreed regulations and provisions, it can dispose de facto and legally freely of the assets irrespectively of the founder.\textsuperscript{23} In this context, it must be taken into consideration that a non-domestic foundation continues to be subject to the substitutional inheritance tax if its place of management is located in Germany.\textsuperscript{24}

A modification of the charter of association by increasing the number of beneficiaries, who were previously not entitled as beneficiaries, leads, according to the tax authorities’ opinion, to a new formation of the foundation if thereby a more unfavorable tax class would have applied at the time of the formation of the foundation.\textsuperscript{25} The same applies if the foundation’s nature is changed by a modification of the charter of association.\textsuperscript{26} The notional formation of the foundation thus leads to a dissolution of the previous foundation, which is not subject to tax.\textsuperscript{27}

The dissolution of a foundation or association is also tax privileged.\textsuperscript{28} The donor is deemed to be the founder or the person who transferred the assets to the foundation or association;\textsuperscript{29} the tax reduction pursuant to § 26 may apply. Therefore, in case a foundation set up in the interest of a family is converted to a charitable foundation, its acquisition is tax-exempt.\textsuperscript{30}

\textsuperscript{21} § 15 para. 2 sent. 1.
\textsuperscript{22} Cf. Inheritance Tax Reg. R E 1.2 para. 4 sent. 4 (2011).
\textsuperscript{24} § 2 para. 1 no. 2.
\textsuperscript{26} Cf. Inheritance Tax Reg. R E 1.2 para. 4 sent. 2 (2011).
\textsuperscript{27} Cf. Inheritance Tax Reg. R E 1.2 para. 4 sent. 5 (2011).
\textsuperscript{28} § 7 para. 1 no. 9.
\textsuperscript{29} § 15 para. 2 sent. 2.
\textsuperscript{30} § 13 para. 1 no. 16.
V. Non-domestic foundations set up in the interest of a family

Non-domestic foundations set up in the interest of a family are not subject to the substitutional inheritance tax if they do not have their place of management within the domestic territory. On the one hand, this requires that according to the charter of association, the founder cannot dispose de facto and legally freely of the foundation’s assets any more.\(^{31}\) Otherwise, these assets are still attributed to the founder’s estate. It should be assessed carefully, whether this is actually the case from a German point of view. Nevertheless, legal uncertainty is likely to remain to some degree, if no binding ruling is requested. On the other hand, attention has to be paid to the members of the board of the foundation neither having their residence nor their habitual abode in Germany.

It has to be considered that the initial formation of a non-domestic foundation is not tax privileged—in contrast to domestic foundations. However, in the case of the dissolution of a non-domestic foundation, the tax privilege of § 15 para. 2 sent. 2 should be applicable.\(^{32}\) For persons who are subject to limited tax liability pursuant to § 2 para. 1 no. 3, only the domestic assets within the meaning of § 121 of the Valuation Act are subject to tax.

It also has to be noted that the relocation of the registered office of a foundation to non-domestic territory—and vice versa—may result in a notional dissolution or new formation of the foundation with all consequential tax implications.\(^{33}\)

C. Application of the regulations for gifts inter vivos and earmarked gifts (§ 1 para. 2)

Unless otherwise specified, the regulations regarding acquisitions by way of death also apply to gifts and earmarked gifts; the regulations regarding gifts also apply to earmarked gifts inter vivos.\(^{34}\) Hereinafter, the most important regulations in practice are listed, which are not applicable to gifts inter vivos:

\(^{32}\) Cf. § 15 recital 27.
\(^{33}\) Cf. § 1 recital 17.
\(^{34}\) § 1 para. 2.
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The following regulations, which are important in practice, are only applicable for gifts:

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