

German inheritance tax law (IHT) with reference to Business Taxation

Abstract

Inheritance tax¹, which is leviable on the value of an estate on death, is generally perceived as an unfair tax, and is frequently cited by clients as a significant factor in their decision to relocate assets or fiscal residence. Yet the territorial scope of this tax is increasingly couched by taxing States in terms broad enough to counter most planning strategies, leading to severe consequences especially where the client's heirs remain residents of the taxing State.

The purpose of this paper is to consider the case against inheritance tax from a general standpoint, before specifically highlighting some potential pitfalls that can materialise in connection with Germany -based inheritance tax planning structures.

The tax is set up as a tax on a case of inheritance, so that it is connected to the actual passing of inheritance to each heir, legal inheritor, legatee or other recipient. Its connection point is not the deceased person's entire legacy of assets as a whole - as in the estate tax system used by other countries - but rather only the assets received by the relevant heir after all estate obligations have been deducted.

In this article, we broadly discuss [Content]

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1. Or estate duty as it is otherwise known.

1] The concept of inheritance tax

The most compelling argument against inheritance tax is probably that of double taxation, in the sense that it charges an estate comprised of assets that have already been subject to other taxes. Assets typically found in an estate on death include a principal home, other immovable properties, investments in securities, etc. that will have been acquired with after-tax income. Likewise, any savings held in a bank account on death are likely to have incurred income or capital gains taxes.

Unfairness in inheritance tax also lies in the fact that it is on wealth rather than income. Indeed, it is usually family-business owners who are hit hardest by inheritance tax, due to their "asset rich, cash poor" status. In other words, such estates often consist of assets in the form of real estate, stock in trade, plant and equipment, etc. but not of liquid funds. The value of the estate « on paper » may be considerable, giving rise to a hefty estate duty bill that cannot be paid in the absence of available cash funds. In those circumstances, heirs may find themselves compelled to borrow large amounts that will be difficult to service using revenues from the inherited business, or even to sell all or part of that business in order to settle the tax bill.

It is also argued that estate duty is a disincentive to savings and investment and, conversely, an incentive to spending one's fortune away. For instance, Nobel laureate Professor Joseph Stiglitz has expressed the view that estate duty fosters consumerist behaviour: *"prohibitively high inheritance tax rates generate no revenue; they simply force the individual to consume his income during his lifetime."*

Finally, high compliance and administrative collection costs (involving frequent tax audits) mean that actual revenue from inheritance tax can be relatively marginal for a government.

Thus, independently of the oft-quoted judicial pronouncement whereby *"Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes"*², no moral qualms should interfere with tax planners' creativity when practising in the field of inheritance tax, as this does not necessarily entail an economic disservice to their clients' current or former State of fiscal residence.

Basic domestic inheritance tax planning essentially involves two techniques: on the one hand, taking advantage of the exemptions expressly provided by statute (e.g. *inter vivos* gifts to descendants within certain thresholds, estate duty exemptions on the principal residence, non-chargeable bequests to surviving spouses, etc.), and on the other hand, choosing amongst the myriad life-insurance based schemes readily available on the market.

On the offshore front, planning is generally based on the relocation of assets and/or residence to a fiscally attractive jurisdiction – which often carries the added advantage of allowing for anti-forced heirship structuring. To that end, Germany offers several opportunities.

2. Judge Learned Hand, in *Helvering v. Gregory*, 69 F.2d 809, 810-11 (1934), echoed later by Lord Tomlin in *IRC v. Duke of Westminster* (1936) 19 TC 490: "Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax".

2] German inheritance tax (IHT) planning

Germany has a unified inheritance and gift tax called “Erbschaft- und Schenkungsteuer” (ErbSt). ErbSt is imposed on any transfer of property at death or by gift (or by deemed gift). The basis of assessment is the benefit accruing to the transferee (beneficiary or donee), not the estate itself. The ErbSt is regulated on a federal level, although the tax revenue is assigned to the federal states (Bundesländer) of Germany.

Note that in the case of German family foundations, there is a deemed taxable transfer of property every 30 years, which is subject to unlimited German ErbSt (recurrent charge). The 30-year period starts on the date of the first transfer of property to the German family foundation.

If neither the deceased/donor nor the heir/donee is a resident, only German situs property is subject to inheritance or gift tax.

The tax rates depend on the degree of the relationship between the deceased/donor and the beneficiary and the value of the taxable property transferred and range from 7% to 50%, with various exemptions available. Business property/assets are valued at fair market value. Under certain conditions, the gift or inheritance of business property can be 85% or 100% tax free. In December 2014, the Federal Constitutional Court ruled that the extensive exemptions for business property are not in line with the German constitution. The legislator had been requested to revise the law by 30 June 2016 but the legislation had not been finalized as at that date. It is, however, the intention that a new law will be implemented during 2016 and applied with effect from 1 July 2016.

The liability for inheritance tax arises at the time of death and that for gift tax at the time the gift is made.

Rates

The applicable tax rate depends on the tax class of the acquirer (see below) and the value of the taxable acquisition. The tax assessment basis is the taxable value of the assets transferred after exemptions and reliefs.

Taxable value of the acquisition exceeds	Acquirer in		
	Tax class I	Tax class II	Tax class III
EUR - 0	7	15	30
EUR 75,000	11	20	30
EUR 300,000	15	25	30
EUR 600,000	19	30	30
EUR 6 million	23	35	50
EUR 13 million	27	40	50
EUR 26 million	30	43	50

The tax class of the acquirer depends on the relationship of the acquirer (donee or heir) to the donor or decedent. Acquirers are divided into three tax classes based on their relationship to the donor or decedent:

Tax class I:

- The spouse or partner in a registered same-sex partnership. This should include foreign registered partnerships if such a form of partnership is legally recognized under foreign law
- Children and stepchildren
- Descendants of children and stepchildren
- Parents and ancestors (acquisition by death only)

Tax class II:

Parents and ancestors (acquisition by gift)

- Siblings
- Nephews and nieces
- Stepparents
- Sons-in-law and daughters-in-law
- Parents-in-law
- Divorced spouse or the partner in a dissolved registered same-sex partnership

Tax class III:

- All other individuals and legal entities (including foundations), and special purpose funds

3. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide-2019

3] Trigger Point – German Inheritance Tax (IHT) Liability

Transfers of worldwide net property are taxable in Germany if the deceased/donor or the heir/donee is a resident at the time of the deceased's death or at the time when the gift is made, i. e. if one of them is

- An individual with a home or habitual abode in Germany;
- A German citizen who has been staying abroad for no longer than five years;
- A German citizen who lives abroad and is paid by the German government; or
- A corporation, association or estate with its place of management or registered office in Germany.

i] Place of residence

Under German tax law, an individual's place of residence is the place (dwelling or domicile) that he or she occupies under circumstances that indicate that he or she will retain and use it on more than a temporary basis. Residence requires an intent to stay, which must be evidenced by objective criteria. The German tax authorities' interpretation of intent to stay is quite broad: such intent will be presumed if an owned or rented dwelling is held available for the exclusive use by the owner, even if it is used only from time to time. Therefore, an individual can be resident in different places at the same time.

ii] Habitual place of abode

The term habitual place of abode implies the location where a person is physically present under circumstances that indicate that his or her presence in that particular place is not merely temporary. As a general rule, a habitual place of abode, and thus tax residence, is deemed to exist if the individual's stay in Germany exceeds six months. In this case, he or she will be deemed resident for the entire period of his or her stay in Germany, including any brief interruptions.

iii] Residency and double-taxation treaties

Special rules on the consequences of dual residency apply with regard to certain double-tax treaties (DTTs). For example, according to the German-US DTT, an individual who is considered a resident in both contracting states pursuant to national tax law but who is a citizen of only one of the contracting states will be deemed to have its place of residence for purposes of the DTT in that state for a period of 10 years after becoming a resident for inheritance- and gift-tax purposes in the other state

The (direct or indirect) transfer of German real estate is basically subject to real estate transfer tax of between 3.5% and 6.5%, depending on the federal state in which the real estate is located. But a transfer by inheritance or gift is usually exempt from real estate transfer tax.

Who is liable to pay inheritance tax?

a) Unlimited liability

Any transfer of worldwide net property either at death or by gift (or by deemed gift) is generally subject to unlimited taxation if either the decedent (donor) or the beneficiary (donee) is considered to be resident in Germany for tax purposes. German tax residence exists if any of the following conditions apply:

1. An individual has a residence or his or her habitual place of abode in Germany.
2. A nonresident German citizen has been resident for tax purposes in Germany at any time within the last five years prior to a transfer at death or by gift.
3. A nonresident German citizen is employed by a legal entity organized under German public law. In this case the
4. dependents who live in the household of such German citizen have a German tax residency as well.
5. A corporation or any other legal entity or estate has its place of management or legal seat in Germany.

b) Limited liability

Any individual or legal entity who is not resident as aforementioned will be subject to ErbSt only upon the transfer of net property, which is regarded as German-situated according to German national tax law. German-situated property means:

1. Real estate, agricultural and forestry property situated in Germany
2. Assets pertaining to a permanent establishment of a commercial business located in Germany
3. Shareholdings in German resident corporations if the shareholder owns (individually or jointly with other persons closely related to the shareholder) directly or indirectly at least 10% of the registered share capital
4. Inventions, designs and topographies recorded in a German register
5. Assets that have been leased to a commercial business operated in Germany
6. Mortgages or any other receivables secured by German-situated real estate or by German-registered ships, except for such receivables for which negotiable bonds have been issued
7. Claims arising from silent partnerships and profit participating loans if the debtor has a residence, his or her habitual place of abode or, in case of corporations, its place of management or legal seat in Germany
8. Any beneficial interests (e.g., right of usufruct) in the aforementioned assets

A nonresident individual as decedent or donor is subject to an extended limited tax liability (e.g., with regard to capital claims vis-à-vis German debtors, with regard to other German assets not mentioned above and with regard to assets that would be subject to German controlled foreign company (CFC) taxation in the case of a German resident), provided all of the following conditions are met:

1. Such individual was subject to unlimited income tax liability in Germany within the last 10 years prior to a transfer at death or by gift.
2. Such individual was cumulatively a German national and subject to unlimited German income tax liability for a combined period of 5 years within a 10-year time period prior to the end of the unlimited income tax liability.
3. Such individual is resident of a low-tax jurisdiction according to the German CFC legislation.
4. Such individual has substantial economic interests in Germany within the meaning of the German CFC legislation.

Trusts

German civil law does not contain specific provisions for trusts, and Germany has not ratified the Hague Convention on

the Recognition of Trusts dated 20 October 1984. Therefore, German civil law does not recognize trusts.

For example, a foreign trust with German-situated property set up by a will is invalid from a German civil law perspective. Any trust that is created will be assimilated to the legal arrangement under German civil law that most closely resembles the provisions of the trust (e.g., foundation, aggregation of property, nominee agreement, execution of a last will).

Taxation of the trust

The German tax authorities classify a trust basically on the basis of the following criteria:

- **Revocable trust:** the ownership of the assets is regarded as not being transferred to the trust. Income and assets of the trust remain taxable in the hands of the settlor.
- **Irrevocable discretionary trust:** the ownership of the assets is regarded as being transferred to the trust. The trust itself with its income and assets is subject to tax.

Taxation of the endowment with capital — inheritance and gift tax

The German tax treatment of a trust created under a foreign jurisdiction depends mainly on the economic substance of the foreign settlement. The basic criterion for determining whether the formation of a trust does constitute a taxable event under German tax law depends on whether the settlement involves a final and irrevocable disposal of ownership of the transferred assets. The transfer of assets to a trust is only subject to gift tax if the trust is then factually and legally able to freely dispose of the assets. According to the German Supreme Tax Court, the review of this criterion should be limited to the civil law position. The ruling stated that the party to whom the assets are attributable from an economic perspective is irrelevant. Consequently, the structure must be deemed a revocable trust and not constitute a transaction subject to gift tax if the settlor has reserved the following rights under the trust's constitution:

- To amend the constitution at any time
- To revoke the trust at any time
- To issue instructions to the trustee

Accordingly, the creation of a grantor's trust is, as a rule, not subject to gift tax if the settlor of a grantor's trust reserves the right to issue wide-ranging instructions to the trustee that extend to revoking the trust.

Tax class III is applied to foreign trust transfers that are subject to gift tax.

4. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide-2019

5. <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-germanyhighlights-2020.pdf>

6. https://www.pwc.com/hu/hu/german_business_group/assets/doing_business_in_germany_guide_2017.pdf

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3] German Tax exemptions provision under inheritance Tax (IHT) Law

There are several asset and purpose-related exemptions and personal exemptions. Furthermore, there are certain categories of tax-favored assets.

Asset and purpose-related exemptions

- Household goods including linens and clothing in the case of receipt by persons of tax class I, as long as the value does not exceed 41,000 Euro.
- Land ownership or part thereof, objects of art, art collections, scientific collections, libraries and archives at 60 percent of their value, if the preservation of these items is in the public interest due to their significance for art, history or science, if the annual costs generally exceed the gained income, and if the objects are or are made available for research purposes or public education, to a reasonable extent.
- Land ownership or partial land ownership, which is made accessible without legal obligation for the use of the general public or a public charity, and whose preservation is in the public interest, if the annual costs generally exceed the gained income.
- Financial contributions among living persons for the purpose of appropriate support or for education of the intended heir.
- Normal occasional gifts.
- Financial contributions dedicated exclusively to churches, non-profits or charity purposes, if their use is ensured to meet the specified purpose.
- Financial contributions to political parties according to § 2 of the Party Law.

Tax exemption for self-used residential premises

In the case of inheritance or gifting of self-used residential premises located in Germany, a member state of the EU or a state belonging to the European Economic Area, under some circumstances this transfer can be completely exempted from tax.

Allocation of built-up land among living persons (gifting) to the spouse or partner are always tax free if there is an apartment in the building for the owner's use (as a family home) or with the gifting the other is released from entered obligations in connection with the purchase or construction of the family home.

In the case of the inheritance of a family home in which the bequeathed has his own dwelling used for residential purposes up until his death, or if he was prevented by urgent reasons from using it himself, but which is intended for immediate use by the receiving spouse or partner for their own residential purposes (as a family home), the receipt shall remain tax free with the further condition that the recipient maintains this self-use for at least ten years.

Children - or grandchildren, if the children die first - are released from inheritance tax under the same conditions as spouses or partners in terms of a built-up piece of land that they inherit, if they begin to use it themselves immediately and with the additional condition that the floor area of the apartment must not exceed 200 mtr.

Tax exemptions for business assets

According to the stipulations of §§ 13a and 13b in the German Inheritance Tax Law [ErbStG], 85 percent of the value of business assets, assets of agricultural and forestry businesses and certain portions of corporations are exempt from inheritance tax. This is called the relief deduction (Verschonungsabschlag).

The main purpose of this exemption is the continuation of the business about its employees. Therefore, this exemption has a condition for businesses employing 20 or more persons: in a period of five years, the total salary sum must not be lower than four times the outgoing salary sum. The outgoing salary sum is the average annual salary sum of the business in the last five years before inheritance. The exemption is not applicable if the business is sold within the five-year retention period, and in case of partial sale, the exemption applies only partially.

The recipient may opt for a seven-year retention period instead of five, and must in this period attain seven times the outgoing salary sum instead of four times. By extending to seven years, the recipient gains a relief deduction that applies to 100 percent of the received business assets instead of 85 percent (making it completely free of inheritance tax).

Inland business assets and the relevant business assets of a business location within the EU or in a state of the European Economic Area are benefited. The benefited business assets must not consist of more than 50 percent, or in case of the seven-year retention period option not more than 10 percent, of administrative assets, whereby the law defines this concept precisely about the characteristic of serving the actual business.

In the usual case of the five-year retention period, 15 percent of the business assets are subject to inheritance tax. But if this value is not over 150,000 Euro, it shall also remain untaxed (deducted amount). This regulation ensures that the deduction amount only benefits smaller businesses.

Personal Exemption

In addition to the asset- and purpose-related exemptions, personal allowances as described below are available upon taxable acquisitions. Please note that these allowances will be granted only once within a rolling 10-year period in each transferor/transferee relationship.

Beneficiary or done	Allowance (EUR)
Spouse and the partner of a registered same-sex partnership	EUR500,000
Children, stepchildren and children of deceased children	EUR400,000
Children of living children	EUR200,000
Other persons in tax class I	EUR100,000
Persons in tax classes II and III	EUR20,000

For any transfer between nonresidents, which is subject only to limited German tax liability, these allowances are reduced in accordance with the ratio of the assets acquired which are not subject to German limited tax liability to the assets acquired in total (worldwide), again based on a rolling 10-year period.

An additional allowance of up to EUR256,000 is granted to the surviving spouse and the surviving partner of a registered same-sex partnership, provided that the surviving spouse or the surviving partner of a same-sex partnership is not entitled to pension payments upon the death of the spouse or the partner of a registered same-sex partnership. If so, the allowance is reduced by the net present value of such pension claims. An additional allowance of up to EUR52,000 is granted to surviving children (up to age 27) depending on their age. Any entitlement to pension and similar payments reduces the allowance in the same way as described for the spouse or the partner of a registered same-sex partnership. In the case of only limited German tax liability, these allowances apply only if the deceased or the acquirer is resident in a state which provides for an administrative assistance in tax matters.

⁶As per report in year 2019 Germany Millionaires pay little inheritance tax in Germany. Germans only paid around 5% tax on inheritance or gifts totalling €31 billion last year, a newspaper report has revealed. Critics say Germany is a "tax haven for multimillionaires".

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7. <https://www.weforum.org/agenda/2019/11/the-great-wealth-tax-debate/>
 8. <https://www.dw.com/en/millionaires-pay-little-inheritance-tax-in-germany/a-51498361>
 9. <https://www.german-tax-consultants.com/german-taxes/inheritance-tax-erbschaftsteuer.html>
 10. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide-2019

4] Scope and Efficacies of Double Taxation Avoidance Agreements and OECD guidelines

In cross-border cases, foreign inheritance or gift tax is credited against the German tax to the extent the foreign property is taxed in Germany. Inheritance and gift tax treaties apply with Denmark, France, Greece, Sweden, Switzerland and the US.

Different nations have different mechanism for taxation and taxation mechanism of one nation may not match with the taxation mechanism of other nation. As a result, the same income of the taxpayer may get taxed in both the countries (i.e. the home and the host country). Therefore, countries enter into Double Tax Avoidance Agreement (DTAA's) to prevent such double taxation of income earned in both countries.

The design of sensible tax policies requires that due consideration to their international ramifications. Analysis of tax design in economies entails all of the complications and intricacies that appear in closed economies, with the addition of many others, since multiple, possibly interacting, tax systems are involved.

More than 3000 bilateral income tax treaties are currently in effect and the numbers seems to be growing with time. Double taxation in tax treaties can be eliminated by either of the following means –

- allocation of sharing taxing rights
- exclusive right to tax
- provision of giving credit for taxes paid in the source state by the residence state
- for providing co-relative adjustment

Tax treaties ¹²

- **Unilateral rules**
Foreign tax on the acquisition of certain foreign assets by death or gift, which is comparable to the German Inheritance and Gift Tax, can be credited against the ErbSt falling to the acquisition of these assets.
- **Double-taxation treaties**
Germany has concluded estate, inheritance and gift tax treaties with the following countries: Denmark, France, Greece (applies only to inheritance tax regarding movable property), Sweden, Switzerland (applies only to inheritance tax; corresponding application to gift tax only for business assets and very specific cases) and the United States.

The definition of treaty provided in Article 2 of the Vienna Convention of Law of treaties, 1969 ('VCLT') reads as under –

'Treaty means international agreement concluded between states in written form and governed by international law, whether embodied in a single instrument or in two or more related instruments and whatever its particular designation'

The provisions are discussed below –

Article 2(1) of the tax treaty defines the subject of the Convention, stipulating that the treaty applies respectively to 'taxes on income and on capital' and 'taxes on estates and inheritances and on gifts' that are 'imposed on behalf of a Contracting State or of its political subdivisions or local authorities, irrespective of the manner in which they are levied'

Article 2(2) of the tax treaty gives a somewhat imprecise description of 'taxes on income and capital' and it states:

There shall be regarded as taxes on income and on capital all taxes imposed on total income, on total capital, or on elements of income or of capital, including taxes on gains from the alienation of movable or immovable property, taxes on the total amounts of wages or salaries paid by enterprises, as well as taxes on capital appreciation

Article 2(3) of the tax treaty provides that 'The existing taxes to which the Convention shall apply are in particular ...', the contracting states list the taxes covered for each country and existing at the time of signature of the treaty. The term 'in particular' clearly indicates that the list is not exhaustive. In contrast, Article 2(3) of the tax treaty in the Estates, Inheritances and Gifts Model Convention does not contain the phrase 'in particular'; the list therein is thus exhaustive.

Some treaties do not contain a general description of the taxes covered corresponding to paragraph 1 and 2 and omit the phrase 'in particular' in paragraph 3. In these cases, the enumeration is thus exclusive as to the taxes covered under the treaty. This option to exhaustively list the taxes covered is explicitly mentioned in the OECD Income and Capital MC.

The commentary to the OECD MC states that the list of taxes in force shall not be exhaustive but only an illustrative list to support the preceding Paragraphs of the Article. However, in principle it shall enumerate all the taxes to which the Tax Treaty applies, which are in force at the time of entering into an agreement.

Article 2(4) of the tax treaty aims to prevent the tax treaty from instantly becoming inoperative in case changes are made to the taxation laws of a contracting party that may affect the taxes covered by the treaty. The text provides that the tax treaty will automatically apply to all identical or substantially similar taxes imposed after the date of signature of the treaty. However, no criteria are specified regarding the categorization of a tax as 'identical or substantially similar'.

11. <https://www.ifo.de/DocDL/dice-report-2018-2-drometer-frank-hofbauer-p%C3%A9rez-rhode-schworm-stitteneder.pdf>

12. <https://data.oecd.org/tax/tax-on-property.htm>

13. https://www.ey.com/en_gl/tax-guides/worldwide-estate-and-inheritance-tax-guide-2019

5] Inheritance Tax regime in different tax jurisdiction

The property in possession of a person which passes onto his successors upon his death can be termed as Estate of such deceased person. Estate duty is tax on such Estate being passed on or beneficiary receiving the Estate, depending on how law is framed. Normally, the liability of Estate duty is restricted to the value of Estate.

Inheritance tax works on similar principle as Estate Duty and accordingly both the terms are often used interchangeably. However, in the USA these are two separate taxes, Estate duty is federal (centre) tax and inheritance tax is state specific tax applicable in certain states of US.

Furthermore, the collection mechanism and payment liability vary in case of Estate Tax vis-a-vis Inheritance Tax. Upon death of the person, his estate normally vests onto the executor (normally named in Will), who is responsible to pay-off all the dues, liabilities, expenses of deceased person. If needed, executor has the power to dispose portion of asset to discharge the liabilities and expense of deceased person. Liability to pay Estate Duty is on such Executor who needs to pay off applicable Estate duty before distributing remainder assets to intended beneficiaries. On the contrary Inheritance tax levied by specific states in the US are to be discharged by beneficiaries (bequest holders) and in most cases there is 100% exemption for state level inheritance tax, if immediate relatives (Class A relative) receive property through inheritance in US.

WORLD OVERVIEW

Countries	Type of Tax	Max Rate	Applicable Thresholds^[14]	HDI Ranking^[15]
<u>Developed Nation</u>				
France	Inheritance tax	45%	Yes (Euro 0.1 Mn)	24
Germany	Inheritance tax	30%	Yes (Euro 0.5 Mn)	5
Japan	Inheritance tax	55%	Yes (Yen 36 Mn)	19
United Kingdom	Estate Tax	40%	Yes (GBP 0.325 Mn)	14
United States	Estate tax + Inheritance tax	40%	Yes (USD 11.2 Mn)	13
<u>Developing Nation</u>				
Brazil	Estate Tax	8%	Yes (State specific)	79
China	No Estate Duty or Inheritance tax	86		
Mexico	No Estate Duty or Inheritance tax	74		

Russia	No Estate Duty or Inheritance tax since 2006	49		
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The facts in above table clearly demonstrate that developed countries with High GDP per capita and good social security infrastructure providing access to world class healthcare, transport and education can afford to levy Inheritance tax at higher rates on Estate Duty. However, for developing country, where capital creation is of paramount importance, inheritance tax, if at all should be levied, should be at sub 10% rate.

Estate or Inheritance tax regimes in some large countries:

1] USA: The US imposes an estate tax on the transfer of a decedent's worldwide estate for its citizens and residents – which means in case of persons having a US citizenship the worldwide estate is liable to pay the estate tax irrespective of them being domiciled or residents in USA. For an individual who is neither a US citizen nor a US resident (i.e., a non-resident alien), the gross estate includes only US situs property (including real estate and financial instruments) owned at death.

The rate of Estate taxes in USA peaks at 40%, with the estate and gift tax exemption threshold being \$5.49 million per individual for 2017. The exemption doubles to \$10.98 million for married couples filing joint tax returns. Besides the Estate tax being a federal tax, several states have a state-level estate tax over and above the federal limit.

2] United Kingdom: ¹⁷UK has a unified regime of estate and gift tax called inheritance tax (IHT). IHT applies to the value of an individual's estate when he or she dies (in which case he or she is deemed to make a transfer of the whole estate immediately before such time) and to certain transfers or gifts made during the individual's lifetime. The tax applies on the basis of the loss to the donor's estate that arises by reason of the transfer of value.

The taxation of individuals in the UK is largely determined by their domicile status or at times by their residential status, although residence is less important for IHT. IHT is levied on the worldwide estate of a decedent who was domiciled in the UK. While UK recognises the concept of domicile as a country considered as permanent home, IHT is applicable (with some variations) to deemed domiciled persons as well. The deemed domiciled and non-domiciled taxation laws have undergone significant changes in 2017, requiring careful reassessment of even existing planning in place, if any.

IHT is also levied on the UK sited assets of a person who was not domiciled in the UK. One should be aware and plan well before eyeing and buying that hot London property!

The standard rate of the Inheritance tax is set at 40% which is charged on the estate which is above the threshold, which is 325,000 pounds currently. If the estate is given to the children or grandchildren, the threshold increases to 425,000 pounds.

3] Canada: ¹⁸Canada does not have an Estate Tax but, after the death of a person, their estate is considered to have devolved upon their spouse and if there is no spouse then in that case, the deceased is considered to have sold all of his/her property at fair market price immediately before

his death. It often results in the recognition of some amount of gain or loss which is included in computing income in the year of death. These deemed gains are then taxed at the applicable capital gains tax rates.

The taxation of individuals in Canada is determined by residence. The deemed disposition at death applies to the worldwide assets of all Canadian residents at the time of death. In addition to the judicially developed tests, the Canadian Tax Act has provided statutory tests that may deem a person to be a Canadian resident. In the case of an individual, the key rule is that a person is deemed to be a resident for any tax year in which he or she spends 183 or more days in Canada. Separate rules apply if the person is considered a resident of more than one country.

Non-residents may also be liable for tax at the time of death if they own taxable Canadian property.

The introduction of IHT happened worldwide in developed countries like Netherlands, UK and Germany where Kings have left behind not only their legacy for legal heirs and next generation but also huge wealth for them and it is effective, say in UK and USA, because they have a very strong social security system in place. The concept of levying ED (Estate Duty) / IHT then spread over in various developed countries like Canada, Portugal, Sweden, USA, Israel, etc. and developing countries like Argentina, Russia, Mexico, etc. including India who introduced ED in 1953 on 19th Century English enactment.

Latest trends over the last few decades are that many countries like Australia, Russia, Sweden, etc. have abolished IHT / ED.

¹⁴Latest news from Ireland, Inheritance tax should be abolished for anyone inheriting an average priced home, as per statement given by president Mr Leo Varadkar.

14. Threshold apply slab-wise and dependent on relationship with recipient and in some cases asset type.

15. The Human Development Index (HDI) published on <http://hdr.undp.org> is a geometric mean of normalized indices in three key dimensions of (1) human development: a long and healthy life, (2) access to knowledge and (3) a decent standard of living (GDP per capita). – United Nations Development Programme

16. <https://www.independent.ie/irish-news/politics/varadkar-will-push-for-inheritance-tax-to-be-abolished-on-average-priced-homes-39303897.html>

17. <https://www.gov.uk/inheritance-tax/overview>

18. <https://www.canada.ca/en/revenue-agency/services/forms-publications/publications/rc4111-canada-revenue-agency-what-following-a-death/canada-revenue-agency-what-following-a-death.html>

6] Case Study - with reference to developing country (India) introduction of inheritance tax

Estate duty is also referred as pro-poor tax or Robinhood tax as its main objective is to reduce income inequality, wherein it recovers the tax from rich and the revenue collected is intended to be used for upliftment of poor society by spending on developing necessary infrastructure. As per recent study[i], India's richest 10% population hold 77.4% of country's total wealth and accordingly the need for tax like Estate Duty cannot be undermined.

However, considering the small tax base in India, where ~ 4% of Indian population pays income-tax, imposing additional taxes on them as Estate tax or Inheritance tax would create additional burden on the same tax payer base, it may disincentivise High Net-worth Individual (HNIs) from wealth creation for future generation, which is inherently part of Indian culture and break the ethos. To put this into perspective, let's look at an example of HNI engaged in family business earning profit of INR 1000 Crores and distributing entire profit after tax as dividend to himself and evaluate effective tax impact in with and without estate tax scenario.

Particular		Scenario 1 – Existing	Scenario 2 – Post IHT/Estate tax re-introduced @ say 30%
Profit Before tax in Business	I	1,000.00	1,000.00
Tax @ 34.94%	A	-349.44	-349.44
Profit After Taxation	PAT= (I-A)	650.56	650.56
Dividend Distribution Tax on Dividend of 539.64 Crores (Effective DDT @ 20.55%)	B	-110.92	-110.92
Dividend received by Individual (Profit after Dividend)	PAD=(PAT-B)	539.64	539.64
Additional tax on dividend @ 11.96%	C	-64.54	-64.54
Net Corpus created	NC=(PAD-C)	475.1	475.1
Estate Tax @ 30%	D	0	-285.06
Total Taxes	TT=(A+B+C+D)	-524.9	-809.96
Received by HNI family	HNI=(NC-D)	475.1	190.04
Effective tax on earnings	ETE=(TT/I)	52.49%	80.99%

India had the Estate Tax regime from 1953 to 1985. However, it was removed in 1985 with the realisation that Estate Tax had failed to bring equilibrium in the society. Prior to removal, estate duty was payable on a slab basis ranging from 7.5% to 40% of the principal value of the estate.¹⁸

It is noteworthy that since past few years, there has been widespread speculation that Estate tax will be reintroduced in India, but no formal proposal has yet been tabled before the Parliament.

Furthermore, Indians normally do not keep investment in liquid assets as they yield low returns. Therefore, to discharge Estate duty liability, Executor may have to sell/liquidate the illiquid asset like real estate at distress valuation. In such an event, while there may be erosion of capital, transaction at distress value would ideally be again tested for deemed income provision of section 50C/50CA and for purchaser under 56(2)(x) of IT Act, thereby making resulting in further taxation. In order to safeguard this, HNIs take term insurance of insured value matching the potential estate duty liability.

19. http://pib.nic.in/archive/docs/DVD_46/ACC%20NO%20917-BR/FIN-1953-10-06_1502.pdf

5] Concluding Thoughts

i] Democracies across the world have the inheritance tax built into their tax system. German has shown the will for bold structural reforms. Now is undoubtedly the time for a fair tax. The naysayers make some persuasive arguments. But these relate to design flaws. The “how to” rather than “whether to”. This tax is based on data.

Technology has made data on the financial side available. What is sorely lacking is data on the real assets side. For inheritance tax to function, robust mechanisms that digitally validate real assets holdings must emerge.

ii] It is illogical to tax an estate that has in a way already suffered income tax and capital gain tax. Merely introducing taxes with similar names as prevalent in developed countries would not put us on par with developed countries in terms of economic and financial stability. The basic idea for levying such taxes abroad is to generate revenue for social security programmed.

It will in a way burden that strata of the population, which is already paying substantial taxes and contributes to the direct tax collections in a big way. If at all such a tax is introduced, HNIs would always have the option to form family trusts. The family trusts would be out of the taxation net since no ownership is transferred but only the shareholding of the trust changes. The option of making a family trust outside country will also be available, which would not only result in avoidance of tax in developing countries but would also lead to accumulation of wealth outside the country. While the government is time and again promising the citizens of bringing back the accumulated wealth of certain persons stashed outside, inheritance tax might result in further stashing of wealth abroad. The need of the hour is a robust taxing mechanism and not for hit and trial mode in anticipation of finding a successful revenue collection model.

iii] In vogue of globalisation, whether Germany need to initiated negotiation to enter into IHT treaties with other countries to avoid double taxation.

Also, in an era of proliferation of mutual assistance provisions and extended territoriality of taxes, inheritance tax planners must be wary of strategies that are overly reliant on the benefits traditionally afforded by offshore trusts. In that respect, the current example of France is a "worst case scenario", but one that should prove most useful in terms of lessons to be drawn when devising structures from other jurisdictions.