

# Inheritance and Gifts in Germany

## The Growing Fiscal Importance of Inheritance Tax for the Federal States

In the current debate on the fundamental modernisation of income tax it is often forgotten that inheritance tax has also long been on the reform agenda. The present undervaluation of real estate and commercial assets is an infringement of the principle of equal and uniform taxation. At its present volume of around 3 billion euros inheritance tax only accounts for less than 1% of total tax revenues in Germany, but the trend is upward.

The data from the Socio-Economic Panel (SOEP) compiled by DIW Berlin in conjunction with Infratest Sozialforschung now makes it possible to give estimates of the annual volume of inherited assets in a breakdown by socio-demographic factors. According to the SOEP estimates, around 1.5% of all private households in Germany currently have an annual increase in assets of on average 65 000 euros from inheritance. Just under a further one percent of all households receive annual gifts of on average 30 000 euros. These transfers amount to income to private households of about 50 billion euros annually, which is more than 2% of GDP.

## The importance of inheritance and gifts tax in Germany

In accordance with the decisions of the Mediation Committee, the tax concessions on commercial assets for the purposes of inheritance tax were slightly reduced on 1 January 2004.<sup>1</sup> These changes in Accompany Budget Law came as something of a surprise, and we still await a further amendment to the taxation of private inheritance. The Social Democrats intend to change the regulations on inheritance tax as per 1 January 2006,<sup>2</sup> the main aim being 'appropriate' increases in the taxation of large private assets. The additional revenue is to be used for investment in the future, mainly in education.

<sup>1</sup> Cf. Erbschaftsteuer auf Betriebsvermögen steigt, in: *Financial Times Deutschland*, 19.12.2003; Stefan Bach and Jürgen Schupp: 'Pauschale Begünstigungen abbauen', in: *Süddeutsche Zeitung*, 31.12.2003.

<sup>2</sup> Decided at their Party Conference in Bochum in November 2003, cf. the documentation of the paper 'Unser Weg in die Zukunft' (Our Way into the Future) under [www.spd-parteitag.de/servist/FB/show/1451580/2003-11-18-scholz.pdf](http://www.spd-parteitag.de/servist/FB/show/1451580/2003-11-18-scholz.pdf).

Under the present legislation the market values of real estate are only assessed at about half the value of monetary assets,<sup>3</sup> but this is an infringement of the principle of equal and uniform taxation; it also encourages tax avoidance.<sup>4</sup> The Federal Fiscal Court has stated that these regulations are not in conformity with the constitution and has presented them to the Federal Constitutional Court for consideration.<sup>5</sup> A decision is not expected until next year at the earliest.<sup>6</sup>

Inheritance tax is an old tax that was even levied in Ancient Rome.<sup>7</sup> It was introduced in German states in the 17th and 19th centuries, and the revenue still accrues to the federal states. Almost all the industrial countries charge inheritance tax, but whereas in the Anglo-Saxon countries inheritance is traditionally taxed regardless of who inherits (estate tax), almost all the other European countries tax the heirs (inheritance tax or tax on assets received) and do take each heir's relationship to the deceased into account in assessing the tax payable. That is also the practice in Germany, and here the inheritance and gifts tax law has three classes, depending on the relationship between the heir or recipient of the gift and the deceased or the donor. The tax-free allowances and the rates of tax also depend on the amount involved (see box).

## Relatively high tax-free allowances in Germany

At present in Germany the undervaluation of assets and tax-free allowances result in tax only being charged on high amounts inherited or received as gifts.<sup>8</sup> An international comparison shows that the total volume of inher-

<sup>3</sup> In 1996 the decision of the Federal Constitutional Court of 22 June 1995 that the unequal treatment of real estate and capital assets was unconstitutional led to reform of the legislation on inheritance and gifts tax in a version of 27.2.1997. Further action by the legislature followed, the most important being the legislation allowing more tax concessions to foundations passed in 2000.

<sup>4</sup> The German Council of Economic Experts also strongly criticised the many tax concessions 'that are undermining the assessment basis for inheritance and gifts tax and are counter to the principle of equal and uniform taxation', Item 560, Annual Report for 2002/2003.

<sup>5</sup> Cf. decision by the Federal Fiscal Court of 22.5.2002, II R 61/99.

<sup>6</sup> Cf. 'Erste Bewegung im Erbschaftsteuerstreit', *Handelsblatt*, 14.1.2004.

<sup>7</sup> On the historical genesis of inheritance tax see Peter Meinecke: 'Erbschaftsteuer- und Schenkungssteuergesetz - Kommentar', 13th edition, Munich 2002, pp. 13ff.

<sup>8</sup> An example will make this clear. If a testator leaves real estate and buildings to a spouse and two children, and the property is assessed at about half its current market value, an inheritance of more than 1.4 million euros can be entirely free of tax to the heirs [(307 000 + 205 000 + 205 000) x 2].

## Inheritance and Gifts Tax in Germany

The legislation under which inheritance and gifts tax is charged in Germany is the Inheritance and Gifts Tax Law in the version as notified on 27 February 1997. The tax is levied on transfers of assets through inheritance or gifts during the donor's lifetime. The Law is based on the concept of a tax on acquisitions or accruals, and it contains three tax classes or rates of tax, which differ according to the relationship of the heir or recipient of the gift to the testator or donor (table B1); it also contains various tax-free allowances (table B2).

Table B1  
Rates of Inheritance Tax by Size of Inheritance

Value of taxable inheritance up to and including ....000 euros	Tax rate (%) in tax class		
	I	II	III
52	7	12	17
256	11	17	23
512	15	22	29
5 113	19	27	35
12 783	23	32	41
25 565	27	37	47
More than 25 565	30	40	50

Table B2  
Tax-free Allowances in Inheritance Tax by Tax Class

In euros

Tax class	Heirs	Personal tax-free allowances under § 18 Inheritance Tax Law	Personal exemption for recipient of a pension or social security benefits under § 17 Inheritance Tax Law (inheritance)	Tax-free allowance for household goods under § 13, Para. 1 (1a) Inheritance Tax Law (inheritance)	Tax-free allowance for other mobile goods (inheritance)
I	Spouses	307 000	256 000	41 000	10 300
I	Children, stepchildren, adopted children, descendants of deceased children	205 000	10 300 to 52 000 (scaled according to age up to 27)	41 000	10 300
I	Descendants of children not deceased, parents and grandparents (as heirs)	51 200	N.a.	41 000	10 300
II	Parents and grandparents (gifts), brothers and sisters, nieces and nephews, step-parents, children- and parents-in-law, divorced spouses	10 300	N.a.	10 300	N.a.
III	All other recipients	5 200	N.a.	10 300	N.a.

Spouses also have a claim to compensation for goods acquired during marriage, unless otherwise contractually agreed. The claim is for half of the difference between each partner's assets on the wedding day and the assets on the date of death. If the testator has achieved a higher growth in assets than the surviving spouse the claim to compensation can be deducted from the tax payable in the form of an additional tax-free allowance under § 5 Inheritance Tax Law.

inheritance and gifts tax revenue in Germany is rather below the average (cf. table 1). That is probably due mainly to the combination of considerable tax-free allowances for the closest relatives and high thresholds where the top rates apply. The top rate of tax payable by spouses and children is 30% in Germany, but it only applies to a taxable inheritance of more than 25 million euros, while in France the top rate, which is 40%, applies to less than 2 million euros. Some countries do have lower bottom rates of inheritance and donation tax, but they only give relatively low tax-free allowances to spouses and children, which can certainly result in higher revenue from

these taxes, as the example of Belgium shows. Italy and Switzerland are countries that largely refrain from taxing inherited assets and gifts, at least those accruing to close relations.

### New federal states greatly disadvantaged in inheritance taxation

In Germany revenue from inheritance tax has about doubled in the last ten years. In 2002 it was around 3 billion euros (cf. table 2), despite a reduction in revenue

Table 1  
Inheritance and Gifts Tax by European Comparison

	Inheritance					Gifts	Taxes on inheritance and gifts as % of GDP (2001)
	Spouses and children <sup>1</sup>				Other heirs		
	Tax-free allowance (in euros) <sup>2</sup>	Bottom rate of tax (%)	Minimax <sup>3</sup> (in euros) <sup>2</sup>	Top rate of tax (%)	Rate of tax (%)	Number of years counted in assessing tax <sup>4</sup>	
Belgium <sup>5</sup>	15 000	3	500 000	30	30 to 80	3	0.45
France	76 000 (46 000)	5	1 700 000	40	60	10	0.55
Denmark	Tax free (30 150)	(15)	Tax free (6 700)	(15)	36.25	Yearly	0.04
Germany	307 000 (205 000) <sup>6</sup>	7	25 565 000	30	17 to 50	10	0.15
GDR <sup>7</sup>	1 022 (511)	4	511 292	50	11 to 80	10	—
Finland	6 800 (3 400)	10	50 000	16	30 to 48	3	0.28
Greece	19 076	5	211 299	25	35 to 60	None	0.26
Ireland	Tax free (402 253)	(20)	Tax free (402 253)	(20)	20	Lifetime	0.15
Italy <sup>8</sup>	Tax free	3	Tax free	3	3	None	0.08
Netherlands	467 848 (7 996) <sup>9</sup>	5	799 554	27	41 to 68	2	0.30
Austria	2 200	2	4 380 000	15	14 to 60	10	0.08
Portugal	3 641 (Tax free) <sup>10</sup>	3	355 344 (Tax free) <sup>10</sup>	24	16 to 50	Lifetime	0.07
Spain	15 957 (47 858) <sup>11</sup>	7.65	797 555	34	Same <sup>12</sup>	3	0.21
Sweden	30 939 (7 735) <sup>13</sup>	10	66 298	30	Same	10	0.19
Switzerland <sup>14</sup>							0.28

1 Amounts in brackets are the tax-free allowances or upper tax thresholds for children, where these differ from the tax-free allowances for spouses. — 2 Converted at exchange rates on 1 January 2004. — 3 The top rate of tax applies from this amount upward. — 4 Number of years determining the tax rate. — 5 In the Flemish region the top rate of tax for spouses and children is 27% on an inheritance of more than 250 000 euros, and 65% for other heirs. — 6 Special tax-free allowances apply for spouses and children up to the age of 27 receiving a pension or social security benefits. — 7 Applied from 1970 to 1990; currency converted to euros (one Mark = one DM). — 8 Inheritance tax has not been charged since 25 October 2001. Instead, a general mortgage and land registry tax is charged on real estate and land (2% or 1%). — 9 For children under 23, 3999 euros a year, but at least 7996 euros. — 10 Under-age children tax free; older children treated the same as spouses. — 11 If the child is under 13 the tax-free allowance amounts to 15 362 euros; it rises to a maximum of 46 086 euros by the age of 21. — 12 Effective rates are higher because there is no basic deduction. — 13 In addition to the tax-free allowance children have a special maintenance allowance of 1 105 euros for every year below the age of 18. — 14 In Switzerland inheritances are not taxed by the Federation; however, nearly all the cantons (Schwyz is the exception) tax inheritance and gifts at various rates. But in most cantons spouses, and in many direct descendants as well, are not charged tax.

Sources: A. Mennel and J. Förster (eds.): 'Steuern in Europa, Amerika und Asien'. Herne/Berlin 2003; OECD Revenue Statistics and scheme according to Roger S. Smith: 'Personal Wealth and the European Union (mimeo 2001)'; DIW Berlin updates and supplements.

from inheritance tax following the reform of the legislation on foundations in 2000.<sup>9</sup> As the other sources of revenue

to the federal states showed markedly lower growth rates during the same period, and some actually fell, the share of inheritance tax in total state tax revenues has risen noticeably since the early 1990s (1991: 9%). According to calculations by the Working Group on Tax Estimates it was just under 18% last year. Its share in total federal state tax revenues (including com-

<sup>9</sup> The Federal Government puts the loss in tax revenue from the extension of § 29, para. 1, no. 4 of the Inheritance Tax Law to include concessions to foundations at around 330 000 euros; cf. Bundestagsdrucksache 14/9492.

Table 2  
Cash Tax Revenues 1991 to 2004<sup>1</sup>

	Inheritance tax	Federal state taxes	Tax revenues to the federal states <sup>2</sup>	Total tax revenues	Share of inheritance tax in		
					Federal state taxes	Tax revenues	
						To the federal states	Total
In mill. euros					%		
1991	1 348	14 886	116 499	338 434	9.05	1.16	0.40
1992	1 549	16 854	128 497	374 128	9.19	1.21	0.41
1993	1 557	17 752	133 139	383 018	8.77	1.17	0.41
1994	1 779	18 688	137 636	401 957	9.52	1.29	0.44
1995	1 814	18 714	160 165	416 337	9.69	1.13	0.44
1996	2 073	19 705	167 815	409 047	10.52	1.23	0.51
1997	2 076	17 732	167 721	407 577	11.71	1.24	0.51
1998	2 459	19 071	175 952	425 913	12.89	1.40	0.58
1999	3 056	19 564	184 003	453 068	15.62	1.66	0.67
2000	2 982	18 444	189 493	467 253	16.17	1.57	0.64
2001	3 069	19 628	178 690	446 247	15.63	1.72	0.69
2002	3 021	18 576	178 552	441 705	16.26	1.69	0.68
2003	3 301	18 584	177 288	441 634	17.76	1.86	0.75
2004	3 402	19 310	182 893	453 361	17.62	1.86	0.75

<sup>1</sup> 2003 and 2004 estimate by the Working Group on Tax Estimates in November 2003. — <sup>2</sup> Distribution of total tax revenues to the federal states. Sources: Federal Ministry of Finance, I A 6; DIW Berlin calculations.

munity tax) rose during the same period from 1.2% to 1.9%. The growth in revenue from inheritance tax is largely due to the considerable accumulation of assets in Germany since the Second World War. The wealth built up during the 'economic miracle' is now being passed on to the next generation.

It must be borne in mind here that many federal states benefit at only an under-average level from inheritance tax revenue. Inheritance tax revenue per inhabitant amounted on average to around 37 euros in 2001 (cf. table 3). Hamburg, Berlin and Bremen have noticeably higher per capita revenue from inheritance tax, but the territorial states Bavaria, Hesse and North Rhine-Westphalia have above-average figures as well.<sup>10</sup> The new federal states, on the other hand, have much lower tax

<sup>10</sup> Revenue from inheritance tax is below average in Lower Saxony and Schleswig-Holstein, and this may be due to the relatively low assessment value of agricultural and forestry real estate.

revenues from assets transfers, and here the very much smaller opportunities to acquire private assets in the GDR are still having an effect.<sup>11</sup> Studies on the distribution of assets give ample evidence of this.<sup>12</sup>

### Inheritance and gifts in the statistics

Apart from the fiscal statistics little research has been done into inheritance and gifts practices in Germany,

<sup>11</sup> It may be recalled in this context that the GDR had a steep scale of inheritance tax, particularly on exceptionally large amounts, and very low tax-free allowances, of only 1000 or 2000 Marks. 'With a top rate of 50% for spouses and children on inheritances of more than 1 million Marks, and 80% for all other heirs it could be called confiscatory': Georg Brunner: 'Einführung in das Recht der DDR', 2nd edition, Munich 1979.

<sup>12</sup> Richard Hauser and Holger Stein: 'Die Vermögensverteilung im vereinten Deutschland', Frankfurt a.M., 2001.

Table 3  
Population and Inheritance Tax Revenues by Federal State

	Inheritance tax revenue in 2001		Population on 31.12.2000		Average inheritance tax per capita	Relation of state average to national average
	In 1 000 euros	as %	in 1 000	as %	in euros	as %
Baden-Württemberg	426 111	13.9	10 524	12.8	40.49	8.5
Bavaria	612 055	19.9	12 230	14.9	50.04	34.1
Berlin	206 482	6.7	3 382	4.1	61.05	63.7
Brandenburg	10 316	0.3	2 602	3.2	3.96	-89.4
Bremen	34 607	1.1	660	0.8	52.42	40.5
Hamburg	142 986	4.7	1 715	2.1	83.35	123.4
Hesse	283 064	9.2	6 068	7.4	46.65	25.0
Mecklenburg-Western Pomerania	3 111	0.1	1 776	2.2	1.75	-95.3
Lower Saxony	220 661	7.2	7 926	9.6	27.84	-25.4
North Rhine-Westphalia	825 944	26.9	18 010	21.9	45.86	22.9
Rhineland-Palatinate	147 021	4.8	4 035	4.9	36.44	-2.3
Saarland	32 976	1.1	1 069	1.3	30.86	-17.3
Saxony	14 980	0.5	4 426	5.4	3.38	-90.9
Saxony-Anhalt	6 542	0.2	2 615	3.2	2.50	-93.3
Schleswig-Holstein	96 462	3.1	2 790	3.4	34.58	-7.3
Thuringia	5 374	0.2	2 431	3.0	2.21	-94.1
Total	3 068 692	100.0	82 260	100.0	37.30	x

Sources: Cash receipts from inheritance tax in 2001, from Bundesdrucksache 14/9492; Federal Statistical Office; DIW Berlin calculations.

and so far these transfers of assets between generations are not shown in detail in the official statistics.<sup>13</sup> The Federal Statistical Office is currently building up new statistics on inheritance and gifts tax in cooperation with the fiscal administration in the federal states,<sup>14</sup> but these will still only show acquisitions that are taxable, so that in the future it will still be impossible to identify any of the forms of tax-free gifts and bequests from these figures.<sup>15</sup>

Nor does the quota sample on incomes and consumption provide satisfactory information, as bequests and gifts are not part of its programme. Hence, estimates of

inheritances based on these samples have to include particular assumptions on the deaths involving inheritance.<sup>16</sup> A study by DIW Berlin based on the distribution of assets according to the quota sample of 1998 and a compilation of the assets of private households drawn from the macroeconomic statistics shows an average annual volume of inheritance of 130 billion euros for the next few years.<sup>17</sup> That means that only a good 2% of the total volume of inheritance is taxed.<sup>18</sup>

<sup>15</sup> They include all the tax exemptions under § 13 Inheritance Tax Law, like donations to foundations. The Stifter Studie (Study on Foundations) initiated by the Bertelsmann-Stiftung, which is to undertake the first listing of the foundations in Germany, is not aiming to make a quantitative assessment of the entire volume of foundation assets either, (although a full list of persons who have set up a foundation since 1990 is to be included). Cf. [www.bertelsmann-stiftung.de/documents/StifterStudieProjektbeschreibung.pdf](http://www.bertelsmann-stiftung.de/documents/StifterStudieProjektbeschreibung.pdf).

<sup>16</sup> These estimates are generally made from the official mortality tables, which are then simulated in the random sample's micro data set for private households.

<sup>13</sup> In particular, only limited statements are so far possible on the influence of inheritance on the distribution of assets between private households. Cf. the first Poverty and Wealth Report by the Federal Government, Bonn 2001, pp. 65ff.

<sup>14</sup> The first results of the rates of inheritance and gifts tax set in 2002 will only be available in the course of 2004.

## Volume of inheritance and gifts low in eastern Germany

The data on households in the Socio-Economic Panel (SOEP)<sup>19</sup> provide information on the size of inheritance and gifts<sup>20</sup> in every year since the survey was started in 2000; they also permit detailed analyses of the demographic structure of the receiving households. The data show that from 1999 to 2001 private households in Germany received assets<sup>21</sup> of around 50 billion euros a year (cf. figure), with gifts accounting for around one quarter of the monetary amounts. Even after deduction of the tax revenue the SOEP aggregate is clearly below the estimate of the total volume of taxable inheritance. A considerable difference is to be expected simply because the SOEP survey does not include all the bequests and gifts to foundations or non-profit-making, charitable or church organisations. Moreover, 'small' transfers (of less than 2500 euros) are not shown in the SOEP aggregate. In addition, there are considerable uncertainties in regard to the estimates based on assets in the economy as a whole. In particular, they do not take into account to what extent the potential testators consume their assets themselves, e.g. for nursing care.

According to the analyses based on SOEP<sup>22</sup> only about 1.5% of all households inherit large amounts of money (gifts just under 1%, cf. table 4). For the period 1999 to 2001 that is just under 600 000 households a year on average with an inheritance, and another approximately 300 000 receiving a gift. The average amount of the inheritance was around 65 000 euros in the SOEP random sample, with marked differences

<sup>17</sup> Cf. Stefan Bach and Bernd Bartholmai: 'Perspektiven der Vermögensbesteuerung in Deutschland', research project for the Hans Böckler Foundation, Berlin 2002, p. 105. [www.diw.de/deutsch/produkte/publikationen/gutachten/docs/diw-gutachten-vermoegsteuer-lang200210.pdf](http://www.diw.de/deutsch/produkte/publikationen/gutachten/docs/diw-gutachten-vermoegsteuer-lang200210.pdf).

<sup>18</sup> For figures on all past inheritance and amounts to be expected in future see Marc Szydlík: 'Lebenslange Solidarität? Generationenbeziehungen zwischen erwachsenen Kindern und Eltern', Opladen 2000.

<sup>19</sup> The SOEP is a representative repeat survey of private households carried out every year throughout Germany. The field work is done by Infratest Sozialforschung, Munich. For more detailed information on this study see [www.diw.de/soep](http://www.diw.de/soep). The respondent is asked to give the (approximate) amount received. The SOEP gives no information on the tax (inheritance or gift tax) payable.

<sup>20</sup> However, it must be borne in mind here that SOEP does not, as a rule, give a breakdown of inheritances or gifts. The question names 'Sums of money or material assets above DM 5000' (2500 euros since 2002), and this tends to underestimate the actual volume of inheritance and gifts in Germany.

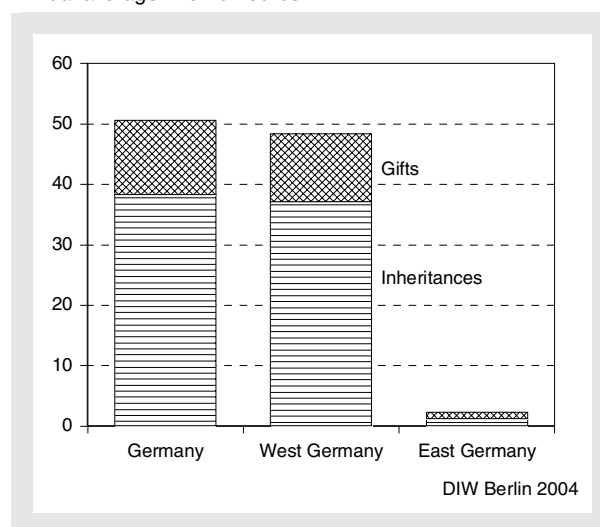
<sup>21</sup> This is a valuation by private households that is close to market prices.

<sup>22</sup> Unlike the random sample, the SOEP sample also contains a representative selection of households in which the head of the household is foreign.

Figure

### Annual Volume of Inheritance and Gifts Tax Charged to Private Households 1999 to 2001

Annual average in billion euros



Sources: SOEP; DIW Berlin calculations.

between west and east Germany (71 000 euros compared with 16 000 euros). The average amount of a gift was around 30 000 euros.

In inheritances as in gifts there is a huge spread between the assets received: 44% of all inheritances were less than 20 000 euros (68% in east Germany), and only 1.5% of all households that profited from an inheritance received at least 500 000 euros; this means only 2% of all households.

Besides the description of the annual volume of inheritance, the SOEP also enables analyses to be made of the social differentiation of receivers of inherited assets. Results to date show that most of those who inherit are already well off financially: to those who have shall be given. Certainly micro-analyses so far have shown that university graduates inherit much more frequently and in larger amounts than elementary school-leavers.<sup>23</sup>

## Conclusion

The legislature is currently preparing to amend the law on inheritance and gifts tax in accordance with the

<sup>23</sup> Cf. Marc Szydlík: 'Erben in der Bundesrepublik Deutschland: Zum Verhältnis von familiärer Solidarität und sozialer Ungleichheit', in: *Kölner Zeitschrift für Soziologie und Sozialpsychologie*, vol. 51, 1999, pp. 80-104; *ibid.*: 'Lebenslange Solidarität?' *loc. cit.*; Jürgen Schupp and Marc Szydlík: 'Zukünftige Vermögen - wachsende Ungleichheit'. To appear shortly in Marc Szydlík (ed.): 'Generation und Ungleichheit', Opladen.

Table 4

## Inheritances Received by Private Households by Size Class

Annual average 1999 to 2001

	Inheritances received			Gifts received		
	Germany	West Germany	East Germany	Germany	West Germany	East Germany
Receiving households (share in all households as %)	1.5	1.7	0.9	0.8	0.9	0.5
Amount from ... to less than.... euros						
2 500 to 5 000	11.3	9.3	(26.9)	18.1	17.1	(23.7)
5 000 to 10 000	14.2	13.7	(17.7)	32.1	32.2	(31.5)
10 000 to 20 000	18.8	18.2	(23.3)	20.1	19.8	(22.7)
20 000 to 50 000	19.8	18.6	(29.7)	11.5	11.7	(10.3)
50 000 to 100 000	15.0	16.7	(1.4)	10.6	10.8	(9.2)
100 000 to 250 000	17.8	19.9	(1.0)	(6.0)	(6.6)	(2.6)
250 000 to 500 000	(1.6)	(1.8)	–	(0.8)	(0.9)	–
500 000 and more	(1.5)	(1.8)	–	(0.8)	(0.9)	–
Total	100	100	100	100	100	100
Memo item:						
Average number of cases of inheritance or gifts per year (in 1000s)	576	532	64	307	282	36
Average value of inheritance or gift in euros <sup>1</sup>	65 104	71 151	16 431	30 009	31 653	19 820

( ) Number of cases is less than 30 households in the three year period.

<sup>1</sup> Base: households receiving inheritance 1999 to 2001.

Sources: SOEP, pooled data from survey years 2000 to 2002; DIW Berlin calculations.

expected decision of the Federal Constitutional Court on the taxation of real estate. Even if the result should be roughly equal treatment of real estate on the one side<sup>24</sup> and monetary assets on the other, the tax-free allowances will remain so high, even if the valuation is close to market values,<sup>25</sup> that family members in Tax Class I will still be largely exempt from inheritance tax. There could actually be scope for reducing the tax-free allowances. If fewer inheritances benefit from the tax-free allowance thresholds the bottom rates of tax could be lowered, particularly for smaller amounts: a rate of 5%, for example, up to an inheritance of under 125 000 euros.<sup>26</sup>

<sup>24</sup> As market valuations can easily be disputed the Valuation Commission suggests an average assessment level of at least 80% of the market value. Cf. 'Bewertung des Grundbesitzes für Zwecke der Vermögensbesteuerung', report by the Council of Experts on the Taxation of Assets for the Federal Ministry of Finance, final report 2002 (Mimeo). See [www.bundesfinanzministerium.de/fach/abteilungen/besiverk/grundbes.pdf](http://www.bundesfinanzministerium.de/fach/abteilungen/besiverk/grundbes.pdf).

<sup>25</sup> The Federal Constitutional Court proposes orienting to the average price of a detached house. Bach and Bartholmai see this as acceptable with a tax-free allowance of 250 000 euros. Cf. Bach and Bartholmai, loc. cit, pp. 83 ff. and p. 119.

International comparison suggests that attention should be concentrated not so much on increasing the top rate of inheritance tax, which is currently 30% for spouses and children in Germany, as on lowering the threshold at which the top rate applies. It is at present extremely high in Germany at 25 million euros.

It could be argued that if real estate were valued more highly in individual cases for tax purposes there could in future be 'sales pressure' on such property.<sup>27</sup> However, it must be borne in mind that liabilities are deducted from the assessment of inheritance tax. To avoid cases of hardship an opening clause could be included to the effect that where the taxpayer can prove a lower figure it will be used as the assessment base. Instead of renouncing revenue altogether by increasing the tax-free allowances, the possibilities which the legis-

<sup>26</sup> DIW Berlin suggests lowering the bottom rate of the tax while at the same time reducing the tax-free allowances. Cf. Stefan Bach and Bernd Bartholmai: 'Immobilien sachgerecht bewerten, Mehrbelastungen begrenzen', in: *Wochenbericht des DIW Berlin*, no. 22/2001, p. 336.

<sup>27</sup> It must be remembered that the usual property acquisition tax is not payable on inherited real estate. It is only charged on the purchase of property and it is currently 3.5% of the purchase price.

lation already allows of postponing tax payments in the case of commercial assets (Section 28 Inheritance and Gifts Law) could be extended to private assets of family members. This would also create scope for reducing tax-free allowances.

When the legislation is being amended the present period of ten years for offsetting gifts against inheritance (Section 14 Inheritance and Gifts Law) should be reconsidered and extended, possibly to 15 years, for with growing life expectancy the possibilities of avoiding inheritance tax by bringing gifts forward have increased in recent years. An amendment of this nature would only involve higher tax payments for households with very high assets.

The revenue from inheritance tax accrues entirely to the federal states – while expenditures on education are largely state expenditures in the German federal system. If those who benefit most from inherited assets are mainly those who have profited particularly from these education expenditures, it certainly makes sense for (rising) education costs to be partly financed by (growing) inheritance tax. Reducing the tax-free allowances – accompanied by lowering the bottom rate of tax – combined with a more commercial valuation of real estate and higher tax revenues from particularly large inheritances could thus not only help to level out the social inequalities resulting from inheritance but also free additional funds for education investment. These funds are urgently needed for the German education system to make up ground in international competition.

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