The Influence of ECJ Case Law on the German Inheritance and Gift Tax Act

This article describes the German inheritance and gift tax regime in the context of the recent decision of the ECJ in Sabine Hünebeck (Case C-479/14), concerning the optional resident taxation of EU/EEA citizens. The German rule enshrined in section 2(3) of the Inheritance and Gift Tax Act did not withstand the scrutiny of the ECJ in Hünebeck and might be changed shortly to bring the Inheritance and Gift Tax Law in line with EU law.

1. Introduction

German inheritance taxation has always been a bone of contention and the subject of continual amendment. On the one hand, there has been endless scrutiny of this regime by the German Constitutional Court, which has declared the German Inheritance and Gift Tax Act (IGTA) unconstitutional on several occasions in the last decade. The last such decision was issued in December 2014. In particular, the German Inheritance and Gift Tax Act has tended to favour assets allocated to companies over assets held privately by granting generous, and in certain circumstances, full exemptions from inheritance taxation for company assets. It has thus induced taxpayers inheriting mainly private assets to claim that they are being unfairly disadvantaged on account of the allocation of their assets.

On the other hand, the European Court of Justice (ECJ) has frequently ruled on the compliance of German tax rules with EU law, including the rules enshrined in the IGTA. Mainly, these decisions have concerned the treatment under the IGTA of non-resident taxpayers. The rather low allowance of EUR 2,000 granted to such taxpayers within a 10-year period has attracted particular attention and has been ruled impermissible by the ECJ on several occasions. Under pressure due to the ECJ decision in Vera Mattner (Case C-510/08), the German legislator introduced section 2(3) to the IGTA, allowing EU/EEA based taxpayers to elect to be treated as resident taxpayers and thus take advantage of the substantially higher allowances for resident taxpayers. Since the ECJ, in Welte (Case C-181/12), ruled that the low personal allowance for non-resident taxpayers was incompatible with EU law with regard to persons in third countries as well, the rule became outdated soon after its introduction.

In the face of such mounting problems, other European nations have also repealed their inheritance tax acts, for example, Portugal and Sweden, or let them expire in various ways (for example, Austria). In light of the revenue derived under the German Inheritance Tax Act, which has oscillated between approximately EUR 3 and 6 billion per year in the last couple of years, there have been calls to abolish the tax altogether. The German legislator, however, is currently finalizing the latest revisions to the Inheritance Tax Act to bring it in line with the recent demands made by the German Constitutional Court. It is hence highly unlikely that it will be abolished, in particular given the political nature of the tax.

Against this backdrop of fiscal insignificance and frequent, multi-pronged attacks both at the national and EU level, this article describes recent developments concerning the territorial scope of the German Inheritance Tax Act under the influence of recent ECJ case law.

2. The German Inheritance Tax Act

2.1. Scope of the German Inheritance Tax Act

2.1.1. Taxable events under the Act

Section 1 of the IGTA describes the taxable events under the Act. Apart from the obvious taxation of inheritances and donations, it also encompasses “restricted gifts.” Inheritances and donations are treated very similarly (section 1(2) of the IGTA), preventing a substitution of gifts inter vivos for inheritances to avoid the tax. Also, the assets of a domestically-based family foundation are subject to inheritance tax in 30-year intervals.

It should be noted that German inheritance taxation levies the tax on the enrichment of the recipient (heir or donee), not on the assets transferred by the testator or donor as such. To this end, section 10 allows the taxpayer to deduct certain costs. Under section 10(6) of the IGTA, debts connected to the assets transferred and passed over to the recipient.

* Tax Advisor at Flick Gocke Schaumburg in Berlin, Germany. The author can be contacted at martin.weiss@fgs.de.

1. DE: German Inheritance and Gift Tax Act (Erb schaffststeuer- und Schenkungsteuergesetz). National Legislation IBFD.
5. See DE: ECLI, 22 Apr. 2010, Case C-510/08, Vera Mattner, ECI Case Law IBFD.
7. Zweckzuwendungen.
ent can be deducted. The deduction, however, mirrors the taxability of the asset in question, i.e. if 10% of the asset value is exempt under the IGTA, 10% of the debt is non-deductible as well (“correspondence principle”).

2.1.2. Resident taxation

The personal scope of the IGTA is mainly determined under section 2. Under section 2(1), no. 1, sentence 1 of the IGTA, resident taxation applies if the testator at the time of his death, the donor at the time of the donation, or the recipient at the time the tax is triggered is deemed to be a German resident. Residency in this respect is assumed in respect of (section 2(1), no. 1, sentence 2 of the IGTA):
- lit. a: a natural person – irrespective of nationality – who has his or her permanent residence or habitual abode in Germany;
- lit. b: a German citizen who has lived outside Germany for a time period of no longer than five years without being resident on account of having his or her permanent residence in Germany;
- lit. c: independent of the five-year period, German citizens who are not resident in Germany but derive income from a domestic public source; and
- lit. d: a corporation whose place of management or seat is located in Germany.

For German citizens, an impromptu migration to a foreign country to avoid German resident inheritance or gift taxation is thus not advisable since resident inheritance taxation will apply for five years after the migration under lit. b.

With regard to resident taxation, worldwide assets are taxed under the German inheritance tax regime, with the possibility of a credit for foreign taxes suffered under section 21 of the IGTA. Further, generous allowances ranging from EUR 20,000 to 500,000 (section 16 of the IGTA) and additional special allowances under section 17 of the IGTA are provided.

2.1.3. Non-resident taxation

If none of the conditions in section 2.1.2. for resident taxation are satisfied, under section 2(1), no. 3, non-resident taxation may apply. In particular, if both the testator and the heir are not considered resident in Germany, non-resident taxation sets in: as a consequence, the tax base is restricted to “domestic assets”: section 121 of the German Valuation Act (VA) provides for an – exhaustive – list of domestic assets that are subject to non-resident inheritance taxation. Among them is real estate based in Germany, shares in domestic corporations if the direct or indirect participation quota exceeds 10% and assets allocated to a domestic permanent establishment (PE). It should be noted that the list excludes assets such as bank accounts. The deduction of debts is restricted to debts connected to the domestic assets that are subject to German inheritance and gift taxation (section 10(6), sentence 2 of the IGTA).

2.1.4. Extended non-resident taxation

Under section 4 of the Foreign Transaction Tax Act (FTTA), non-resident taxation is extended beyond the specific domestic assets enumerated in section 121 of the VA to include all assets that would yield non-foreign income within the meaning of section 34d of the ITA if the taxpayer was resident in Germany. The scope of this rule governing the “extended non-resident taxation” is, however, quite restricted, since it requires German citizenship and only kicks in once the five-year period for resident taxation has expired. Even then, it only applies for ten years in total, counting from the time the taxpayer relinquishes his former residency in Germany. It also requires the new state of residency to levy an inheritance tax of less than 30% of the German inheritance and gift tax. It is mainly designed to capture the assets of rich taxpayers moving to low-tax locations and is meant to serve as a deterrent. It is applied in lockstep with section 2 of the FTTA, which provides for extended non-resident taxation for income tax purposes and section 5 of the FTTA governing participations in foreign corporations held by non-residents.

2.2. Determination of the tax base and tax rates

The tax base for the IGTA is determined under section 12 of the IGTA, mainly relying on market values as defined in section 9 of the VA. Several important exemptions are granted, such as in respect of firm assets under sections 13a and 13b of the IGTA and for the family home under section 13(1), no. 4a-4c of the IGTA. Asset values are aggregated, taking into account any transfers received from the same person during the last ten years (“aggregation period”, section 14 of the IGTA).

Taxpayers are allocated to tax categories based on the degree of closeness or kinship between the testator and his heir, or between donor and donee. The closest association exists between spouses or between parents and their children, who are allocated to tax category I. Tax allowances – for resident taxpayers – are highest in this category, ranging from EUR 100,000 to 500,000 (section 16(1) of the IGTA). As an added benefit, spouses and children, as resident taxpayers, may enjoy an additional deduction from their tax base under section 17 of the IGTA. The “special

8. Unbeschränkte Steuerpflicht.
11. See sec. 2.3.
13. DE: German Valuation Act (Bewertungsgesetz), National Legislation IBFD.
15. DE: Foreign Transaction Tax Act (Außensteuergesetz), National Legislation IBFD.
17. Erweiterte beschränkte Steuerpflicht.
18. See sec. 2.1.2.
19. Currently under review following a decision of the German Constitutional Court. See 1 BvL 21/12 (17 Dec. 2014).
20. It is thus not possible to transfer assets in a piecemeal fashion to enjoy the allowances for each transfer. After the expiry of the ten-year period stipulated by section 14 IGTA, the allowances can be utilized anew.
allowance\textsuperscript{22} exempts a further EUR 256,000 for spouses and between EUR 10,300 and EUR 52,000 for children, depending on their age, in the event of the death of the spouse or parent. In the event of tax-free rent payments being transferred, their capitalized value must be deducted from this special allowance.

Tax rates are flat and are the lowest in tax category I, ranging from 7% up to a ceiling of EUR 75,000 to 30% for taxable assets exceeding EUR 26 million (section 19(1) of the IGTA). Once the ceiling for the flat tax rates is exceeded, even if only slightly, the rate jumps to a higher level on the entire value of the assets transferred. A donee in tax category I receiving a taxable transfer of EUR 75,000, for instance, pays a 7% rate on the donation, leading to a tax of EUR 5,250. Should the taxable transfer be valued at EUR 75,100, the rate jumps to 11% for the entire amount, leading to a tax of EUR 8,261. Hence, an increase of EUR 100 in the taxable transfer would increase the tax liability by EUR 1,011, leading to very high marginal rates. To buffer the discontinuities in the rates, a smoothing mechanism is provided for in section 19(3) of the IGTA, which phases in the higher rate at the kinks of the rate function.

Siblings, nieces and nephews of the testator or donor are examples of persons belonging in tax category II, leading to an allowance – for resident taxpayers – of EUR 20,000 and tax rates between 15% and 43%. All other persons are allocated to tax category III, leading to an allowance – for resident taxpayers – of EUR 20,000 and tax rates of 30%-50%.

What should be noted with regard to the argument that follows is that the most significant distinction between resident and non-resident taxation concerns the personal allowance under section 16 of the IGTA, which, with regard to non-resident taxation, amounts to only EUR 2,000, irrespective of the tax category (section 16(2) of the IGTA). Also, the special allowance under section 17 of the IGTA is not available to non-resident taxpayers, nor is the credit mechanism for foreign taxes.\textsuperscript{23} The tax rates in section 19 of the IGTA, however, do not vary between resident and non-resident taxpayers.

### 2.3. Prevention of double taxation

Since German resident taxation under the IGTA captures assets transferred worldwide, double taxation may arise since the state where the assets are located may tax the transfer under its rules for non-resident taxation as well. Also, the taxpayer may be deemed resident in more than one country, leading to a conflict between two states both applying resident taxation.

The main mechanism for the prevention of double taxation in the IGTA relies on the credit mechanism. Under section 21 of the IGTA, foreign inheritance and gift taxes can be credited against a German inheritance tax liability.

Several caveats apply.\textsuperscript{24} Most importantly, only resident taxpayers can avail themselves of the credit mechanism. Also, the foreign tax that is supposed to be credited must be levied on assets that Germany would treat as domestic under section 121 of the VA if such assets were subject to German non-resident inheritance taxation. Since foreign states may apply different rules and determine the scope of their non-resident inheritance and gift taxation differently, pure double taxation may arise. To be credited against German tax, the foreign tax must also be ‘comparable’ to the German tax, which can give rise to disputes between taxpayers and the tax administration as well.\textsuperscript{25} Also, the credit is restricted to the German inheritance tax on the foreign assets, which may give rise to excess tax credits that cannot be utilized elsewhere.

There is also no deduction method, in contrast to section 34c(2) of the ITA, which allows taxpayers to deduct foreign income taxes upon application instead of crediting them. For the purposes of the IGTA, inheritance tax itself is non-deductible (section 10(8) of the IGTA), regardless of whether it is a foreign or domestic inheritance tax.

Also, Germany has entered into six tax treaties concerning inheritance and gift taxation with France (2006), Denmark (1995), Greece (1910), Sweden (1992), Switzerland (1978) and the United States (1998).\textsuperscript{26} These treaties mainly prevent double taxation via the credit method, which is also the case under section 21 of the IGTA in situations in which no treaty is applicable. The number and importance of these treaties pale in comparison to the body of over 90 German tax treaties regarding income taxes.

### 2.4. Introduction of optional resident taxation

#### 2.4.1. Vera Mattner

In Vera Mattner, the tax court of first instance\textsuperscript{27} of Düsseldorf asked the ECJ to rule on the permissibility of a reduced allowance for inheritance and gift tax purposes under non-resident taxation. As described earlier, the IGTA grants a very low allowance of only EUR 2,000 to non-resident taxpayers (section 16(2) of the IGTA), compared to allowances of between EUR 100,000 and 500,000 for resident taxpayers in tax category I (section 16(1) of the IGTA), while not discriminating with regard to the tax rate structure for both resident and non-resident taxpayers.

Mrs Mattner, a German citizen, had been resident in the Netherlands for several decades, as had her daughter. She

\textsuperscript{22} Besonderer Versorgungsfreibetrag.
\textsuperscript{24} See M. Jülicher, Praxisprobleme im internationalen Erbschaftsteuerrecht, 69 Betriebs-Berater 23, p. 1367 (2014).
\textsuperscript{27} For information regarding the German system of tax courts, see R. Mel-linghoff, The German Federal Fiscal Court: An Overview, 70 Bull. Intl. Taxn. 1/2 (2016), Journals IBFD.
The German legislator, towards the end of the 2011 fiscal year, thus allows for an election by a taxpayer who would be subject to non-resident taxation without it. Upon application, the current transfer from a person who has his residence within the European Union/European Economic Area and all transfers from that person within a ten-year lookback period and for a period of ten years into the future are treated as subject to resident taxation. This allows the transaction to benefit from the higher allowances for resident taxpayers described earlier. Also, the special allowances in section 17 of the IGTA are applicable upon the election.

Hence, even if the past or future transfers from the same donor taken into account via this rule do not even involve German domestic assets, they are still caught by the rule once the recipient has exercised his right to elect resident taxation. The fact that past transfers within a ten-year timeframe are taken into account does not constitute discrimination, since this applies to all resident taxpayers (section 14 of the IGTA), whether by election or not.

The application under section 2(3) of the IGTA, however, involves a fair amount of risk since it is dependent on events up to ten years in the future as well. Should a previous donor, for instance, die within this time frame, the resulting inheritance would automatically be subject to resident taxation in Germany, driving up the applicable tax rate under the rate structure described earlier. Also, the residence of the testator and the heir during the ten-year timeframe does not matter. The resulting additional tax liability is mitigated by a credit for foreign taxes suffered under section 21 of the IGTA, subject to the caveats outlined in section 2.3.

2.4.3. Comparison to optional resident taxation under section 1(3) of the Income Tax Act

Similar to the ECJ decisions leading up to the introduction of section 2(3) of the IGTA, the German legislator was also prompted to introduce, in 1996, optional resident taxation for non-resident taxpayers under the Income Tax Act (ITA). The introduction was in response to the ECJ decision in Schumacker (Case C-279/93).

Under section 1(3) of the ITA, non-resident taxpayers for income tax purposes, can elect to be treated as resident taxpayers. While the basic notion of an optional right to switch to resident taxation upon application is quite similar to section 2(3) of the IGTA, the conditions and legal consequences of both rules are not at all identical:

- Section 1(3) of the ITA lays down stringent criteria that have to be met with regard to the splitting of the applicant’s income between foreign and domestic sources. In certain instances, spousal income can be

29. At the time of the transfer in the Mattner case (2007 fiscal year), the personal allowance for non-resident taxpayers amounted to EUR 1,100, in contrast to the EUR 2,000 under current legislation.
30. Vera Mattner (C-510/08).
31. Id. at nn. 27.
32. Id. at nn. 28.
33. See DE: ECJ, 17 Oct. 2013, Case C-181/12, Welte, ECJ Case Law IBFD.
34. See Jülicher, supra n. 24, at 1378.
taken into account as well, complicating the necessary calculations (section 1a of the ITA).\(^{39}\) Only if these criteria are met can the application under section 1(3) of the ITA for resident taxation succeed. With regard to section 2(3) of the IGTA, no requirements of a particular share of domestic or foreign assets exist.

- Section 1(3) of the ITA does not contain a requirement regarding EU/EEA residency, but rather applies to any natural person worldwide. Section 2(3) of the IGTA is, however, in its version currently in force, only applicable if the testator at the time of his death, the donor at the time of the donation or the recipient at the time the tax originates is based in the European Union or in the European Economic Area.

- Section 1(3) of the ITA subjects only German domestic income (section 49 of the ITA) to resident taxation upon application, while section 2(3) of the IGTA taxes worldwide assets transferred.

- Section 1(3) of the ITA is applicable for the fiscal year in respect of which the taxpayer elects to apply the rule and takes into account any non-domestic income not within its remit via a progression provision\(^{40}\) in section 32b(1), sentence 1, no. 2 of the ITA.\(^{41}\) Section 2(3) of the IGTA, however, applies to assets transferred from the same person ten years prior to and ten years after the application. It subjects them to German resident taxation as well, even though no domestic assets, within the meaning of section 121 of the VA, may have been transferred in the process.\(^{42}\)

3. Recent Developments Regarding Non-Resident Inheritance Taxpayers

3.1. ECJ decision in Sabine Hünnebeck (Case C-479/14)

In Sabine Hünnebeck (Case C-479/14),\(^{43}\) Mrs Hünnebeck and her two daughters were German citizens. Mrs Hünnebeck had been resident in the United Kingdom since 1996 while her daughters had never been resident in Germany. Mrs Hünnebeck transferred a 50% interest in real estate located in Germany to her two daughters as a gift in 2011. The inheritance and gift tax due in Germany was supposed to be borne by Mrs Hünnebeck herself.\(^{44}\)

The German tax authorities assessed the inheritance and gift tax liability on the basis of a valuation of the real estate involved and a personal allowance of only EUR 2,000 per donation since the case involved non-resident taxation. Mrs Hünnebeck challenged this decision, applying for the full personal allowance of EUR 400,000 applicable to resident taxpayers in respect of transfers to children (section 16(1), no. 2 of the IGTA).\(^{45}\) The tax authorities denied the request.

The lower tax court of Düsseldorf, aware of the ECJ decision in Mattner,\(^{46}\) ruled\(^{47}\) that the low personal allowance granted to Mrs Hünnebeck, in itself, was a violation of EU law. Since the German legislator had introduced section 2(3) of the IGTA,\(^{48}\) however, the breach may have been remedied because EU/EEA-based non-resident taxpayers such as Mrs Hünnebeck and her daughters could avail themselves of the option of resident taxation.\(^{49}\) The mere fact that section 2(3) of the IGTA requires an application to become effective may, however, be seen as a breach of EU law: in the absence of such an application, the usual rules for non-resident taxpayers apply. Furthermore, the restriction of section 2(3) of the IGTA to EU/EEA-based non-resident taxpayers may be regarded as being in conflict with the ECJ decision in Welte,\(^{50}\) which extended the breach of EU law by virtue of low personal allowances for non-resident taxpayers to persons resident in third countries.

The ECJ replied to the request of the Düsseldorf Court\(^{51}\) that it had already ruled in Commission v. Germany (Case C-211/13)\(^{52}\) that Germany was in breach of its treaty obligations because the personal allowance in respect of non-resident taxation was lower than in cases of resident taxation.

The introduction of section 2(3) of the IGTA had not improved the situation of the regime under EU law, however, for two main reasons. Firstly, the application of resident taxation for non-resident taxpayers is optional, which in itself constitutes a violation of EU law. Secondly, the period of aggregation of gifts and inheritances on which the tax liability is assessed is twice as long in respect of optional resident taxation (20 years) compared to regular resident taxation (10 years; section 14 of the IGTA).

On the first point, the court noted\(^{53}\) that the optional nature of the mechanism makes it incompatible with EU law even if the optional mechanism itself may be compatible with EU law. This argument was even more pertinent in respect of the German rules under examination where the incompatible mechanism – normal non-resident taxation – was the default and the optional mechanism – optional

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40. Progressionsvorbehalt.
41. Hence, the tax rate applied to the domestic income is raised or lowered depending on the average income tax rate that would prevail if worldwide income was subjected to German income tax. Foreign-source income thus impacts the tax rate but remains tax-free otherwise.
42. See Lüdicke & Schalz, supra n. 36.
43. DE. ECI, 8 June 2016, Case C-479/14, Sabine Hünnebeck v. Finanzamt Krefeld, ECI Case Law IBFD.
44. Under sec. 10(2) of the IGTA, the donor can pay the gift tax due himself; however, the tax thus borne by the donor counts as another donation to the donee, leading to gift tax on the tax itself. This process is stopped after one iteration, facilitating the calculation of the resulting tax.
resident taxation under section 2(3) of the IGTA – was the one claimed to be compatible with EU law.\footnote{54}

On the second point, the court ruled that while the personal allowances in respect of optional and regular resident taxation are indeed identical, the period of aggregation of 20 years in the former case exceeded that of the latter case (10 years) substantially. Quite apart from this obvious fact, the Court also drew attention to the unpredictability of taxation in respect of optional resident taxation: since the aggregation period reached back 10 years – as in the case of regular resident taxation – but also 10 years into the future – in contrast to regular resident taxation – the amount of tax eventually payable at a future date is inherently unpredictable for the taxpayer. Indeed, Mrs Hünnbeck had advanced just such an argument as a reason for her failure to apply for optional resident taxation. This may have the effect of deterring non-residents from acquiring or maintaining property situated in Germany – which constitutes a breach of the free movement of capital.

The submission by the German government, to the effect that the difference in treatment cannot be considered to be incompatible with the provisions of the Treaty on the Functioning of the European Union (TFEU) (2007)\footnote{55} relating to the free movement of capital, on the ground that it relates to situations that are not objectively comparable, was also rejected. The derogation of the principle of free movement of capital enshrined in article 65 of the TFEU has to be interpreted strictly. It does not imply that “all tax legislation which draws a distinction between taxpayers on the basis of their place of residence or the State in which they invest their capital is automatically compatible with the Treaty”.\footnote{56} The Court thus maintained its reasoning in the \textit{Welte} case.\footnote{57}

A justification for the restriction on the free movement of capital did not exist, according to the ECJ decision.\footnote{58} The coherence of the German tax system, the principle of territoriality and the need to ensure a balanced allocation of the Member States’ powers to impose taxes were all rejected as inapplicable in this case.

### 3.2. Possible reaction of the German legislator

So far, the German legislator is still working on amendments to the IGTA based on the decision of the German Constitutional Court of 17 December 2014.\footnote{59} These amendments concern the question of valuation of assets transferred under the Act, and thus address a different set of questions than those under consideration in \textit{Hünnbeck}.

Section 2(3) of the IGTA is, based on \textit{Hünnbeck}, as well as \textit{Welte},\footnote{59} untenable in its current form. Under the latter decision, it will have to be extended to persons residing outside the EU/EEA area as well, in order to bring it in line with EU law. Under the former decision, more substantial and detailed changes will be required if section 2(3) of the IGTA is to be maintained at all. In particular, the aggregation period enshrined in section 14 of the IGTA would have to be made consistent between optional and regular resident taxation.\footnote{60}

Quite another option would be to drop section 16(2) of the IGTA altogether and hence grant identical personal allowances regardless of resident or non-resident taxation, although this option may be infeasible due to fiscal considerations.\footnote{62} Section 17 of the IGTA, concerning the special allowances, would probably be subject to the same pressure since it is currently only available to resident taxpayers: either abolish it for all taxpayers, or extend it to non-resident taxpayers as well.

### 3.3. Current stance of the German tax administration and judiciary

The German tax administration has reacted to the recent developments regarding non-resident taxpayers under the IGTA. In an administrative decree\footnote{63} the administration stated – before the \textit{Hünnbeck} case was decided – that based on the \textit{Mattner} case,\footnote{64} the legislator had introduced section 2(3) of the IGTA. Under this provision, cases of EU/EEA residents have been handled. With the recent \textit{Hünnbeck} decision\footnote{65} in mind, this position is probably untenable.

With regard to persons resident outside the EU/EEA area, in respect of whom the current form of optional resident taxation is not applicable, the personal allowance is to be granted to non-resident taxpayers at the same amount as that applicable to resident taxpayers, based on the \textit{Welte} case.\footnote{66} According to the tax administration, however, the full personal allowance should be reduced with reference to the value of assets transferred outside the scope of German non-resident taxation, i.e. the assets transferred during the aggregation period of 10 years (section 14 of the IGTA) and not subject to German non-resident taxation, should be taken into account to reduce the full personal allowance substantially in order to prevent “reverse discrimination” of residents who have their full set of assets transferred worldwide taken into account.

The first cases to reach the lower tax courts regarding this new stance of the German tax administration demonstrate a reluctance on the part of the courts to apply this rule – and outright rejections. The Lower Tax Court of Düsseldorf ...

\footnotesize{\textsuperscript{54} See DE: ECJ, 28 Feb 2013, Case C-168/11, \textit{Reker}, para. 62, ECJ Case Law IBFD.\textsuperscript{55} Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), EU Law IBFD.\textsuperscript{56} \textit{Hünnbeck} (C-479/14), nn. 51 et seq.\textsuperscript{57} \textit{Welte} (C-181/12).\textsuperscript{58} \textit{Hünnbeck} (C-479/14), nn. 61 et seq.\textsuperscript{59} I BvL 21/12 (17 Dec. 2014).\textsuperscript{60} \textit{Welte} (C-181/12).}
dorch, in a case involving Swiss residents, has ruled\(^{67}\) that this practice constitutes yet another breach of EU law and has granted the full, unrestricted personal allowance. The Lower Tax Court of Stuttgart – in another case involving Swiss residents – has also rejected this practice as a violation of EU law.\(^{68}\) Appeals against both cases are currently pending before the German Federal Tax Court.\(^{69}\)

4. Conclusion

German inheritance tax law has been under pressure from several directions for a number of years. Apart from the constitutional issues regularly being brought up in Germany, the ECJ has ruled consistently that the discrimination between resident and non-resident taxpayers with regard to their personal allowances is not permissible under the free movement of capital. This prohibition against such discrimination extends to persons resident in third countries. The German legislator’s attempt to remedy the situation by introducing optional resident taxation has now been rejected by the ECJ in Hünnebeck as well. Further, the attempt by the German tax administration to apply the ECJ ruling, but reduce personal allowances for non-resident taxpayers with regard to foreign assets not subject to the German IGTA, must be regarded as having failed, based on recent decisions by the lower tax courts.

The German legislator may thus amend the application of the personal allowances in section 16 of the IGTA in the near future and/or repeal optional resident taxation under section 2(3) of the IGTA. The direction of the change in the personal allowances, whether non-resident taxpayers will enjoy the higher allowances for resident taxpayers or the other way around, cannot currently be reliably predicted.\(^{70}\) The recent action by the European Commission against Germany regarding the “special allowances” enshrined in section 17 of the IGTA will only add to the pressure for change in the IGTA.\(^{71}\)

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