Special Section
The Constitutional Court's Inheritance Tax Case

Federal Constitutional Court Declares Inheritance and Gift Tax Act Unconstitutional

By Hanno Kube[*]

Abstract

In December 2014, the German Federal Constitutional Court declared the Inheritance and Gift Tax Act unconstitutional. The following article presents and discusses the judgment. Instead of trying to comply by changing as little as possible, the legislator should consider a fundamental and consequent alternative: an inheritance and gift tax that treats everybody the same.

[*] Prof. Dr. Hanno Kube, LL.M. (Cornell) is director of the Institute for Finance and Tax Law at Ruprecht-Karls-University Heidelberg, Germany (kube@uni-heidelberg.de).

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

A. A Long History of Inheritance Taxation in Germany

Germany looks back on a very long history of inheritance taxation.[1] Inheritance tax law has often been reformed in Germany, in the last decades mostly after judgments of the Federal Constitutional Court (FCC). After the FCC in 1995 declared the Inheritance and Gift Tax Act (*Erbschaft- und Schenkungsteuergesetz* – ErbStG) of 1974 as incompatible with the guarantee of equality according to Article 3, section 1 of the German Constitution (*Grundgesetz* or "Basic Law"),[2] in particular with regard to the assessment of real estate on the one hand and capital on the other hand, the legislator enacted a new inheritance tax regime in the end of 1996.[3] With this regime, important and far-reaching tax exemptions for business assets were introduced (Paragraphs 13a and 19a ErbStG). Just a few years later, in 2002, the Federal Finance Court (*Bundesfinanzhof*) again questioned the constitutionality of the law and—as only the FCC has the power to declare parliamentary laws unconstitutional—submitted the concrete case to the FCC for a ruling under Article 100, section 1 of the Basic Law.[4] While the proceedings were pending, the new government elected in 2005 intended to reform the law in order to further facilitate the transfer of companies. The legislative process was delayed in order to be able to take account of the upcoming judgment of the FCC. Shortly after, in 2006, the FCC handed down the judgment and once more declared the existing law as unconstitutional. In particular, the Court criticized the assessment rules for business assets, shares in companies and real estate.[5] The legislator was given time to reform the law until the end of 2008. On Christmas Eve in 2008, substantial modifications to the Inheritance and Gift Tax Act were promulgated, aiming at conforming to the holding of the FCC.[6] Further modifications followed, after the government had changed in 2009.[7] Yet, the constitutionality of inheritance taxation remained controversial. It was just a question of time, when the FCC would have to deal with the matter again. It was given the opportunity, when the Federal Finance Court submitted a new case in September 2012.[8] It was this case that gave rise to the FCC judgment to be presented and discussed here.

---

[1] *See* MEINCKE, ERBSCHAFT—UND SCHENKUNGSTEUERGESETZ, KOMMENTAR, Einführung no.13 ff (C.H. Beck ed., 16th ed. 2012).

[2] Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] 93 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 165.

[3] 1996 BUNDESGESETZBLATT, TEIL I [BGBL. I] at 2049, 2055 (Ger.).

[4] Bundesfinanzhof [Federal Finance Court] [BFH], 2002 BSTBL. II at 598.

[5] Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], 117 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 1.

[6] 2008 BUNDESGESETZBLATT, TEIL I [BGBL. I] at 3018.

[7] For an overview, see MEINCKE, *supra* note 1, at Einführung no. 18.

[8] Bundesfinanzhof [Federal Finance Court] [BFH], 2012 BSTBL. II at 899.

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

B. The FCC Decision of December 2014—Facts of the Case and Summary of the Holding

The facts of the case are rather straightforward. The plaintiff in the initial proceedings was co-heir of a testator, who was his uncle. The estate consisted of money in various bank accounts and of a claim for a tax refund. The tax office determined that the inheritance tax amounted to thirty percent under tax bracket II. The plaintiff did not question the applicability of tax bracket II but argued that it was unconstitutional to treat individuals under tax brackets II and III the same. His objection, however, was rejected by the tax administration as well as the Finance Court of first instance. In the course of the appeal proceedings, the Federal Finance Court also considered the equal treatment under tax brackets II and III to be constitutional, but it questioned the constitutionality of the privileges for business assets according to Paragraph 19, section 1 in conjunction with Paragraphs 13a and 13b of the ErbStG. Hence, the Federal Finance Court submitted the question of constitutionality to the FCC according to Article 100, section 1 of the Basic Law.

In a long-expected judgment, released on 17 December 2014, the First Senate of the FCC declared Paragraphs 13a, 13b, and Paragraph 19, section 1 of the ErbStG unconstitutional.[9] The legislature may award preferential tax treatment to small and medium-sized companies managed by their owners in order to ensure their continued existence and to preserve jobs. However, it is—as the FCC holds—disproportionate to favor the transfer of business assets that go beyond the range of small and medium-sized companies without an economic needs test. It is also disproportionate to favor companies with up to twenty employees without requiring them to sustain a certain minimum wage sum and to fully exempt the transfer of business assets even though these assets contain up to fifty percent investment assets (*Verwaltungsvermögen*). The unconstitutionality of Paragraphs 13a and 13b of the ErbStG (the provisions exempting business assets) also affects the applicability of Paragraph 19 of the ErbStG (the provision on tariffs) and therefore the whole Act. The provisions shall—according to the FCC—continue to apply for the time being, but the legislature has to adopt new regulations until 30 June 2016. The decision was taken unanimously with regard to the results and the grounds. Three Justices jointly submitted a separate opinion.

C. Constitutional Law Aspects of the Case

The FCC decision is highly interesting, because it deals with the important question of the admissible extent of tax privileges for the sake of the economy. But looking closer, it is also interesting for a number of further reasons. The Court actually addresses a range of fundamental issues of constitutional law.

[9] Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court] BVerfG, 2015 NEUE JURISTISCHE WOCHENSCHRIFT [NJW] 303.

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

I. Admissibility of the Submission—The Reach of the Guarantee of Equality

While the general public and the media from the beginning concentrated on the substance of the case, it was not clear at all, whether the submission to the FCC was admissible. The submission of a question of constitutionality under Article 100, section 1 of the Basic Law requires that the outcome of the initial proceedings depends on the provision whose constitutionality is being questioned. German courts do not have to the power to submit abstract questions to the FCC. Against this background, the German government claimed in the oral proceedings before the FCC that the question submitted by the Federal Finance Court was inadmissible, because the constitutionality or unconstitutionality of Paragraphs 13a and 13b of the ErbStG—the provisions on tax exemptions for business assets—does not affect the taxation of the plaintiff. Some critics have argued that the Federal Finance Court only submitted the case, because it wanted to attack the inheritance tax privileges for business assets despite lacking a suitable case.

The FCC, however, admitted the question. In general, the Court said, the taxpayers' constitutional guarantee of equality (Article 3, section 1 Basic Law) is not affected if tax regulations that do not concern his own legal obligations under the tax code favor third parties in violation of the principle of equality. The situation is different, however, if the unconstitutional privileges undermine the general structure of the tax and the equitable burden as a whole. Under such circumstances, the FCC assumes, the unconstitutionality of privileges granted to certain taxpayers leads to the unconstitutionality of the tax regime as such. In our case, the preferential treatment was considered to be of such weight that—in the event of its unconstitutionality—the taxation of non-business assets could not remain unaffected. Hence, the FCC held that the outcome of the initial proceedings does depend on the constitutionality of Paragraphs 13a and 13b of the ErbStG.

Here, the FCC extends the reach of the constitutional guarantee of equality in a remarkable way. In prior decisions the Court has already stated that a taxpayer can claim a violation of equality in cases in which he is being taxed in accordance with the law, but in which other taxpayers are effectively not being taxed, because the properties of the applicable rules result in structural deficits in administering the rules.[10] Hence, the insufficient, unequal application of a tax rule by the tax administration leads to the unconstitutionality of the tax rule itself. Even though he is being taxed in a legally correct way, a taxpayer can therefore successfully object to his taxation under the condition that structural problems with administering the tax in other cases can be proven. In the new judgment, the Court now holds that the guarantee of equality also helps a taxpayer who finds that substantial tax privileges that others receive are unconstitutional.

[10] Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], 84 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 239.

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

This new line of argument is certainly consistent with the general idea of equality in taxation. However, it has to be noted that taxpayers may in future cases feel inclined to invoke the argument in order to attack various tax privileges granted to competitors or other groups of people. In this regard, it is important to emphasize that the Court held that a tax law as a whole is only affected by unconstitutional tax privileges of substantial weight and reach. If this condition is not met, a taxpayer who is being taxed correctly is not able to bring an action against unconstitutional privileges granted to others. In this case, it is up to other institutions to claim the unconstitutionality of the privileges (for example, proceedings according to Article 93, section 1, number 2 Basic Law initiated by Federal parliament, by the Federal government or a *Länder* government) and to initiate reform.

II. Federal Power to Enact the Inheritance and Gift Tax Act—"Necessary for Reasons of National Interest"?

There is another important issue in the case that goes beyond substantive inheritance tax law—the issue of the Federal power to tax. In the course of the current political discussions about the reform of fiscal federalism in Germany, many argue that the *Länder* should be granted more powers to levy their own taxes. Traditionally, the *Länder* budgets largely depend on taxes imposed by the Federal government. At the same time, the *Länder* have to execute laws—at their own costs—enacted on the Federal level. Recently, the *Länder* have further been curtailed by the new prohibition to incur any structural debts (Article 109, section 3 Basic Law, so-called "debt brake"). New *Länder* powers to impose taxes could give them some leeway and could also accentuate the nexus between taxing and spending.

In particular, new *Länder* powers in the area of inheritance and gift taxation are being discussed. According to Article 106, section 2 of the Basic Law, the revenue of this tax goes into the *Länder* budgets. However, the Federal government relies on Article 105, section 2 in conjunction with Article 72, section 2 of the Basic Law in order to regulate in this field. Pursuant to Articles 105, section 2 and 72, section 2 of the Basic Law, the Federation has the legislative power, if a federal regulation is deemed necessary for reasons of national interest, alternatively the interest in maintaining legal unity or the interest in maintaining economic unity. Yet, it has been questioned whether a comprehensive federal regulation of inheritance tax is actually necessary in this sense. Some argue that it may be sufficient if the Federation enacts only few regulations aimed at coordinating inheritance taxation by the *Länder*, in particular in order to avoid double taxation or double non-taxation of an estate.[11] Therefore, the scientific community became very interested when it was communicated that the question of Federal taxing power might be addressed by the FCC in the case. And indeed, it did.

[11] *Hey*, *in* VVDSTRL Vol. 66, 277 (311 f.) (2007); KORTE, DIE KONKURRIERENDE STEUERGESETZGEBUNG DES BUNDES IM BEREICH DER FINANZVERFASSUNG 153 (2008).

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

The Court ruled that the Federation was competent to enact the provisions submitted for review. It held that pursuant to Article 105, section 2 and Article 72, section 2 of the Basic Law, a federal regulation is necessary for reasons of national interest not only if it is indispensable to maintain legal or economic unity. It is sufficient if the federal legislature could otherwise expect problematic developments for the legal and economic unity of the country. The legislature has a prerogative for assessing the conditions of a federal regulation and its necessity in the interest of the state as a whole. In the present case, the federal legislature could—in view of its prerogative—assume that without federal regulation a fragmentation of the law could ensue that would entail significant disadvantages for the testator and the heir of business assets, as well as for the tax administration.

It is generally wise for a court to point to the prerogative of the democratically elected legislator. Here, however, the Federal legislature applies a rule that grants a competence. It appears questionable whether in such a case the same kind of prerogative should be assumed as in other cases. In prior decisions, the FCC has interpreted Article 72, section 2 of the Basic Law in a very strict way[12] in order to give teeth to the reform of 2006 when Article 72, section 2 was modified so that the *Länder* would have more legislative freedom. In our case, on the contrary, the Court emphasizes the authority of the Federal government. Of course, it would have been rather courageous and also surprising, if the Court had held that the Inheritance and Gift Tax Act as a whole is unconstitutional because the Federal legislative has promulgated the Act without being competent to do so. Nevertheless, the inheritance tax may still be a good reference for thinking about new forms of cooperative regulation between the Federal government and the *Länder*; with the Federal government enacting general regulations on the tax base and the coordination of taxation and the *Länder* filling in the details on exemptions, the tax rates etc.

III. Constitutionality of the Preferential Treatment

1. Principle of Proportionality

The core issue of the case, of course, is the preferential tax treatment of business assets. The holdings of the FCC on this point are, to a significant extent, based on case law that has been developed over a period of decades.[13] While in Germany the written constitution is

---

[12] Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], 106 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 62; Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], 111 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 226.

[13] *See* P. KIRCHHOF, BESTEUERUNG IM VERFASSUNGSSTAAT (2000); STEUERRECHT UND VERFASSUNGSRECHT – ZUR ROLLE DER RECHTSPRECHUNG BEI DER VERFASSUNGSKONFORMEN GESTALTUNG DER STEUERRECHTSORDNUNG (Birk ed., 2009); G. Kirchhof, *in* HERRMANN/HEUER/RAUPACH, EINKOMMENSTEUER- UND KÖRPERSCHAFTSTEUERGESETZ, EINFÜHRUNG ZUM

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

rather silent on the limits to taxation arising from liberty and equality rights, it is fair to say that the FCC and also the scientific community have substantially contributed to the rise of a specific constitutional law on taxation.

In the area of tax law, the constitutional guarantees of freedom and equality demand that the individual taxpayer is being taxed according to his or her economic ability to pay (*Leistungsfähigkeitsprinzip*). This leaves a wide margin of appreciation to the legislature, both regarding the selection of the taxable object and the determination of the tax rate. However, after a taxable object has been chosen (income, wealth, consumption etc.), the tax law must be shaped consistently (*Folgerichtigkeit*).

Even though an equitable taxation is a taxation according to the individual ability to pay, the legislature is not prevented from supporting goals outside the narrow fiscal scope, in particular through tax exemptions. The legislature has wide discretion in assessing which goals it deems worthy of support and which tax breaks it offers for their achievement. However, the legislature remains bound by the principle of equality. Tax benefits therefore require a special objective justification. The weight of the justification required depends on the intensity of inequality caused by the tax treatment (principle of proportionality; *Verhältnismäßigkeitsgrundsatz*).

2. Proportionality of the Exemption in General – Requirement of an Economic Needs Test for Larger Companies

Based on these principles, the FCC considered the tax exemption for business assets in Paragraphs 13a and 13b of the ErbStG as such as compatible with the constitutional guarantee of equality (Article 3, section 1 Basic Law). The exemption regulation leads to an unequal treatment of heirs of business and non-business assets that can reach enormous proportions. Pursuant to Paragraphs 13a and 13b ErbStG, eighty-five percent or even one hundred percent of the value of business assets, of agricultural and forestry assets, and certain shares in corporations remain tax-exempt if several legal conditions are met. Added to this is a general application of the lower tax bracket pursuant to Paragraph 19a of the ErbStG. Hence, the distinction between assets with and without preferential treatment is much more than marginal. Thus, the legislature is subject to a strict standard of proportionality. Moreover, heirs usually have little influence on whether the assets inherited by them are eligible for preferential treatment, which also implies a strict standard of review.

Applying the principle of proportionality to the case, the FCC first identifies the aim of the preferential treatment. The exemption regulations are primarily aimed at protecting

EINKOMMENSTEUERRECHT, TEIL B (2014); Kube, *Financing the State—The Tax-funded State Versus Multiple and Mixed Financing Strategies*, *in* DEBATES IN GERMAN PUBLIC LAW 131 (146 ff.) (Pünder & Waldhoff eds., 2014).

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

companies which are characterized by a special personal bond of the testator or the heir to the company, as is typical for family-owned businesses. Their productive assets are to receive preferential treatment under tax law, so as not to jeopardize the company's continued existence and its jobs because of tax-related liquidity problems. These objectives do, as the FCC holds, not raise any general constitutional concerns.

In the next steps of the proportionality test, the FCC finds that Paragraphs 13a and 13b of the ErbStG are suitable (*geeignet*) as well as—at least in principle—necessary (*erforderlich*) to achieve the objectives pursued. The legislature has a wide margin of appreciation in this regard. Against this background, it is sufficient that it has, in a reasonable and plausible way, identified a serious risk of liquidity problems in the context of taxing a transfer of companies. There is, as the FCC holds, no need to empirically prove that taxation would give rise to dangers for the businesses in more than just exceptional cases. To make the exemption contingent on a needs test would not constitute an equally suitable, but less encroaching measure, because it would entail rather complicated procedures, especially due to assessment questions. Neither would forbearance of debt constitute an equally effective, but less restrictive measure.

Finally, the unequal treatment effected by the exemption regulations is, as the FCC finds, in general also compatible with the requirement of adequacy (proportionality in a narrower sense, balancing test; *Angemessenheit*), even if it leads to a tax exemption of one hundred percent. However, in view of the considerable degree of inequality caused, the FCC differentiates here. It would be incompatible with Article 3, section 1 of the Basic Law to grant fully unconditional exemptions without regard to the size of the company involved. More precisely, preferential treatment of business assets is disproportionate if it covers more than small and medium-sized companies without any economic needs test. In other words, small and medium-sized companies may receive preferential treatment without an economic needs test. In case of larger companies, on the contrary, an economic necessity to exempt the acquired company from inheritance taxation has to be shown. It will now be up to the legislator to create a meaningful economic needs test for larger companies, should the legislator want to hold on to the general exemption scheme.

3. Constitutionality of Concrete Requirements for the Exemption

Beyond these general elements of the decision, the FCC also judged upon the constitutionality of several concrete requirements for the tax exemption.

3.1. Minimum Participation

According to the Inheritance and Gift Tax Act, preferential treatment of an heir requires a minimum participation of over twenty-five percent in a corporation. This is aimed at excluding mere financial investments and at limiting preferential treatment to shareholders who are actually involved in the company's business practice. The FCC did not

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

see any constitutional problems with this reasoning of the legislator. Furthermore, it was held to be compatible with the guarantee of equality to generally favor the acquisition of shares in partnerships. The legislature could also assume that shares in agricultural and forestry businesses do generally entail some personal involvement in the company's business practice so that these shares may be tax exempt.

3.2. Aggregate Wage Requirement

According to the aggregate wage regulation, the tax exemption will only be granted if the aggregate of the wages and salaries paid within five years after the transfer of the company is no less than 400 % of the average sum of wages paid per year before the transfer. The aggregate wage regulation is based on the objective of the legislator to preserve jobs. It is, as the FCC holds, within the legislature's discretion to apply an aggregate wage regulation instead of a strict commitment to preserve specific jobs. However, according to the law the aggregate wage requirement only applies to companies with more than twenty employees. This qualification aims at administrative simplification — an aim that can generally justify inequality to some degree. The FCC, however, points to the fact that well over ninety percent of all businesses in Germany have no more than twenty employees. Thus, nearly all companies can claim tax benefits without any regard to the actual preservation of jobs in the future. At the same time, the administrative burden generated by the verification of the minimum of total wages and salaries is not as high as is sometimes alleged. Hence, the FCC did not accept the twenty employee limit. Should the legislature decide to hold on to the current exemption scheme, it will have to think about a different way of protecting the tax administration from inadequate burdens due to the aggregate wages and salaries requirement.

3.3. Investment Assets

Finally, the FCC ruled on the fifty percent limit to investment assets. According to the Act, business assets are fully tax exempt, if they include up to a maximum of fifty percent investment assets (*Verwaltungsvermögen*). The legislature's objective for the limit is to support productive assets and to prevent circumvention through tax planning. This objective is, of course, reasonable. However, the objective cannot—according to the FCC—justify that assets containing up to fifty percent investment assets fully benefit from the tax exemption. The regulation can hardly achieve its goal to prevent opportunities for tax planning. On the contrary, it is more likely that it will encourage the relocation of private investment assets into business assets. Hence, the FCC struck the rather generous fifty percent limit down as unconstitutional.

3.4. Unconstitutionality of a Tax Law that Allows for Unintended Tax Breaks

Additionally, the FCC takes a look at inheritance tax practice, in particular at the practice of tax avoidance. In regard to this problem, the Court holds that a tax law is unconstitutional

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

if—beyond atypical individual cases—it allows for situations in which one can attain unintended tax breaks that cannot be justified under the principle of equality. In the context of the Inheritance and Gift Tax Act, this is particularly the case in constellations in which the aggregate wage requirement is bypassed by corporate restructurings—several companies with less than twenty employees each. Also, the fifty percent limit on investment assets can effectively be circumvented in multi-layered corporate structures.

By claiming that a tax law can be unconstitutional if it allows for factual tax avoidance, the FCC once more extends the reach of the guarantee of equality. Having ruled that a tax law can be unconstitutional if structural deficits in administering the law can be found,[14] and having held that tax provisions applicable to a taxpayer can equally violate the guarantee of equality if other tax provisions grant tax privileges to other taxpayers in an unconstitutional way,[15] the Court now declares that also tax avoidance by taxpayers can lead to the unconstitutionality of the law itself. On the one hand, this appears as coherent, on the other hand it seems to be rather revolutionary, as the responsibility for factual tax avoidance by the taxpayer is effectively attributed to the legislator. In my opinion, this new reasoning by the Court deserves support, as it makes sure that the honest taxpayer is not the one who suffers from a law that leaves loopholes for the ones who aim at avoiding taxes. However, it will again be important to define the right standard of scrutiny in future cases. The FCC provides some guidance by asserting that the law is only considered to be unconstitutional if it allows for "substantial" tax avoidance. This leaves sufficient room for the application of Paragraph 42 of the General Tax Act (*Abgabenordnung* – AO), the provision on the consequences of tax avoidance; A provision that presupposes the constitutionality and validity of the regulation that is being circumvented.

IV. Unconstitutionality of the Inheritance and Gift Tax Act as a Whole—Continued Validity Until Mid-2016

The violations of the principle of equality identified concern Paragraphs 13a and 13b of the ErbStG and also Paragraph 19, section 1 ErbStG—the regulation on tariffs—which covers the taxation of both exempt and non-exempt assets. As a result, the Inheritance and Gift Tax Act becomes inapplicable as a whole. Yet, the FCC rules that the Act shall continue to apply until the end of June 2016 at the latest, by which date the legislature must have enacted new regulations.

Regarding tax planning in the meantime, the FCC is quite explicit on the protection of legitimate expectations. The continued validity of the unconstitutional provisions does not entail, as the Court holds, that there is a protection of legitimate expectations with regard

[14] *See* Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], 84 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 239.

[15] *See supra* Section 3.1.

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

to these regulations against the retroactive enactment of new regulations. In other words, the legislator may—until mid-2016—enact a new Inheritance and Gift Tax Act that retroactively comes into force in the end of 2014. This holding is in line with other recent judgments on the retroactivity of law that very much focus on the protection of real confidence only.

V. Separate Opinion—The Principle of the Social State

The decision of the Court was taken unanimously. However, the Justices Gaier, Masing, and Baer added a separate opinion regarding the grounds of the judgment. They argue that a further element must be considered to support the holding: the principle of the social state, as guaranteed by Article 20, section 1 of the Basic Law. It is, as these Justices write, only through this principle that the justice-related dimension of the issue becomes clearly visible. Inheritance tax not only aims at providing revenue, but is also an instrument of the social state. It makes sure that the succession of generations does not lead to wealth accumulating in the hands of few and of increasing disproportionately on the sole basis of background or personal relations. This is in fact a challenge today, as indicated by the development of the actual distribution of wealth. In his dissenting opinion to the decision on the 1993 property tax, Justice Böckenförde already pointed out that eighteen percent of all private households in Germany possessed sixty percent of all net financial assets.[16] In 2007, this percentage of financial assets was held by merely ten percent of private households. It is—as the Justices hold—within the responsibility of lawmakers—and not subject to their discretion—to compensate for these inequalities that would otherwise become even more permanent. The three Justices conclude that the justification requirements in cases of tax inequality increase when those are exempted from taxation who are already more powerful in conditions of a market economy than others. Thus, Article 3, section 1 of the Basic Law—the guarantee of equality—has to be interpreted in the light of Article 20, section 1 of the Basic Law, the principle of the social state.

While the concept of the social state is without doubt related to the idea of equality, it appears questionable whether the constitutional principle of the social state can actually and meaningfully supplement the constitutional guarantee of equality in our context. Certainly, the legislator will take account of the principle of the social state when shaping the tax tariff, as the tariff defines the volume of the tax-based redistribution of wealth (flat tax, progressive tax, degree of tax progression). However, it has to be borne in mind that tax law is always encroaching upon the rights of the individual citizen. Therefore, the calculation of tax, in particular the calculation of the assessment basis, primarily has to conform to the individual guarantees of freedom and equality. Hence, any inequality caused by tax law, in particular by a tax exemption, has to be founded on a sufficiently

[16] Bundesverfassungsgericht [BVerfG] [Federal Constitutional Court], 93 ENTSCHEIDUNGEN DES BUNDESVERFASSUNGSGERICHTS [BVERFGE] 121, 149, 164.

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press

important reason, relative to the intensity of the inequality. The principle of the social state does not make a substantial difference in this regard.

D. Future Perspectives

It is now up to the legislator to react to the FCC holding. While the Court granted the legislator quite some time to develop modifications to the existing law, the first signals from Berlin indicate that the Federal Ministry of Finance will attempt to draft the new law as quickly as possible — in order to end the current period of uncertainty and to provide to the taxpayers, more precisely to the economy a solid normative basis for further planning.

It appears that the legislator will try to change as little as possible ("*minimalinvasiv*"), with a view to the aim of continuing to support the economy. The economic needs test that the Court requires for a constitutional tax exemption for larger companies should, as the Federal Ministry of Finance indicates, be regulated in the Act as far as possible and should not be left to the tax administration;[17] this will require normative typifications. Regarding the exemption from the aggregate wage requirement for small companies (so far twenty employees), the Ministry considers a different regulation that allows small companies with an aggregate wage sum of up to one million Euros per year to benefit from the tax exemption without having to sustain a certain aggregate wage over a period of five years. Finally, a solution will have to be found for the treatment of investment assets that are part of the business assets of a company. Here, the legislator thinks about fully or partially abolishing the tax exemption for the share of investment assets only.

All of this shows that the legislator is indeed trying to change as little as possible. The question remains whether this strategy will actually lead to the adoption of an Inheritance and Gift Tax Act that conforms to the constitution. Of course, the FCC approved of the general distinction between private assets and business assets and of granting tax exemptions to business assets only aiming to support the economy. But as a matter of fact, it will be very difficult to devise concrete regulations that reliably meet the expectations of the FCC.

Against this background, the legislator should consider one fundamental and consequent alternative: An inheritance tax that treats everybody the same, that is equitable and that does not require sophisticated delineations between different kinds of assets and companies. Should the heir of a company, in particular of a family-run business, not be able to pay the inheritance tax at once, he should be given the option of a partial forbearance. Considering a reasonable tax tariff of—for example—ten percent and a step-like forbearance for a total of ten years, this would mean a one percent tax per year. Such a tax burden should, under normal circumstances, not put a company into difficulties.

[17] *See* FRANKFURTER ALLGEMEINE ZEITUNG [FAZ] 21 (Jan. 10, 2015).

https://doi.org/10.1017/S2071832200021106 Published online by Cambridge University Press