Headnotes

to the Judgment of the First Senate of 17 December 2014

– 1 BvL 21/12 –

1. **Art. 3(1) of the Basic Law does not grant taxpayers a right to constitutional review of tax law provisions that favour third parties in violation of the principle of equality, but that do not concern the individuals' own legal obligations under the tax law. However, this is different if tax breaks undermine the equitable burden the tax shall impose altogether.**

2. **Pursuant to Art. 72(2) of the Basic Law, a federal legal provision 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 Federal Constitutional Court has to ascertain whether these conditions are met; the legislature has a prerogative of assessing the conditions of a federal legal provision and its necessity in the interest of the state as a whole.**

3. **In the area of tax law, the principle of equality leaves a wide margin of appreciation to the legislature, both regarding the selection of the taxable object and the determination of the tax rate. Deviations from a final decision on taxation issues must be measured against the principle of equality (requirement of consistent design of the basic tax provision). They require a special factual reason. The requirements to the justification increase in relation to the scope and extent of the deviation.**

4. **Considering its scope and the possible design options, it is incompatible with Art. 3(1) of the Basic Law to exempt the transfer of business assets from inheritance tax under §§ 13a and 13b of the Inheritance and Gift Tax Act (*Erbschaftsteuer- und Schenkungsteuergesetz* – ErbStG).**

a. **It is within the legislature's scope of decision-making to, largely or completely, exempt from inheritance tax small and medium-sized companies that are managed personally by their owners, in order to ensure their continued existence and to preserve jobs. For any measure of tax exemption, the legislature does however need sound reasons for justification.**

b. Preferential treatment of the acquisition of business assets is, however, disproportionate if it applies to other than small and medium-sized companies without an economic needs test.

c. The aggregate wage provision (*Lohnsummenregelung*) is, in principle, constitutional; however, the exemption of companies with no more than 20 employees from a minimum wage total (*Mindestlohnsumme*) constitutes a disproportionate preferential treatment.

d. The provision for non-operative assets (*Verwaltungsvermögen*) for tax purposes is incompatible with Art. 3(1) of the Basic Law. Without sound justification, it completely excludes the acquisition of preferentially treated assets from taxation even when they consist of up to 50% non-operative assets.

5. A tax law is unconstitutional if it allows for situations in which one can attain tax breaks that are not intended and that cannot be justified with respect to the right to equality.

FEDERAL CONSTITUTIONAL COURT

- 1 BvL 21/12 -

Pronounced
on 17 December 2014
Kehrwecker
Amtsinspektor
as Registrar
of the Court Registry

IN THE NAME OF THE PEOPLE

**In the proceedings
for constitutional review of**

whether § 19(1) of the Inheritance and Gift Tax Act (Erbschaftsteuer- und Schenkungsteuergesetz – ErbStG), in the version applicable in 2009, in conjunction with §§ 13a and 13b ErbStG is unconstitutional due to a violation of the general guarantee of the right to equality (Art. 3(1) of the Basic Law, *Grundgesetz* – GG),

– Order of suspension and referral from the Federal Finance Court (*Bundesfinanzhof*) of 27 September 2012 – II R 9/11 –

the Federal Constitutional Court – First Senate –

with the participation of Justices

Vice-President Kirchhof,

Gaier,

Eichberger,

Schluckebier,

Masing,

Paulus,

Baer,

Britz

held on the basis of the oral hearing of 8 July 2014:

Judgment

1. **§ 13a of the Inheritance and Gift Tax Act (*Erbschaftsteuer- und Schenkungsteuergesetz*), in the version of the Economic Growth Acceleration Act (*Wachstumsbeschleunigungsgesetz*) of 22 December 2009 (Federal Law Gazette, *Bundesgesetzblatt,* I p. 3950), and § 13b of the Inheritance and Gift Tax Act, in the version of the Inheritance Tax Reform Act (*Erbschaftsteuerreformgesetz*) of 24 December 2008 (Federal Law Gazette I p. 3018), both in conjunction with § 19(1) of the Inheritance and Gift Tax Act, in the version published on 27 February 1997 (Federal Law Gazette I p. 378), and also in all subsequent versions, are incompatible with Art. 3(1) GG since the Inheritance Tax Reform Act entered into force on 1 January 2009.**

2. **The provisions shall continue to apply until new regulations come into effect. The legislature is required to enact new provisions by 30 June 2016 at the latest.**

R e a s o n s:

A.

The referral relates to the question of whether the provisions for the exemption from inheritance and gift tax for business assets, agricultural and forestry businesses and shares in corporations in §§ 13a and 13b of the Inheritance and Gift Tax (*Erbschaft- und Schenkungsteuergesetz* – ErbStG) in conjunction with the taxation provision in § 19(1) ErbStG in the version applicable in 2009 violate Art. 3(1) GG. 1

I.

1. a) […] 2

b) […] 3

c) […] 4

d) Both § 13a ErbStG as amended by the Inheritance Tax Reform Act and § 13b, which was newly inserted into the Inheritance and Gift Tax Act, provide for exemptions for business assets. The version of the Act applicable for the year 2009, which is the relevant year in the present case – later, certain points were designed more generously by the Economic Growth Acceleration Act (*Wachstumsbeschleunigungsgesetz*) – provides that pursuant to § 13b ErbStG the assets recognised for preferential treatment can be exempt from inheritance or gift tax to a degree of 85% (regular relief – *Regelverschonung*) or of 100% (optional relief – *Optionsverschonung*) if certain legal conditions are met with regard to the composition of the transferred assets, to its continued existence in the hands of the beneficiary, and to the preservation of jobs connected to the assets. 5

[*Excerpt from press release no. 53/2014 of 12 June 2014*]

A prerequisite for the exemption pursuant to §§ 13a and 13b ErbStG is that the relevant assets do not consist of so-called non-operative assets to more than 50%. If this prerequisite is fulfilled, the entire transfer (including the non-operative assets) profits from the preferential treatment; if not, the entire transfer is excluded therefrom. Pursuant to the act, non-operative assets include, inter alia, real estate let to third parties, securities or art objects. With these specific rules for non-operative assets the legislature intended to exclude such assets from preferential treatment that “serve to generate a largely risk-free return and neither create jobs nor additional economic output”. The beneficiary must further hold the company assets for five years in order to benefit from the exemptions. If the beneficiary disposes of the preferentially treated assets during this time frame, for example by selling the company or parts of it, the exemption is cancelled with a retroactive effect. Finally, the preferential treatment requires that the jobs existing at the time of the transfer of assets must, to a certain extent, be preserved for the duration of five years. In this regard, the number of employees is not relevant, but rather the development of aggregate wages. Within the first five years after the transfer, the aggregate wages paid by the preferentially treated company may not fall below 400 % of the initial wage total (*Lohnsumme*), calculated retrospectively from the average wage total in the years prior to the transfer. This prerequisite does not apply to companies with an initial wage total of 0 euros or no more than 20 employees.

[*End of excerpt*]

[…] 6-20

e) […] 21

2. […] 22-23

3. […] 24-38

4. […] 39

5. […] 40-41

II.

1. The initial proceedings relate to the equal treatment of beneficiaries in the tax brackets II and III in 2009. 42

The plaintiff is co-heir to a quarter of the testator’s estate, his father's brother, who died in 2009. The estate consisted of money in various bank accounts and a claim for tax refund. […] The tax authority determined the inheritance tax to be paid by the plaintiff on the basis of a tax rate of 30% […], which constituted the applicable tax rate for beneficiaries of such assets in tax bracket II in 2009. 43

The plaintiff's objection (*Einspruch*) and action, by which he aimed to reduce his tax burden [...], were unsuccessful. […] 44

2. In the proceedings on the appeal on points of law, the Federal Finance Court [...] suspended the proceedings and referred the question to the Federal Constitutional Court, 45

> whether § 19(1) of the Inheritance and Gift Tax Act, in the version applicable in 2009, in conjunction with §§ 13a and 13b ErbStG, is unconstitutional because it violates the general guarantee of the right to equality (Art. 3(1) of the Basic Law).

a) The Federal Finance Court argued that the equal treatment of individuals in tax brackets II and III as provided for under § 19(1) ErbStG in the year 2009 was acceptable under Constitutional Law. […] 46

b) It stated, however, that § 19(1) ErbStG in conjunction with §§ 13a and 13b ErbStG violated the principle of equality […]. 47

[…] 48-69

III.

[…] 70-90

B.

The referral from the Federal Finance Court is, for the most part, admissible (I.). Whilst §§ 13a and 13b ErbStG meet the formal requirements of the Constitution (II.), the provisions partially violate the guarantee of the right to equality and are, to that extent, unconstitutional (III.). 91

I.

[…] 92-105

II.

[…] 106-117

III.

Preferential taxation accorded to the transfer of business assets, agricultural and forestry assets, and shares in corporations by inheritance is, in principle, constitutionally unobjectionable. However, its design in §§ 13a and 13b ErbStG partially violates the right to equality. 118

In the field of inheritance tax law, the general guarantee of the right to equality, from the outset, leaves wide latitude to the legislature with regard to the design of exemption provisions. Considering the freedoms that are affected and the extent of unequal treatment, it may, however, be subject to restrictions reaching as far as a strict review 119

of proportionality (1.). Accordingly, the exemption pursuant to §§ 13a and 13b ErbStG is, in principle, constitutional, but corrections are required with regard to preferential treatment of transferring large company assets (2.). Also regarding certain aspects – in particular with respect to aggregate wages and non-operative assets –, the specific design of the exemption provision violates Art. 3(1) GG (3.).

1. The exemption provisions in §§ 13a and 13b ErbStG must be measured against Art. 3(1) GG. They exempt the transfer of certain assets from inheritance and gift tax, which leads to unequal treatment in numerous ways. At the same time, the provisions do not, from the outset, constitute an excessive tax burden that would call into question the guarantee of the right of inheritance (cf. Decisions of the Federal Constitutional Court, *Entscheidungen des Bundesverfassungsgerichts* – BVerfGE 93, 165 <173 and 174>). 120

a) Art. 3(1) GG demands that all people be treated equally before the law. The resulting principle to treat issues which are essentially alike equally and treat essentially different issues unequally applies to unequal burdens and unequal privileges (cf. BVerfGE 121, 108 <119>; 121, 317 <370>; 126, 400 <416>). To grant one group of persons a privilege that is denied to another group constitutes an exclusion from preferential treatment, thus violates the right to equality and is therefore prohibited (cf. BVerfGE 116, 164 <180>; 121, 108 <119>; 121, 317 <370>; 126, 400 <416>). At the same time, Art. 3(1) GG does not prevent the legislature from differentiating. However, any differentiation must always be justified by factual reasons adequate to the aim and extent of the unequal treatment. The standard of constitutional review applicable here is a fluid one that is based on the principle of proportionality, and whose limits cannot be determined in the abstract but instead are defined by the particular subject matters and regulatory areas affected (cf. BVerfGE 75, 108 <157>; 93, 319 <348 and 349>; 107, 27 <46>; 126, 400 <416>; 129, 49 <69>; 132, 179 <188 para. 30>). 121

Depending on the matter regulated and the criteria for differentiation, the general guarantee of the right to equality results in different constitutional requirements relating to the factual reasons justifying the unequal treatment; this may range from a standard limited to the mere prohibition of arbitrariness to strict requirements of proportionality (cf. BVerfGE 117, 1 <30>; 122, 1 <23>; 126, 400 <416>; 129, 49 <68>). Stricter ties for the legislature may apply because of the freedoms affected in a given case (cf. BVerfGE 88, 87 <96>; 111, 176 <184>; 129, 49 <69>). Moreover, the less the individual can influence the criteria on which the legislative differentiation is based (cf. BVerfGE 88, 87 <96>; 129, 49 <69>), or the closer such criteria are to those listed in Art. 3(3) GG (cf. BVerfGE 88, 87 <96>; 124, 199 <220>; 129, 49 <69>; 130, 240 <254>; 132, 179 <188 and 189 para. 31>), the stricter the constitutional requirements. 122

b) The principle of equal burdening (*Lastengleichheit*) constitutes the basis for equality considerations in the field of tax law. According to this principle, taxpayers must, de facto and de jure, be equally burdened by a tax law (cf. BVerfGE 117, 1 123

<30>; 121, 108 <120>; 126, 400 <417>). The right to equality leaves wide latitude to the legislature when deciding on the object of taxation and determining the tax rate (cf. BVerfGE 123, 1 <19>; established case-law). After an object of taxation is chosen and thus, a decision on a tax burden is made, deviations from such a decision must, however, be in accordance with the right to equality (requirement of consistent design of the basic tax provision, cf. BVerfGE 117, 1 <30 and 31>; 120, 1 <29>; 121, 108 <120>; 126, 400 <417>). Accordingly, such deviations require a specific factual reason (cf. BVerfGE 117, 1 <31>; 120, 1 <29>; 126, 400 <417>; 132, 179 <189 para. 32>) that can justify unequal treatment. In such a case, the requirements for the reason justifying the deviation increase relative to the scope and extent of the deviation (cf. BVerfGE 117, 1 <32>).

c) The legislature is not prevented from pursuing non-fiscal promotion and steering objectives by means of tax law (cf. BVerfGE 93, 121 <147>; 99, 280 <296>; 105, 73 <112>; 110, 274 <292>; established case-law). If a tax law results in tax exemptions that are contrary to equal taxation of the relevant taxable objects within a certain tax type, such an exemption can be justified with regard to the right to equality if the legislature intends to promote or steer the tax payers' behaviour for reasons of the common good (cf. BVerfGE 93, 121 <147>). 124

The legislature is largely free to decide on the circumstances, persons or companies which should be supported by an exemption (cf. BVerfGE 17, 210 <216>; 93, 319 <350>; 110, 274 <293>). In particular, the legislature has a wide margin of appreciation with respect to the objectives it supports. The legislature may introduce tax exemptions if it anticipates that, resulting from unrestricted collection of taxes, the common good may be adversely affected. Nevertheless, the legislature remains bound by the right to equality. Initially this does, however, only mean that the legislature is barred from distributing benefits based on non-factual reasons, i.e. arbitrarily. Therefore, a wide range of factual considerations is available to the legislature as long as the provision is not based on an assessment of the respective circumstances contrary to any life experience and if, in particular, the circle of persons who benefit from the exemption is adequately drawn (cf. BVerfGE 17, 210 <216> with reference to BVerfGE 12, 354 <367 and 368>; 110, 274 <293>; 117, 1 <32>). 125

The legislature's wide latitude when deciding on whether and what circumstances, persons or companies it intends to support by exempting them from a certain tax, and which objectives of common good it thereby intends to pursue, does, however, not rule out that the specific design of such exemption provisions may be subject to stricter constitutional review. Apart from the individuals' possibility to influence the criteria for differentiation, the significance with respect to freedoms, and the similarity to the criteria for differentiation listed in Art. 3(3) GG, which have already been mentioned, the legislature's liberty in the field of tax law may be restricted by the degree of unequal treatment caused by the tax exemptions, and by its overall effect on equal collection of that tax. Depending on the intensity of unequal treatment, this may lead to a stricter review of the objectives that the legislature intends to pursue by the Fed- 126

eral Constitutional Court.

2. The exemption provisions under §§ 13a and 13b ErbStG lead to a preferential treatment of beneficiaries of business assets as opposed to beneficiaries of other assets which is, in principle, compatible with Art. 3(1) GG, yet requires a revision with regard to the descent of large company assets. The unequal treatment of beneficiaries of preferentially treated assets and other assets caused by the exemption provisions is substantial (a). Therefore, the legislature is subject to a stricter oversight, applying the standard of proportionality that exceeds a mere review of arbitrariness (b). The tax exemptions pursuant to §§ 13a and 13b ErbStG are particularly aimed at shielding companies shaped by a characteristic personal bond of the donor, the testator or the beneficiary to the company from liquidity problems resulting from the burden of the inheritance or gift tax upon descent of the company, in order to ensure their continued existence and to preserve jobs after business succession (c). The exemption provisions of §§ 13a and 13b ErbStG are suitable (d) and necessary (e) to achieve these aims. In principle, they are also proportionate in a stricter sense. This does, however, not apply to cases in which the exemption reaches beyond the range of small and medium-sized companies without providing for an economic needs test (f). 127

a) The exemption provision leads to an unequal treatment of beneficiaries of business and non-business assets that can amount to a substantial degree. Pursuant to §§ 13a and 13b ErbStG, a percentage of 85% or 100% of the value of business assets, of agricultural and forestry assets, and of shares in corporations are not taken into account to determine inheritance or gift tax, if certain other legal conditions are met, relating to the amount of non-operative assets, the aggregate wages and the duration for which the company must be held after the descent. Even if the full exemption of 100% is not already applicable, further reductions apply, pursuant to § 13a(2) ErbStG as well as the general application of the lower tax bracket pursuant to § 19a ErbStG. There is no similar exemption from inheritance tax or gift tax for the transfer of other assets. […] Thus, the Inheritance and Gift Tax Act that refers to the increase of assets in the recipient's hand (cf. BVerfGE 93, 165 <167>; 117, 1 <33>; 126, 400 <421>) imposes different tax burdens […] on the beneficiaries' gains. 128

[…] 129

b) The constitutionality of unequal treatment of different types of assets under §§ 13a and 13b ErbStG requires a sufficiently sound reason to meet the stricter review of proportionality that reaches beyond a mere review of arbitrariness. 130

The substantial degree which the […] unequal treatment of single cases of preferentially treated assets compared with other assets can reach, and which is […] set as a standard in the system of these statutory provisions, requires a review of the constitutionality that clearly extends beyond a mere review of arbitrariness. This also applies in view of the fact that the distinction between business assets subject to preferential treatment and other assets which are not does not only affect a marginal area of in- 131

heritance and gift tax collection, but rather leads to a structural division of this tax. […]

As far as the strictness of the review of the legislative differentiation is guided by the individual's possibility to influence the criteria, the effect on exercising freedoms and the proximity to the criteria listed in Art. 3(3) GG (see 1 a above), only the possibility of the individual to influence the differentiation based on the types of assets is relevant here. This aspect leads to a stricter review of the legislature's latitude to differentiate. […] 132

c) The unequal treatment resulting from §§ 13a and 13b ErbStG serves to pursue legitimate objectives. The tax exemption for the acquisition of business assets without payment aims to protect companies from liquidity problems that can be caused by an inheritance or gift tax burden on such transfers of companies. The exemption provision is intended to protect, in particular, companies which are characterised by a special personal bond of the testator or the heir to the company, as is especially typical for family-owned businesses. The productive assets of such companies are to be preferentially treated with regard to taxation, in order not to jeopardise the company's continued existence and the jobs related thereto, in case of a company succession. This can be deduced from the legislative materials (aa) and a systematic reading of the exemption provision (bb). These objectives do not raise constitutional concerns (cc). 133

aa) […] 134

bb) […] 135-137

cc) The legislature is largely free to decide on the objectives it wants to achieve or at least promote by tax exemptions. However, the legislature reaches its limits if it pursues objectives that are disapproved under the Basic Law (cf. the respective restrictions on common good objectives being the basis of expropriations in BVerfGE 134, 242 <292 and 293 para. 172>) or if its objectives result in an irresolvable contradiction to other legislative determinations. Thus, supporting and preserving company structures that the legislature regards as particularly valuable for the economic success of Germany, i.e. small and medium-sized companies personally managed by their owners, and in particular, family-owned companies, as well as preserving jobs by protecting such companies from liquidity problems caused by taxation, do constitute legitimate objectives of significant weight (cf. also BVerfGE 93, 165 <175 and 176>). 138

d) §§ 13a and 13b ErbStG are suitable for achieving the objectives pursued. The constitutional requirement of suitability does not require the provision or measure leading to the challenged unequal treatment – in this case the exemption – to fully achieve its objective, but rather to be suitable for promoting these objectives (cf. BVerfGE 115, 276 <308>; 130, 151 <188>; cf. also further references in BVerfGE 106, 62 <149>). It is sufficient that a possibility to achieve the objectives exists (cf. BVerfGE 67, 157 <175>; 121, 317 <354>). Here, it is obvious and does not require 139

stating any additional reasons that the extensive or full exemption of preferentially treated transfers of companies from inheritance and gift tax is, in principle, suitable to prevent these companies from the threat of liquidity problems that the companies might otherwise face (for details regarding the design of the tax exemption, in particular with regard to aggregate wages and non-operative assets, see 3 below.).

e) In principle, the exemption provision is also necessary. The legislature could assume that the companies would otherwise face the threat of economic difficulties. Leaving the details of the design of the exemption provision aside, there is no solution at hand that would be as effective in protecting the liquidity of companies or parts of a company which are inherited or transferred without payment, and thus preserve jobs, whilst at the same time creating a smaller disadvantage to beneficiaries of assets not subject to this preferential treatment. 140

Also with respect to the right of equality, the necessity of the legislative measures is subject to a lenient standard of constitutional review (aa). Therefore, it is constitutionally unobjectionable that the legislature assumed that exempting the transfer of companies without payment from inheritance and gift tax might generally be necessary in order to protect the companies from liquidity problems (bb), and that it would not require an economic needs test in each individual case (cc). A possible deferral of debt, as suggested, is not a more lenient and equally effective measure either (dd). 141

aa) Extensively or fully exempting the acquisition of business assets without payment from inheritance and gift tax is necessary if no other means are available by which the legislature can achieve or promote the objective sought by the provision that is equally effective yet causes less inequality (for cases of an interference with a specific freedom cf. BVerfGE 80, 1 <30>; 117, 163 <189>; 121, 317 <354>). In this regard, the legislature enjoys a wide margin of appreciation and prognosis (cf. BVerfGE 117, 163 <189>; 120, 224 <240>; 121, 317 <354>). 142

bb) The legislature was justified to assume that, without an exemption from the impending inheritance and gift tax burden, the liquidity of companies would be at risk. Therefore, it could generally consider an exemption provision to be necessary. 143

(1) It is within the legislature’s margin of appreciation to take an assessment of risk as a basis for its decision on measures to be taken if circumstances are not clearly determined and cannot be determined without further ado. The legislature may not, however, base its decision on an assessment of the respective circumstances that is virtually contrary to every real-life experience (cf. BVerfGE 110, 274 <293>; 117, 1 <32>). With regard to this prerogative, it is sufficient that the legislature has, in a reasonable and plausible way, identified that a serious risk of liquidity problems might occur when imposing taxation on company transfers without payment. In light of constitutional law, it is not required to empirically prove that imposing an inheritance and gift tax would cause problems in the continuation of business which may even be a threat to the company’s existence and a loss of jobs not only in exceptional cases,. […] 144

(2) […] 145-146

(3) It is plausible and not far-fetched that the legislature assumed that the increased tax burden for company transfers without payment to be expected because of the Inheritance Tax Reform Act would, without an exemption provision, reach an amount […] often only financeable for heirs or donees by drawing on business assets. Without the exemption provisions and the related tax rate cap in § 19a ErbStG, the transfer of business assets, agricultural and forestry assets, and shares in corporations without payment would in total be subject to the usual tax rates, i.e. depending on the value of the assets, a tax rate of up to 30% for the closest relatives, and in all other cases tax rates starting at 25% for medium-sized assets up to 50% for large assets. […] 147

This assessment of risk by the legislature corresponds to the European Commission's assessment regarding the inheritance and gift tax burden for company transfers within the family. […] 148

(4) […] 149

cc) The necessity of unequal treatment is, in principle, not challenged by the fact that the exemption is granted without an economic needs test, i.e. that it is not determined in each individual case whether or not an exemption is specifically necessary. 150

[…] 151

If the legislature is free to assume that the gift and inheritance tax burden might lead to liquidity problems for businesses in cases of company succession in more than just a few cases, thereby putting jobs at risk (see (1) above), it also is within its leeway to grant the exemption without an individual economic needs test. Such a test does not constitute an equally effective yet more lenient measure for ensuring the continued existence of the business and the related jobs. Whilst the degree of unequal treatment towards the beneficiaries of assets not subject to this preferential treatment would be reduced if individual exemptions were not granted […], such solution would, however, lead to considerable complications with regard to the collection of inheritance and gift tax […]. Already for this reason, the exemption on the basis of an individual economic needs test does not constitute a more lenient measure. 152

Extending the economic needs test to an examination of the heir's or donee's existing assets would clearly contradict the inheritance tax law system which bases the calculation of the tax solely on the gains obtained through the succession or gift and generally grants exemptions regardless of the needs of the beneficiary in other respects. 153

dd) The possibility to defer the tax debt as provided for in § 28 ErbStG, in cases of a transfer of business assets or agricultural and forestry assets, does not conflict with the necessity of an exemption provision in order to achieve the legislature's intended objective. A deferral does not result in relief as effective as an exemption. Whilst re- 154

stricting the preferential treatment of the transfer of business assets to a deferral pursuant to § 28 ErbStG would practically eliminate the unequal treatment of beneficiaries of assets who are not granted preferential treatment, this approach, however, proves not to be as effective as the exemption provision for ensuring the continued existence of the business transferred and securing jobs. Apart from the fact that the deferral burdens the person concerned with repayment obligations for up to ten years, it further requires an individual proof of need. In the course of the Senate proceedings, multiple economic and business associations plausibly stated that, in particular, small and medium-sized companies want to avoid disclosing liquidity problems to their banks, even if these problems solely result from the inheritance tax burden because they fear difficulties as to their credit standing. […]

f) The unequal treatment that results from §§ 13a and 13b ErbStG is not consistently appropriate in the stricter sense. The […] unequal treatment […] is appropriate in the stricter sense in principle, (aa - cc), but not to the extent that the exemption extends beyond the circle of small and medium-sized companies without providing for an economic needs test (dd). 155

aa) The unequal taxation of acquiring different types of assets without payment, within the meaning of § 13b(1) ErbStG under inheritance and gift tax law and respectively placing other assets at a disadvantage, is proportionate if the degree of preferential treatment of business assets, is in appropriate proportion to the importance of the objective pursued by the differentiation and to the degree and extent to which this objective is thereby achieved. 156

bb) The unequal treatment caused by the exemption of the acquisition of preferentially treated assets as compared to assets not subject to such preferential treatment is substantial (cf. above 2 a). With regard to a tax exemption of 100% and at least of 85% of the acquisition – the latter combined with further allowances pursuant to § 13a(2), § 19a ErbStG –, the relative exemption from inheritance and gift tax is already comprehensive or at least far-reaching; it can, however, also be very high in absolute numbers, since the scope of preferential treatment is not subject to numerical restrictions. In contrast, the beneficiaries of assets that do not benefit from such preferential treatment are subject to unlimited taxation of the acquisition, with tax rates of up to 50% if the value of the personal tax allowance (cf. §§ 16, 17 ErbStG) is exceeded and no other tax exemption applies (cf. §§ 5, 13, 13c, 18 ErbStG). 157

However, the objective of the promotion, which is to facilitate the transfer of business assets without payment without a tax-induced liquidity risk, is achieved […]. 158

cc) Based on this, the exemption concept under §§ 13a and 13b ErbStG, in principle, proves to be proportionate. It is within the legislature's prerogative of appreciation and its leeway to design to consider the continued existence of primarily small and medium-sized companies personally managed by their owners so important (see 2 c above) that they are largely or fully exempt from inheritance and gift tax, in order to ensure their existence and at the same time preserve jobs. 159

(1) In exempting, in particular, small and medium-sized family-owned companies from inheritance and gift tax in order to protect such businesses from potential liquidity problems, and thus to ensure their continued existence and preserve the jobs connected to them, the legislature pursues important reasons of the common good. As was already the case with equivalent provisions on tax exemptions in the years before the Inheritance Tax Reform Act entered into force, the legislature intends to primarily promote and protect small and medium-sized family-owned companies with the new provisions in §§ 13a and 13b ErbStG as well (see 2 c above). The succession in such companies is not to be burdened by inheritance and gift tax in a way as to impede the investment strength of the beneficiaries or to even force them to sell or liquidate the company (cf. *Bundestag* document, *Bundestagsdrucksache* - BTDrucks 16/7918, p. 33). 160

[…] 161-163

(2) As has already been established in the assessment of necessity, it does not raise constitutional concerns (see 2 e bb above) that the legislature assumed that an unrestricted tax burden on company succession would endanger the investment capability and possibly also the continued existence of companies not only in exceptional cases. 164

(3) The exemption provisions of §§ 13a and 13b ErbStG are designed in a way that they can generally contribute to achieving the legislative objective to a large extent. At this point, it is of no concern whether the legislature's steering instruments regarding the exemption are designed in an adequate and equality oriented way (on this, see at 3.); the provisions for aggregate wages and the duration for which a company must be held are at least in principle suitable to ensure that the transferred company continues to exist under the management of the beneficiary and to preserve jobs (on this, see 2. d above). The provisions for non-operative assets are aimed at ruling out exemptions granted for non-productive assets, which are not deemed worthy of promoting, and thereby ensure targeted preferential treatment. Due to the lack of maximum limits in §§ 13a and 13b ErbStG, there are indeed no provisions that clearly limit the promotion to small and medium-sized companies; however, the fact that the tax-deductible amount is reduced pursuant to § 13a(2) ErbStG if the preferentially treated assets subject to taxation exceed EUR 150,000 indicates, at least to some extent, that the exemption provisions are geared towards smaller companies. To the extent that the inheritance includes shares in a corporation, the personal responsibility for the management of the company, which is typical for family-owned companies, is reflected by the requirement that the beneficiary must hold a minimum share of more than 25% in the company, in order to be eligible for preferential treatment. 165

This design of the exemption provision is, in principle, appropriate and within the legislature's creative freedom. The relevance of the interests of the common good pursued by the exemption provision is, also considering the degree to which the objectives are expected to be achieved, not disproportionate with regard to the consid- 166

erable unequal treatment to the disadvantage of beneficiaries of other assets. The legislature is also within its margin of appreciation and assessment regarding the weighting of the conflicting objectives and positions decisive for this outcome.

(4) The prerequisites for an exemption that the legislature has attached to its promotion concept are indeed absolutely essential for the appropriateness of the provisions as a whole. It cannot be derived in detail from the right to equality that the legislature must specifically subject exemptions to restrictions based on aggregate wage regulations and time periods during which the company must be held, and that it had to limit the exemption to productive assets by excluding non-operative assets. However, a preferential treatment of business assets as extensive as in the case at hand is only appropriate if accompanying legal provisions adequately ensure that the promotion objective which is pursued by granting the exemption is effectively achieved, and that the preferential treatment is reliably limited to assets that are deemed worthy thereof. Also in this respect, the legislature is largely free to decide on the kind of instruments it wants to use in order to ensure a targeted promotion of these objectives based on a sufficiently clear set of rules (cf. BVerfGE 117, 1 <32 and 33>; cf. also 110, 274 <293> and 116, 164 <182>). However, it is constitutionally required that suitable measures are taken in order to ensure proportionality of the exemption provisions. With regard to the considerable degree of unequal treatment, granting comprehensive exemptions for the acquisition of business assets without payment unconditionally and without any measures to ensure the promotion of the objectives would not comply with Art. 3(1) GG. 167

(5) The fact that the option model in § 13a(8) ErbStG offers the possibility to achieve a 100% tax exemption is not per se unconstitutional because of its comprehensiveness. However, the legislature is required to provide sound reasons to justify any type of tax exemption (cf. BVerfGE 117, 1 <32>); therefore, to a complete tax exemption for certain objects of taxation – as can be found in numerous tax exemption rules – is not categorically different from smaller tax exemptions. It does always require a sufficiently weighty factual reason to justify the unequal treatment resulting from such exemptions. 168

If the exceptions, exemptions and allowances for a specific tax type – in particular when granted for steering and promotion purposes – are factually justified and equality oriented on their own, they also do not violate the right to equality when combined, solely because they then cause a tax to be largely ineffective. With regard to the taxation of family members and small and medium-sized businesses under inheritance tax law, the legislature, by ensuring preferential treatment and exemptions regarding inheritance and gift tax, largely accounted for requirements established in the Federal Constitutional Court's case-law, inter alia regarding Art. 14(1) and Art. 6(1) GG (cf. BVerfGE 93, 165 <174 and 175>). The Federal Finance Court's […] constitutional concern that […] the tax exemption […] constituted the rule, and that an actual taxation constituted an exception […], does not per se render the inheritance and gift tax provisions disproportionate. 169

dd) The unequal treatment of preferentially treated business assets and other assets not subject to such preferential treatment is, however, disproportionate to the extent that the acquisition without payment of business, agricultural and forestry assets and of shares in corporations are, to a large part or completely, exempt from inheritance and gift tax, without requiring an economic needs test, and that these are acquisitions of companies exceeding the dimensions of a small or medium-sized company. 170

(1) The more extensive the tax-exempt acquisition, the higher the degree of unequal treatment. Since §§ 13a and 13b ErbStG do not provide a maximum limit with regard to the assets eligible for tax exemption, even businesses worth hundreds of millions or even several billion euros can be transferred exempt from inheritance or gift tax if they comply with the exemption requirements. Obviously, it cannot be ruled out that very large companies also might get into financial difficulties, or loose investment strength, or have to cut jobs, or have to be sold or even liquidated if their beneficiaries are subject to a correspondingly large inheritance or gift tax burden. Consequently, the related detriments to the common good would be larger in this case. These risks can ultimately justify the exemption of very large companies from inheritance and gift tax; with respect to the principle of equal distribution of the tax burden, such cases, however, require specific arrangements to ensure that the objectives pursued by the exemption are achieved. 171

The more extensive the tax exemptions and, as a consequence, the larger the unequal treatment of beneficiaries of assets not subject to such preferential treatment, the more demanding the justification requirements. It is not justified to treat business assets preferentially because the individual beneficiary is to be exempt. In this context, it is not the objective to limit the tax burden based on the constitutional guarantee of the right of inheritance under Art. 14(1) GG in order to avoid an excessive burden that fundamentally affects the assets received by the heir (cf. BVerfGE 93, 165 <172>; 63, 312 <327>). Rather, the protection of the transferred company and the jobs related thereto solely constitute the reason of the common good that justifies unequal treatment. The unequal treatment between beneficiaries of other assets not subject to preferential treatment and beneficiaries of company assets is, in general, still justified in cases of transferring small and medium-sized companies, even without determining, in each case, the risk to the company that the exemption is meant to prevent. However, irrefutably assuming such a risk with regard to the transfer of larger companies cannot be accepted. In such cases, due to the mere scale of the amount exempt from taxation, the unequal treatment reaches a scope that is no longer compatible with the principle of equal taxation, unless a necessity to exempt the acquired company is specifically determined. 172

Additionally, when transferring companies of this size, their protection and continued existence do not contribute to achieving the objective of the exemption provision, which is to preserve the specific structure of small and medium-sized companies. While this is not the only common good objective to be pursued by the exemption pro- 173

visions, the fact that it cannot be achieved weakens the potential of justifying the exemptions, and thus confirms the necessity of an individual economic needs test.

(2) The distinction between small and medium-sized companies on the one hand and large companies on the other hand, is not pre-defined by statutory law in the area of inheritance and gift tax law. Nor do constitutional standards allow a clear determination as to where exactly unequal treatment resulting from the tax exemptions for the acquisition of company assets without payment becomes disproportionate if the tax exemption does not require an economic needs test. The legislature is obliged to stipulate precise and manageable criteria for determining this distinction and thereby considering the objectives of the common good pursued by the preferential treatment. […] 174

However, the legislature is not constitutionally obliged to ensure that the unequal treatment between transfers of preferentially treated and other assets is appropriate by an exact definition of the circle of small and medium-sized companies and by limiting an exemption without an economic needs test to these companies. Alternatives include the definition of an absolute maximum limit […], above which no further exemptions are granted, and tax-related threats to company transfers are countered, for example, by new provisions for deferrals. If the legislature continues to apply the tax exemption model also in cases of transfer of larger companies, it will have to evaluate whether the economic needs test related to beneficiaries of such companies, which would then be required, should also include other assets received in the context of the inheritance or gift that is not subject to the preferential treatment, or, if necessary, assets owned prior to the acquisition. As a consequence, such assets would have to be used to cover a tax obligation arising from the company transfer. 175

3. Also, in parts of their specific design, the exemption provisions in §§ 13a and 13b ErbStG violate Art. 3(1) GG, both with regard to the unequal treatment of assets not subject to preferential treatment and because beneficiaries of preferentially treated assets are treated unequally when compared with each other, which is not justifiable. The determination of the types of assets to be treated preferentially in § 13b(1) ErbStG is, however, ultimately not objectionable (a). The same applies, in principle, to the rules on the period for which the company must be held in order to be granted the tax exemption stipulated in § 13a(5) ErbStG (c). However, the exemption of companies with no more than 20 employees from the requirement of aggregate wages pursuant to § 13a(1) sentence 4 ErbStG (b) and the provisions on the amount of non-operative assets causing an exclusion from the preferential treatment pursuant to § 13b(2) first sentence ErbStG (d) violate the right to equality. Furthermore, §§ 13a and 13b ErbStG allow for tax optimising schemes which are too generous in specific constellations and cause unjustifiable unequal treatment (e). 176

a) The determination of the types of assets that are to be treated preferentially in § 13b(1) ErbStG is constitutional. The determination of the assets subject to preferential treatment by a taxable base discount (*Verschonungsabschlag*) on the basis of 177

§ 13b(1) ErbStG is compatible with Art. 3(1) GG, both in relation to non-business assets and compared with other business assets that are not subject to preferential treatment.

178 The objective of the Inheritance Tax Reform Act was, inter alia, to ensure that especially small and medium-sized companies personally managed by their owners do not run into liquidity problems in case of company succession because of the tax levied on the acquisition (see 2 c above). Although the deductible amount pursuant to § 13a(2) ErbStG is designed degressively and minority interests in large publicly-listed corporations have been excluded from preferential treatment in § 13b(1) no. 3 ErbStG, the legislature was only partially successful in limiting the intended promotion to small and medium-sized companies. With regard to larger companies, this leads to the constitutional requirement of an economic needs test (see 2 f dd above). Apart from that, the definition of the assets subject to preferential treatment in § 13b(1) ErbStG ensures that the exemption is restricted to business assets with a personal involvement of the shareholder. In particular, the requirement of a minimum participation of over 25% in corporations pursuant to § 13b(1) no. 3 ErbStG excludes the promotion of company shares that constitute mere financial investments. The various forms of unequal treatment resulting from this are all justified (aa). […]

aa) […]

179 (1) The legislature pursues legitimate objectives by the unequal treatment resulting from the exemption of shares in corporations pursuant to § 13b(1) no. 3 ErbStG. By applying the exemption provision to large shares in corporations, the legislature intended to ensure preferential treatment of transfers of company shares in which the shareholder is not a mere financial investor, but rather is involved personally in the management of the company. Opposed to this, the transfer of shares in corporations that are held as mere financial investment is not to benefit from preferential treatment. […]

180 […]

181 **(2) […]**

182-184 **(3) […]**

185-195 (4) […]

196 bb) Preferential treatment of business assets under § 13b(1) no. 2 ErbStG is compatible with the right to equality also to the extent that preferential treatment is granted to the acquisition of shares in partnerships without requiring minimum participation.

197 The fact that § 13b(1) no. 2 ErbStG treats the transfer of shares in partnerships of all sizes preferentially, irrespective of the amount of the testator’s or donor’s share, puts shareholders of partnerships in a better position than those of corporations […].

By renouncing the necessity of minimum participation […], the legislature states that it regards any participation in partnerships – irrespective of the amount of the shares held – as business assets which are to be promoted, and not as mere financial investment. With this assumption, the legislature remains in its margin of appreciation and its freedom to standardise when regulating such complex circumstances. The distinction is based on the different ways in which the assets of partnerships on the one hand and of corporations on the other hand are treated under civil law: Whilst the assets of a partnership are attributed to its shareholders […], the assets of a corporation are independent from the assets of its shareholders. In view of the more personalised structure of a partnership, the legislature is authorised to standardise and can therefore base its decision on inheritance and gift taxation for company successions on the generally increased influence and liability of partners in a partnership […]. The legislature could assume, by standardising, that the shareholder's involvement in the company's business practice, at least the involvement in pending business decisions, is the rule for shareholders of a partnership. 198

cc) With respect to the particularities of agriculture and forestry, it is constitutional to generally favour the transfer of agricultural and forestry assets in § 13b(1) no. 1 ErbStG. 199

Considering the fact that agricultural and forestry businesses […] are very frequently family-owned businesses without a major capital basis, the legislature could assume that shares entail personal involvement in such a business. In addition, the known structural particularities of agricultural and forestry businesses (cf. BVerfGE 91, 346 <364>) make it unlikely that there is an interest solely for the purpose of a financial investment. With regard to the general eligibility for preferential treatment, the legislature was, thus, allowed to treat agricultural and forestry assets like business assets, and treat them, in that respect, more preferentially than non-business assets and shares in corporations below the minimum participation level. Apart from the general objective of protecting agricultural and forestry business from the risks resulting from a reduced liquidity, and thereby preserving jobs, the exemption from inheritance and gift tax for the transfer of agricultural and forestry businesses is further legitimate as to their ecological contribution […]. 200

b) The aggregate wage regulation contained in various subsections of § 13a ErbStG is, in principle, compatible with Art. 3(1) GG (aa). However, this does not apply to the exemption of businesses with no more than 20 employees (bb). 201

aa) The aggregate wage provision laid down in § 13a(1) second sentence ErbStG is constitutional. 202

(1) The aggregate wage provision leads to unequal treatment. The review of whether it is justified is not limited to a mere review of arbitrariness. 203

Compliance with the requirement of the minimum wage total (*Mindestlohnsumme*) is a prerequisite for obtaining the taxable base discount. According to § 13a(1) second 204

sentence ErbStG, the exemption is only granted if the total sum of the relevant annual wage total of the business, within five years […] after the transfer, does not fall below 400% […] of the initial wage total. If the wage total does not reach this amount, the taxable base discount decreases corresponding to the deviation (§ 13a(1) fifth sentence ErbStG). Accordingly, compliance with the aggregate wage requirement with regard to preferentially treated assets within the meaning of § 13(1) ErbStG determines who profits from the exemption in full, in part or not at all. Thereby, the aggregate wage provision leads to an internal distinction amongst beneficiaries of preferentially treated assets. At the same time, it shapes the framework for the general distinction between beneficiaries of non-business assets and preferentially treated assets within the meaning of § 13b(1) ErbStG.

The constitutionality review of this unequal treatment is subject to a stricter standard than a mere review of arbitrariness, and corresponds to the standard applied above with regard to the distinction between business and non-business assets. The aggregate wage provision specifically aims to influence free business decisions regarding the personnel structure of the company. Particularly in cases in which the minimum wage total is not met, it can, however, lead to a total loss of the taxable base discount, and thus, in view of the lacking maximum of the taxable base discount, potentially result in considerable inequalities compared to those who comply with the aggregate wage requirement. 205

(2) The unequal treatment resulting from the aggregate wage provision pursues a legitimate objective. The requirement of a minimum wage total aims to motivate the beneficiaries of business assets to preserve jobs; and it specifies those businesses that have, by complying with the aggregate wage regulation, proven that they have preserved jobs. In that respect, the requirement of a minimum wage total serves a legitimate purpose, and it is essential for the superior central objective of the exemption provision to safeguard the transfer without payment of businesses personally managed by their owners from liquidity problems, in order to ensure the continued existence of the company and to preserve its jobs. It has already been determined (see 2 f cc (4) above) that an instrument such as the provision on the minimum wage total is, in principle, required for constitutional reasons in order to ensure, in principle, that the exemption is appropriate. However, this does not answer the question whether the specific design also complies with the right to equality. This requires a separate review. 206

(3) The fact that the exemption is only granted if the aggregate wage requirement is fulfilled is, in principle, suitable for achieving this purpose, as it promotes preserving jobs in companies that are partly or fully transferred to a successor, at least for a medium time period. More lenient means are not in sight […]. The requirement to hold the company for a certain time period (§ 13a(5) ErbStG) cannot fulfil this task alone. 207

(4) Even with regard to unequal treatment caused by the aggregate wage provision, it fulfils the requirements of proportionality in the stricter sense. 208

Apart from the overly broad exemption clause (on this see bb below), the aggregate wage provision is appropriate. It contributes to ensuring that the beneficiaries of business assets are not disproportionately privileged, compared to beneficiaries of non-business assets, if, by adhering to the provision, they profit from the taxable base discount. In principle, the aggregate wage provision satisfies the constitutional necessity requirement not to exempt the transfer of companies without payment from inheritance and gift tax without sufficiently significant reasons, and without exacting evidence that these have been met (see 2 f cc (4) above). 209

Accordingly, those who do not comply with the aggregate wage provision are not subject to an inappropriate disadvantage, compared to those who do, if they subsequently do not receive a taxable base discount or if they only receive a partial one, although they acquired assets that are generally treated preferentially. The aggregate wage provision neither grants the beneficiaries of preferentially treated assets access to a comprehensive tax exemption too easily or without control, nor does it require compliance with provisions unsuitable to achieve the objective of preserving jobs. It also does not lead to a disproportionate disadvantage for beneficiaries of preferentially treated assets that fully or partially lose the exemption because they fail to comply with the provision on the minimum wage total. 210

(a) It was within the legislature's wide leeway to design to opt for an aggregate wage solution instead of strictly requiring that the exact number of existing jobs in the transferred company be preserved. Whilst the substantial […] potential for exemptions under § 13a ErbStG requires that the preferentially treated person be bound to sufficiently strict review criteria to ensure that the objectives of the exemption are met and documented (see 2 f cc (4) above), the legislature has considerable leeway when designing these conditions. It is thus not constitutionally objectionable that the legislature considered the aggregate wage, which gives more latitude to the management of a company than a strict preservation clause regarding the existing jobs, as a sufficiently reliable indicator to determine whether jobs have been preserved […]. The fact that § 13a(1) second sentence ErbStG does not require an annual assessment, but rather adopts an approach according to which the aggregate wage period is assessed as a whole, underlines the legislature's deliberate decision in favour of a provision that protects the entrepreneurial freedom to make decisions, while keeping it suitable for ensuring the preservation of jobs at large. This flexible design gives companies the latitude to react according to business needs even if in crisis. It thereby counters the objections to the aggregate wage as not being suitable for preserving jobs because it prevents necessary modernisation and rationalisation processes, thus being counterproductive. Additionally, whilst satisfying the aggregate wage is a prerequisite for the exemption to be granted, it still leaves the owner of the business the freedom to decide to fully or partially (cf. § 13a(1) fifth sentence ErbStG) renounce it, and thus address a potential liquidity risk resulting from the inheritance or gift tax by applying for deferral of the tax debt pursuant to § 28 ErbStG. 211

(b) Further objections against the modalities of calculation and proof regarding the aggregate wage provision do not challenge its constitutionality, since they fail to recognise the legislature's margin of appreciation and its authority to standardise in this field. […] 212

bb) Exempting all companies with no more than 20 employees from the aggregate wage requirement violates Art. 3(1) GG. 213

(1) The distinction between businesses with no more than 20 employees and other businesses leads to unequal treatment in two ways. 214

Pursuant to § 13a(1) fourth sentence ErbStG, if the business has no more than 20 employees, the requirement of a minimum wage total need not be met to be granted the taxable base discount. On the one hand, this exemption from the aggregate wage obligation privileges beneficiaries of companies with a small number of employees compared to beneficiaries of companies or company shares that have more than 20 employees and are therefore fully bound by the aggregate wage requirement in case they wish to profit from the taxable base discount. On the other hand, the exemption increases the degree of unequal treatment of those privileged by it, compared to beneficiaries of non-business assets, since those persons to which § 13a(1) fourth sentence ErbStG applies can profit from the exemption without having to comply with the minimum wage total provision, provided they fulfil the other prerequisites. 215

(2) The preferential treatment of companies with up to 20 employees especially aims at administrative simplification; it is suitable and necessary for this purpose. 216

[…] 217

Both the administrative simplification for public authorities and companies as well as the increased flexibility with regard to the legal conditions in order to promote small and medium-sized businesses constitute legitimate objectives. The legislature is free to pursue such objectives and does not interfere with constitutional evaluations or requirements. Extending the exemption from the aggregate wage obligation to companies with up to 20 employees is clearly suitable for achieving this objective. There are no apparent equally effective measures that would lead to less unequal treatment than described above (cf. (1) above). 218

(3) The provision, however, is not compatible with the principle of proportionality in the stricter sense. By way of the exemption from complying with the requirement of a minimum wage total, beneficiaries of companies with up to 20 employees are granted a disproportionately preferential treatment compared to purchasers of assets not subject to this. Furthermore, beneficiaries of preferentially treated assets with more than 20 employees working for the transferred companies are placed at a disproportionate disadvantage for these companies must comply with the minimum wage total requirement in order to obtain the taxable base discount. 219

(a) The Federal Finance Court considered it to be […] an overly preferential treat- 220

ment of beneficiaries of assets subject to preferential treatment as opposed to beneficiaries of non-business assets primarily due to the fact that over 90% of all companies in Germany do not have more than 20 employees, and that therefore, the aggregate wage provision is irrelevant for tax exemptions pursuant to §§ 13a and 13b ErbStG in most cases. This is countered by the statement […] that in the year 2008, more than 80% of all employees worked for companies to which the aggregate wage provision applies, and that the largest businesses, which account for less than 1% of all businesses generate roughly 65% of the total taxable company revenues. However, this objection ignores the regulatory concept of §§ 13a and 13b ErbStG, since it relies on a macroeconomic assessment of the aggregate wage provision instead of the company-related assessment prescribed by the Act. The exemption provision is supposed to give the beneficiary of a specific company an incentive to preserve jobs in this company. Therefore, the conditions within the specific company and the number of companies affected by the aggregate wage provision are decisive, and not the ratio of employees in the company in relation to the total number of all employees.

(b) The exemption from complying with the aggregate wage provision in § 13a(1) fourth sentence ErbStG means that the legislature abandons an essential instrument that serves to ensure the objective of preserving jobs, which is fundamental for legitimising the exemption provision. In light of the extent of a potential exemption, the legislature is constitutionally required to achieve this objective by means of sufficiently effective measures (see 2 f cc (4) above). 221

In cases where the successor of the company is not required to comply with the aggregate wage requirement under § 13a(1) fourth sentence ErbStG in order to profit from the exemption from inheritance tax, the achievement of one of the central objectives of the exemption provision is not ensured by law. The fact that the successor of a company is, even without being subject to the aggregate wage provision, required to hold the company for the period specified in § 13a(5) or (8) no. 2 ErbStG in order to be granted the taxable base discount, may ensure in many cases that jobs are preserved in the company that continues to operate. However, in these cases, job cuts are not legally sanctioned if the exemption from the aggregate wage provision does not apply. 222

Waiving the objective to preserve jobs by applying the aggregate wage provision to such a large number of cases, which is the effect of exempting companies with up to 20 employees, considerably reduces the legal possibilities for ensuring that this objective is achieved. There are no apparent and sufficiently sound reasons that would justify abandoning the aggregate wage obligation to such a degree. In particular, neither the aim pursued by the exemption clause to make administration more simple and flexible, nor the legislature's authority to standardise, constitute sufficient justification. 223

(aa) The legislative objective of decreasing the considerable administrative burden for companies and finance authorities resulting from the requirement to prove and to 224

oversee that the minimum wage total obligation has been complied with can, to a certain extent, justify unequal treatment. However, the exemption of more than 90% of all businesses from the obligation to comply with the minimum wage total provision causes the exemption provision to lose a central element for its justification, and has far-reaching consequences. Companies can more or less universally request the taxable base discount without having to preserve jobs. At the same time, the administrative burden of proving and overseeing compliance with the minimum wage total obligation is not as high as sometimes purported. […] Measured against the large number of companies affected by the provision and the considerable effects of not applying the minimum wage total requirement connected with the taxable base discount, the legislature exceeds its leeway to design by implementing the exemption clause in § 13a(1) fourth sentence ErbStG

(bb) […] 225

(cc) The legislature's authority to standardise and to generalise also does not justify the generous exemption from the aggregate wage obligation. 226

In its established case-law, the Federal Constitutional Court recognises standardisation and generalisation requirements as specific factual reason for unequal treatment in the context of decisions on burdens or reliefs under tax law (cf. only BVerfGE 127, 224 <246> with further references). The limits of permissible standardisation have, however, been exceeded if, by applying the standardising provision, the relationship between rule and exception of the legislature's relief decision is virtually changed into its opposite. 227

This is precisely what happened in the case at hand. Applying § 13a(1) fourth sentence ErbStG entails that the aggregate wage provision is only applicable to a very small number of business transfers that are taxable for inheritance and gift tax. Thus, the tax exemption in case of a company transfer depends on the preservation of jobs only as an exception; the preservation of jobs should, however, constitute the essential prerequisite for the tax exemption (see 2. f cc (4) above). 228

(c) An exemption from the minimum wage total obligation can be justified, however, if it is limited to a relatively small group of company transfers, and if this group is defined in such a way that the need for such an exemption is particularly significant. Specifically, this may be the case if the companies concerned have such a small number of employees that even a single, unforeseeable change amongst the staff – which can hardly be ruled out for a time period as long as required by the aggregate wage provision – makes it entirely or largely impossible to comply with the requirement of the minimum wage total. If the legislature, in principle, adheres to the current exemption scheme for taxation of company transfers when remedying the violations of the right to equality that have been determined elsewhere, it will have to limit the exemption from the aggregate wage requirement to companies with few employees only. 229

c) […] 230

d) §13b(2) first sentence ErbStG grants, if the prerequisites are fulfilled, beneficiaries of preferentially treated assets the taxable base discount, even if up to 50% of these assets are non-operative assets which are, in principle, not deemed worthy of such treatment according to statutory law. There is no apparent and sufficiently sound reason to justify this. Therefore, the provision concerning non-operative assets in § 13b(2) first sentence ErbStG is incompatible with Art. 3(1) GG. 231

aa) 232-236

bb) […] 237

cc) […] 238-239

dd) […]

ee) The provision concerning non-operative assets is not compatible with the requirement of proportionality in the stricter sense. 240

(1) The unequal treatment related to the exclusion of non-operative assets from inheritance tax exemptions compared to privileging preferentially treated assets is, in principle, appropriate. Limiting the tax exemption to assets that the legislature considers worthy of preferential treatment […] and that are precisely defined in order to prevent undesired tax schemes is based on sound reasons of justification. It is not inappropriate, but indeed is an equitable differentiation to exclude assets from the tax exemption which the legislature, with its wide margin of appreciation in that respect […], did not recognise as worthy of preferential treatment. 241

(2) The unequal treatment caused by the provision on non-operative assets is, however, disproportionate in as far as it grants preferentially all treated assets within the meaning of § 13(1) ErbStG a reduction, a deduction (§ 13a(2) ErbStG) and tax scale limitations (§ 19a ErbStG), even if they include a share of up to 50% non-operative assets. This puts beneficiaries of preferentially treated assets which consist of non-operative assets to more than 50%, and which therefore do not profit from the tax exemptions at all, to an inappropriate disadvantage. The legislature has not provided any sufficiently sound reason to justify such an extensive inclusion of assets that are, according to the law itself, not actually considered worthy of such preferential treatment. Nor can such reasons be discerned. Accordingly, the comprehensive inclusion of up to 50% non-operative assets into the taxation scheme leads to a disproportionately preferential treatment of beneficiaries with such a large share of non-operative assets, when compared to beneficiaries of assets that are not subject to preferential treatment and are generally excluded from the taxable base discount, i.e. non-business assets in the broader sense. 242

(a) Assuming that, generally, the legislature does not deem non-operative assets as described in § 13b(2) second sentence ErbStG worthy of preferential treatment, it is 243

not discernible how the excessive impact of the 50%-rule in § 13b(2) first sentence ErbStG can serve the legislative objective of limiting the exemption to assets deemed worthy of preferential treatment, and excluding other assets from it. The exemption of 50 % non-operative assets, which are generally not deemed eligible for preferential treatment because their share in the company assets total is not more than half, is as implausible as not exempting up to 50% of business assets that would generally be eligible to preferential treatment, merely because the company assets total consists of non-operative assets by more than 50%. As such, the legislature's declared intent that "companies that mainly administer assets … should generally be excluded from the exemptions" […] cannot substantiate this discrepancy. The legislative aim to generally exclude non-operative assets from the exemption and to prevent tax-optimising schemes could be achieved without causing such distortions by limiting the exclusion from preferential treatment to the determined share of non-operative assets. […]

[…] 244

(b) To the extent that the provision on non-operative assets aims to prevent tax-optimising schemes, related to shifting assets from private to business, the current 50%-rule can promote this objective but insufficiently. At least as far as a share of non-operative assets of up to 50% of the company assets total is preferentially treated, it does not limit tax-optimising schemes. To the contrary, by explicitly taking such a large percentage of non-operative assets into account for the exemption, it is more likely that this will encourage shifting private to business assets within this 50%-range. The provision may effectively prevent tax-optimising schemes beyond that threshold only. 245

[…] 246

(c) Considerations of standardisation or generalisation cannot justify the 50%-rule, as they are inconsistent with the 15%-standardisation stipulated in § 13b(4) ErbStG. 247

[…] 248

Although one may indeed attribute a certain administrative simplification effect to the 50%-rule, in § 13b(2) first sentence ErbStG, since no precise arithmetic attribution to the specific asset categories is required for shares of non-operative assets clearly below the 50% threshold, the ensuing standardisation exceeds the degree of unequal treatment that could, in principle, justify such standardisation. Tax laws generally concern mass operations of economic life. In order to be feasible, they must standardise situations to which they attach identical legal consequences, and disregard particularities of each individual case to a large extent. The economically unequal impact on tax payers may, however, not exceed a certain degree. Rather, tax advantages resulting from the standardisation must be commensurate with the inequality of the tax burden that necessarily results from the standardisation (cf. BVerfGE 120, 1 <30>; 122, 210 <231 et seq.>; 126, 268 <278 and 279>; 127, 224 <246>; 137, 1 <21 para. 50>). 249

Measured against this, the unequal treatment resulting from the 50 %-standardisation is disproportionate. On the one hand, the provision excludes from the preference such preferentially treated assets that only fulfil the prerequisites for it with a share of slightly below 50% entirely. On the other hand, it allows that assets under private management can, to a large extent, be “arbitrarily” attributed to preferentially treated assets, which after a time period of two years are then also to be treated preferentially, up to the value of the “real” company assets. These inequalities, which are tremendously high in percentage and not limited as to their absolute amount, cannot be justified with a mere reference to administrative simplifications they eventually achieve […]. 250

[…] 251

e) To the extent that they allow tax schemes that lead to unjustifiable unequal treatment, the statutory provisions violate Art. 3(1) GG […]. 252

aa) Tax laws that extensively allow tax-optimising schemes that contradict their legislative objectives can be unconstitutional from the outset. If a tax law enables the tax payer to develop schemes that reduce the tax burden which was not intended by the law and is not justifiable under the right to equality, it is, to that extent, unconstitutional from the outset. Particularly in the field of tax law, efforts to design one’s own legal issues within the scope of private autonomy in such a way that tax relief can be obtained where possible, by strategically using the relevant constitutive elements, or to avoid tax burdens respectively, are commonly made and, in principle, have to be accepted (cf. BVerfGE 9, 237 <249 and 250>). If such schemes do not constitute abuse within the meaning of § 42 Fiscal Code (*Abgabenordnung* – AO), they are permissible and must be taken into account. They may, however, restrict (regarding provisions that establish tax obligations) or extend (if there are tax exemptions) the effects of the respective legislative provisions that were the cause and purpose of this specific strategy in such a way that the legislative objective is no longer an apt justification for unequal treatment. However, regarding the validity of a provision, tax-optimising schemes are only relevant if they are not clearly limited to atypical individual cases; thus, undesired schemes which do not constitute an abuse of law in individual cases do not affect the constitutionality of a provision. 253

It is irrelevant whether the legislature was able to foresee such tax reducing schemes that are undesired with respect to the legislative objective. As far as they are not sanctioned by the regular courts as abusive schemes within the meaning of § 42 AO, such legislation may be subject to review by the Constitutional Court also with regard to its potential application. When interpreting and applying § 42 AO, the financial courts are supposed to counter the use of such schemes by means of this provision on the abuse of tax planning schemes. Otherwise, such practices would lead to the unconstitutionality of respective provisions (cf. BVerfGE 22, 156 <161>; 29, 104 <118>). In its decision on the consequences of a violation of the Constitution, the Federal Constitutional Court may, however, take into account whether the tax- 254

optimising schemes leading to the unconstitutionality of the provision were recognisable and foreseeable. This is particularly relevant if the Court orders the provision to remain applicable for a limited time.

bb) […] 255-258

cc) […] 259-270

dd) […] 271-277

C.

I.

1. […] 278-280

2. The violations of the Constitution that have been determined concern, taken for themselves, only parts of §§ 13a and 13b ErbStG; nevertheless, they affect the core of the entire exemption provision. The provision on the aggregate wage constitutes an essential element of the exemption concept by which the legislature aims to ensure the preserving of jobs. Apart from the protection of companies personally managed by their owners in Germany, preserving jobs constitutes the central reason to justify the comprehensive tax exemptions for business assets. The provisions on non-operative assets are another core element of the exemption provisions for the transfer of businesses without tax payment that the legislature introduced by adopting the Inheritance Tax Reform Act. The requirement to conduct an economic needs test, at least for the transfer of assets of a certain dimension, in order to ensure proportionality of unequal treatment of preferentially treated assets compared to assets that are not preferentially treated, affects a part of the exemption provision in its basic structure,. 281

With respect to the determined violations of the right to equality, important elements of the provisions as a whole are unconstitutional. Without these, the remaining elements of §§ 13a and 13b ErbStG – which are not objectionable – can no longer be applied in a meaningful way; in any event, it would lead to results that are not intended by the legislature (cf. BVerfGE 8, 274 <301>). Hence, constitutionality can only be achieved by comprehensive amendments or a general redesign of the exemption arrangement as a whole. The determined violations of the right to equality therefore concern §§ 13a and 13b ErbStG in their entirety. This applies to the provisions in their original version of the Inheritance Tax Reform Act of 24 December 2008 (BGBl I p. 3018), but to all subsequent versions as well. Whilst the gap in the law regarding “cash companies” was closed, and that deficiency has been remedied by § 13b(2) second sentence no. 4a ErbStG, inserted by the Mutual Assistance Directive Implementation Act (*Amtshilferichtlinie-Umsetzungsgesetz*) of 26 June 2013, other elements that are unconstitutional such as the unrestricted preferential treatment of very large assets, the aggregate wage provision and the limits for non-operative assets, 282

were left unchanged.

The overall unconstitutionality of the taxation of company transfers as an inheritance or gift, pursuant to §§ 13a and 13b ErbStG, necessarily also concerns the taxation of a transfer of (private) assets without payment, which are not subject to preferential treatment. If the provisions granting tax privileges in §§ 13a and 13b ErbStG do not apply, this does not mean that the general rules on the taxation of gifts and inheritances would apply instead to the transfer of companies. To burden all transfers of businesses pursuant to the general rules on inheritance taxation, without providing any company-specific privileges, would clearly contradict the legislature's intent that became apparent in the tax exemption concept of §§ 13a and 13b ErbStG, and that is generally not objectionable under constitutional law (cf. B III 2). On the other hand, in case §§ 13a and 13b ErbStG were declared unconstitutional, there is no legal basis and also no sufficient justification for tax exemptions of such comprehensive scope to completely abandon taxation of the acquisition of business assets without payment. Without a taxation provision for the transfer of companies based on the legislature's intent, inheritance tax cannot be levied fairly in other cases without also violating Art. 3(1) GG. 283

This is taken into account by the fact that § 19(1) ErbStG is found to be unconstitutional, which was referred to the Federal Constitutional Court by the Federal Finance Court for review of its constitutionality. This provision, which equally applies to preferentially treated assets and other assets, must therefore also be declared incompatible with Art. 3(1) GG. As a result, inheritance tax can no longer be levied even for the transfer of private assets. 284

II.

However, the current judgment is limited to the finding that §§ 13a and 13b and § 19(1) ErbStG are incompatible with Art. 3(1) GG. These provisions shall continue to apply for a limited period of time, and the legislature must adopt new provisions within a reasonable time period. 285

[…] 286-294

Kirchhof Gaier Eichberger

Schluckebier Masing Paulus

Baer Britz

Separate Opinion of Justices Gaier, Masing and Baer to the Judgment of the First Senate of 17 December 2014

– 1 BvL 21/12 –

We agree with the decision but believe that a further element must be included to support it: the principle of the social state enshrined in Art. 20(1) GG. An assessment of unequal treatment caused by the challenged provisions in light of the principle of the social state further supports the ruling, and allows its justice-related dimension to come into full view. 1

1. Inheritance tax offers a contribution to achieve equal social opportunities which do not come upon by themselves in a free society. The free social order in the Federal Republic of Germany is based on the assumption – which, in a modern state, appears to be a given – that all individuals are free and equal. This founding of the community in the freedom and singularity of the individual which is guaranteed by the Constitution does leave the establishment and development of a social order largely to the arbitrary rules of competition and distinctions resulting from it. Legal equality combined with the individual's freedom to act and to carry on a business, as well as with the constitutional guarantee of the right to property, unleashes extensive dynamics and inevitably leads to material inequality among individuals. This is wanted and constitutes an essential element of a free legal order. However, this inequality requires certain compensation. This applies, in particular, with regard to the system of property ownership; property solidifies the inequalities within a liberal society, and it is the basis of new inequalities (cf. separate opinion of Böckenförde on property tax, BVerfGE 93, 149 <162 and 163>). 2

By binding all public authority to the principle of the social state, the Basic Law turned the orientation towards social equality into a leading principle for all state measures (cf. BVerfGE 5, 85 <198>, also BVerfGE 52, 303 <348>; 134, 1 <14 and 15 paras. 41 and 42>). Thus, inheritance tax does not only serve generating tax income, but rather constitutes an instrument of the social state as well, applied to prevent the accumulation of wealth in the hands of a few in successive generations and an excessive increase of wealth solely due to descent or personal relationships. The development of the actual distribution of wealth in our social reality shows that this in fact constitutes a challenge. Whilst Böckenförde has already pointed out in his separate opinion that in 1993 18.4 % of all private households possessed more than 60 % of the total net financial assets (BVerfGE 93, 149 <164>), in 2007, this share of assets was held by merely 10% of all private households […]. In particular, the concentration of wealth in the highest decile has increased considerably in the last decade, although the full extent of the unequal distribution of assets is not even fully reflected by these numbers, as no figures were obtained from particularly wealthy households, which could therefore not be taken into account […]. As opposed to this, roughly 28 % of the adult population had no or even have negative wealth in 2012, which is a percentage that has also increased significantly since 2002 […]. Also, the Gini coefficient, an internationally used measurement to determine the distribution of wealth, 3

has increased accordingly from 0.62 in 1993 to 0.78 in 2012. This shows that Germany does currently have the highest degree of unequal distribution of wealth in the Eurozone. Based on national accounts, one reason for the increase in inequality is the fact that the income generated through business activities and assets has increased in particular, compared to the salary of employees […].

In view of this, the inheritance tax determines and limits the content of the right of succession as guaranteed in Art. 14(1) GG. It thereby counteracts the risk that an increasingly unequal distribution of means causes opportunities of social and political participation to drift apart. This would ultimately result in influence and power increasingly bound to birth, thus more and more independent from individual capabilities. Instead, inheritance tax is an instrument which the state can apply to counteract unequal opportunities in life. It enables a compensation which contributes to ensuring that the personal pursuit of freedoms and use of capabilities does not only theoretically remain the basis of our social order, but do so in fact, thus joining freedom and equality in the reality of life. 4

2.Creating compensation for inequalities which might otherwise solidify is a political responsibility, and it is not optional. With the principle of the social state enshrined in Art. 20(1) GG, the Basic Law requires the legislature to provide for compensation with regard to social opposites, and hence ensure the establishment of a fair social order (cf. BVerfGE 22, 180 <204>). By levying inheritance tax, the legislature takes account of this requirement within the scope of the applicable tax and social system – irrespective of the question not to be decided in the case at hand whether and if so under which conditions the legislature could abstain from levying inheritance tax. This also affects the requirements regarding the design of the inheritance tax. If the legislature introduces exemptions that lead to unequal treatment, as they do in the present case, the required justification to which they are subject increases the more such exemptions are likely to solidify social inequalities. 5

As the Senate has already emphasised with respect to review of the right to equality, the Constitution grants the legislature wide latitude in this regard. The obligation to comply with Art. 20(1) GG does, however, not only enable the legislature to impose taxes on inheritance and gifts, but also subjects the legislature to specific justification requirements – particularly if it exempts those from this burden that are more productive under market economy conditions than others. This adds another constitutional foundation to the justification requirements for the exemption of business assets from inheritance tax which the Senate derived from Art. 3(1) GG. The requirement that is described in detail in the decision also has a social state dimension in so far as exemption provisions must be designed in a way that prevents private assets which do not belong to business assets from being withdrawn from inheritance taxation, or prevent tax-optimising schemes from being used to evade the economic and labour market policy objectives of the exemptions. Such a social state dimension is particularly evident in the requirement of a justification that increases in relation to the degree of unequal treatment, and hence, with the amount of exempt assets, as recognised by 6

the Senate. Economic inequality will solidify and eventually increase if especially those profit from exemptions who, as successful business persons, possess large assets and therefore already enjoy considerable influence in society, and if they are given the opportunity to transfer these assets to third parties, in particular to family members, exempted from the burdens otherwise imposed according to productivity, although the successors have not contributed to the wealth with any performance or abilities of their own. In contrast, the standards developed in the Senate decision ensure that the exemption provisions do not lead to further accumulation and concentration of large fortunes in the hands of a few.

The decision correctly emphasises the fact that even the transfer of very large and largest assets can justify tax exemptions. However, this requires that the exemption is in fact necessary in the individual case to preserve jobs, or otherwise for the common good, and thereby contributes to the realisation of a social state. Only in such cases can the exemption justify the unequal treatment it causes. As such, the principle of the social state also informs the right to equality. 7

Gaier Masing Baer

Bundesverfassungsgericht, Urteil des Ersten Senats vom 17. Dezember 2014 - 1 BvL 21/12

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