LEGAL

Family Businesses in Germany – total lack of trust(s)?

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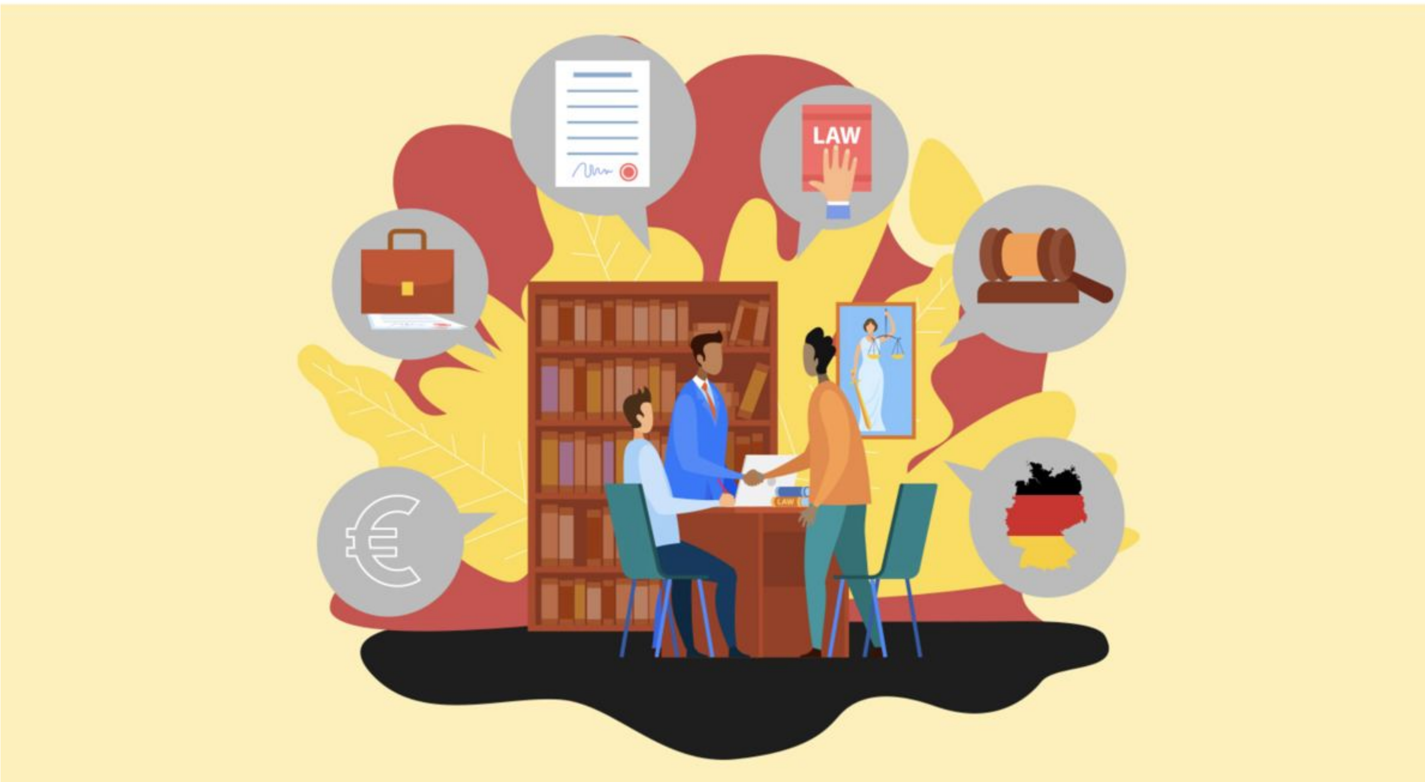

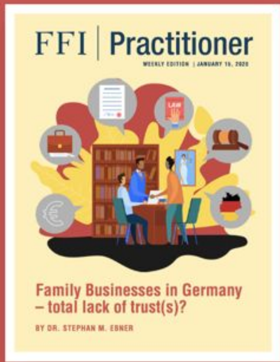

From *FFI Practitioner*

For advisors working with family business clients operating across multiple countries, it is important to keep informed about jurisdictional differences and how they could impact your clients. This week, we are pleased to share such an example, and we thank Stephan Ebner for this examination of German inheritance law, which does not recognize the concept of trusts.

Unlike many other (common law) countries, German law does not recognize the concept of trusts. In particular, internationally active family businesses suffer from this legal difference. Nevertheless, leading industrialized nations have found solutions to deal with this. Starting with some general thoughts, this article provides examples of current issues that first and foremost wealthy families have to cope with in Germany at the moment.

No concept of trusts

Yes, you heard right: German law does not recognize the legal concept of trusts. Why is that? It all comes down to medieval England, where trusts were a vital pillar of the feudal system. German law is a civil law jurisdiction heavily influenced by ancient Roman law. Unlike common law jurisdictions, the Romans did not know equitable interests. Consequently, ownership cannot be split up into legal and equitable interests. The closest legal concept in Germany is a "foundation." However, foundations are separate legal entities, whereas trusts are not. In fact, we are comparing apples and pears. To put it in a nutshell: For historical reasons, the legal systems went down completely different paths. As many (German) family businesses have assets all over the world nowadays, this is where the problems start.

High-tax country: inheritance and gift tax

In addition to this, Germany has an inheritance and gift tax code that is strictly enforced by the tax authorities. Depending on the degree of your relationship to the testator and the amount inherited, you may have to pay tax in the amount of up to 50% of the total value of the assets. In order to avoid such an undesirable outcome, there are rather complicated legal arrangements to consider. As a matter of fact, tax shelters are not even necessary. It makes no sense whatsoever to integrate Liechtenstein or Luxembourg in any structuring, especially due to the automatic tax information exchange between countries. And those who try to get to the root of this by simply changing their German tax residence are very likely to get picked up by the German Foreign Tax Act ("Außensteuergesetz"). If you have lived in Germany for some time, the country´s treasury still wants its share of tax, even if you have moved your domicile to another continent.

Cross-border estate planning in times of Brexit

All quiet on the Western Front? Not exactly. In particular, affluent families with business assets in the UK have a new enemy to deal with.

Line of succession and testamentary dispositions

It is Brexit that will force us to revisit the concept of "fragmentation of succession," even within Europe. As the European Regulation on Inheritance Law will generally no longer be applicable to English citizens residing in Germany after Brexit, different assets of an estate may be subject to different legal regimes. Legal probate processing will become more complicated when real estate and personal assets are dealt with by different countries. Experienced advisors have already begun to draft wills according to the Hague Convention of October 5th, 1961 (Hague Convention on the Form of Testamentary Dispositions). After Brexit, this will become the norm in the above-mentioned constellation. From a legal point of view, this certainly does not progress UK-German relations.

Company succession

Also, corporate succession plans could easily be sabotaged from scratch if corporate assets are no longer able to be spared from tax due to the fine adjustment of the so-called "wage regulations" (another legal instrument of German law). You can be absolutely sure that German authorities will have a close look at respective structures now. This straightforward opportunity for the tax authorities to immensely increase revenue collection seems to be too alluring. Unsurprisingly, the German press also denotes Brexit as a "heir´s trap" in this context.

"CORPORATE ENTITIES ARE PREFERRED ALTERNATIVE LEGAL MODELS TO HELP REDUCE TAXES BY SPREADING THEM OUT ON AN INTERGENERATIONAL BUSINESS BASIS"

Conclusions: Corporate law is key!

Is there an easy way out? No, definitely not. Advising family businesses in asset protection with a connection to Germany needs careful and proactive consideration. Nevertheless, there is a silver lining on the horizon. Since the commonly known concept of trusts cannot be applied successfully in the German legal system, and private individuals are highly taxed, establishing a company to hold the respective assets makes sense. Due to its importance to a national economy, there needs to be legal certainty as to which national laws apply. One way of minimizing the immediate impact of such tax is to spread it out on an intergenerational business basis.

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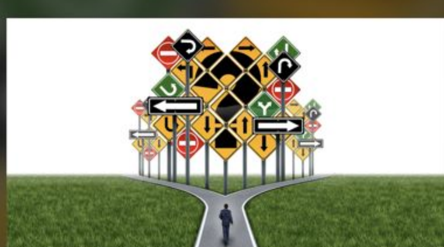

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