Foundation for
Family Businesses

An international comparison of inheritance taxes

Special study accompanying the Country Index for Family Businesses

Summary of the main results

The study in German language is available here:

In Germany, a debate is currently intensifying about the role and design of inheritance tax in the tax system. The background to this is, on the one hand, an approaching judgement by the Federal Constitutional Court on a pending constitutional complaint against the current inheritance tax system with regard to the existing rules exempting business assets. On the other hand, the debate is fuelled by differing ideas of fairness and the state's search for new sources of revenue. Against this background, this study examines the German inheritance tax system, paying particular attention to its impact on family businesses in an international comparison.

An inheritance tax is not a neutral tax because it can affect the behaviour of both the testator during their lifetime and that of the heir. With regard to family businesses, it can influence business decisions regarding investments, choice of location, and generational change. This can also push strategic and management considerations into the background. At the same time, inheritance tax potentially reduces wealth inequality and promotes equality of opportunity. In this respect, decisions on how to "correctly" levy inheritance tax are always characterised by conflicting objectives. Such decisions have to be made politically and are determined by value judgements about the fairness of inheritance tax that cannot be decided economically. An international comparison of the burden on business inheritances can also help to assess these conflicting objectives. The structure of the study takes these various aspects into account.

Initially (in section B), the study looks at the objectives, the economic effects of inheritance tax and the prospects for tax revenue. In this section, the study presents key findings from the literature on the distributional and behavioural effects as well as the potential future tax revenue from inheritance tax in Germany. The empirical evidence shows that inheritance taxes can contribute to minimising absolute wealth inequality in the long term. However, it should be noted that inheritance taxes influence the behaviour of economic entities. Empirical evidence shows that the tax moderately reduces wealth accumulation and incentivises relocation, at least for extremely wealthy households. There is also evidence of corporate reactions in the form of increased succession planning, adjustments to the corporate structure and a change in investment behaviour. Furthermore, there are indications that inheritance taxation can be associated with an increased likelihood of a company being sold. On the other hand, a higher inheritance tax positively affects the labour supply of heirs who, if they are employees, are less likely to retire early, for example. The outlook for tax revenue is positive, given the ageing population and the increase in wealth. According to current estimates, tax revenue could double by 2050 if the current tax remains unchanged.

Section C provides an international comparison of the inheritance tax burden on business assets using a model case. The German inheritance tax burden proves to be extremely high in this comparison. 26 of the 33 countries included in the analysis either do not levy inheritance tax or exempt spouses and, in some cases, children from the tax. When the countries are ranked according to increasing tax burden, Germany ranks in last place regarding inheritances to a spouse, while it ranks in third to last place with regard to inheritances to a child, behind Japan and the United States. However, it should be noted that the relief for family businesses can have a significant impact on the tax burden and that the tax planning options available in the respective countries are not taken into account due to the assumptions of the model case.

The final analysis in section D sheds light on the tax planning options available in Germany and finally summarises the potential structure of conceivable reforms to German inheritance taxation. Empirical studies show that tax planning to reduce the effective inheritance tax burden is common practice internationally. In Germany, these plans can also be seen as a reaction to the particularly high burden on companies transitioning from generation to generation compared to other countries. This situation leads to a high compliance cost burden for companies and the tax authorities. Secondly, tax subjects are not treated equally because some tax planning options are only available to a limited extent or are associated with considerable legal uncertainties, particularly for SMEs. Finally, companies' legal tax planning can also jeopardise the democratic acceptance of the tax system.

A particularly far-reaching reform would be the complete repeal of inheritance taxation. This would effectively eliminate the adverse behavioural reactions and incentives to engage in tax planning activities. However, arguments against this option include the fact that the state would thereby lose an increasingly lucrative source of tax revenue and its potentially important contribution to reducing wealth inequality and improving equality of opportunity. An alternative proposal would consist of expanding the tax base by abolishing the exemption rules and reducing the tax rate in return. This reform would reduce tax complexity and administrative costs. However, despite a lower tax rate, eliminating preferential treatment of business assets would lead to a higher tax burden for those companies whose transferred business assets significantly exceed the individual allowances.

A further proposal is to fundamentally retain the inheritance tax benefits regarding business assets without granting a complete exemption of the transferred business assets, as is currently the case. However, this can increase the tax burden, particularly regarding transfers of substantial amounts of company assets. In return, adjustments to payroll and tax deferral regulations can reduce inheritance tax risks with regard to subsequent taxation and company liquidity. The future approach to inheritance tax will depend on which value judgements about the fairness (or unfairness) of different levels of inheritance prevail in the political discourse and how strongly the potential economic disadvantages of high inheritance taxes are weighted in this discourse.

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