Foundation for
Family Businesses

Family Foundations

Legal Framework, Structures and Taxation

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Foundation for Family Businesses
Prinzregentenstraße 50
80538 Munich
Germany
Phone: +49 (0) 89 / 12 76 400 02
Telefax: +49 (0) 89 / 12 76 400 09
Email: info@familienunternehmen.de
www.familienunternehmen.de

Prepared by:

MARTIN-LUTHER-UNIVERSITÄT
HALLE-WITTENBERG

Martin Luther University Halle-Wittenberg
Faculty of Law, Economics and Business
Große Steinstraße 1
06108 Halle/Saale
Germany

Prof. Dr. iur. Gerhard Kraft, Certified Public Accountant/Tax Consultant
Chair of Business Taxation

https://steuern.wiwi.uni-halle.de/

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Summary of the main results

I. Empirical significance

Family foundations are undeniably en vogue. There has been a boom in this area for some time now. Particularly in the context of asset succession planning and the creation of optimised corporate structures, family foundations can be a highly effective instrument.

Contrary to popular belief, domestic or foreign-domiciled family foundations are almost never set up for tax reasons alone. Quite the opposite: The establishment of a foreign-domiciled private foundation, despite its advantages under civil law, will often only be considered in the context of structuring and advisory practice if the assets can be transferred without incurring tax disadvantages. In many constellations, therefore, family foundations are an attractive instrument for reasons other than tax optimisation.

II. Terminology

While there is now a legal definition for foundations having legal personality, the terminology used in connection with family foundations varies considerably. Section 80 of the German Civil Code (Bürgerliches Gesetzbuch, BGB) defines a foundation having legal personality as a memberless legal entity endowed with assets intended to achieve an object specified by the founder, either on a long-term and sustained basis (perpetual foundation) or for a specific period (principal-depleting foundation). To qualify as a family foundation, further criteria must be met in addition to the general definition of a foundation. Notably, for a foundation to qualify as a family foundation, it must be "established primarily in the interest of a family or certain families in Germany".

There is no standard, generally accepted tax definition of a family foundation. In some cases, the definitions of a family foundation in Germany's various state foundation laws, in inheritance and gift tax law and in the External Tax Relations Act (Außensteuergesetz, AStG) differ more than just slightly. From a systematic point of view, it would be helpful to have a standardised definition.

III. Reasons for setting up a family foundation

There are many reasons why someone might set up a family foundation to organise their assets, whether these are business assets or not. Tax considerations should not be the main reason for doing so. In practice, family foundations are particularly relevant in the context of corporate succession planning, the structuring of decision-making mechanisms in family businesses, corporate risk management and keeping the peace within the family.

IV. Endowment of family foundations

From a tax perspective, the endowment of domestic and foreign-domiciled family foundations is a highly complex decision-making problem. In some respects, there are similarities with other organisational forms of economic activity, but there are also quite considerable differences. Tax law offers no standard solutions. Therefore, every endowment of a domestic or foreign-domiciled family foundation by founders resident in Germany must be analysed individually in terms of what is most advantageous for them, and each case must be decided on its own merits. Founders should therefore carefully consider if a family foundation structure is the right choice for them.

V. Ongoing taxation of family foundations and beneficiaries

The ongoing taxation of domestic family foundations is based on the basic corporation income tax model, since a family foundation having legal personality is subject to corporation income tax. The taxation of beneficiaries is based on the same logic as the taxation of shareholders in a corporation. However, there are some significant differences that must be taken into account from a tax planning perspective in order to avoid missteps in how foundations distribute funds to their beneficiaries. In many cases, landmark rulings by the German Federal Fiscal Court have provided legal clarity in terms of both income tax, and inheritance and gift tax.

The taxation system for foreign-domiciled family foundations is set out in the German Foreign Tax Relations Act, which governs as primary objective the complex attribution taxation of domestic founders and beneficiaries. Without extensive expert support, the establishment and continued use of a foreign-domiciled family foundation thus entails considerable risk, as the liquidity effects and the tax burden resulting from foreign-domiciled family foundations' dry income taxation can quickly take on prohibitive proportions.

VI. The family foundation – not a tax planning model

Neither domestic nor foreign-domiciled family foundations are suitable as a tax planning model. Their establishment should never be based solely on tax considerations. Although the instrument of the family foundation does offer some interesting structuring options (mitigating the prohibitive effects of exit taxation; need-based exemption assessment), such possibilities are neither typical privileges of family foundations nor can they be interpreted as tax loopholes. In certain cases, the use of a family foundation can prove to be highly disadvantageous from a tax perspective. Therefore, the key takeaway is that the instrument of a family foundation should only be contemplated after having conducted a long-term, case-specific analysis of the tax implications.

A. The role of family foundations in the corporate context

I. Boom in foundations and subject of this study

In the corporate context, family foundations have enjoyed unabated popularity for several years. Newly established foundations can be set up as charitable foundations or as private-benefit foundations. The epitome of a private-benefit foundation is the family foundation. Official figures on the ratio of newly established family foundations to the total number of newly established foundations, such as those kept by the supervisory authorities overseeing foundations, do not appear to be publicly accessible. Informal figures shared by experts at specialist conferences, for example, suggest that the proportion of private-benefit family foundations now exceeds the 50 percent mark. This order of magnitude seems plausible, meaning that talk of a boom in foundations would not appear to be exaggerated. In particular, preventive law practitioners have increasingly discovered the family foundation as a tool for a wide range of business and non-business purposes, and it appears that this tool is enjoying constant, if not steadily increasing, popularity.

Following a recent reform in Germany aimed at standardising civil law in relation to foundations, a vast body of literature on this subject has emerged. The literature on foundation tax law is not keeping pace with this. In addition, from the perspective of German tax law, the legal institution of the foreign-domiciled family foundation occupies a particularly prominent position as it is governed by a highly complex and extremely significant provision, albeit a remote one, namely Section 15 of the German External Tax Relations Act.

Few legal and socio-political institutions are surrounded by as many misconceptions and misunderstandings as the family foundation. This legal institution falls victim to all manner of misinterpretations, with poorly researched journalistic reporting and ideologically biased opinions within the political arena playing their part in hindering an objective analysis of the family foundation. Well-founded basic knowledge about family foundations tends to be in short supply; political discussions rarely even make a clear distinction between the different types of foundation. In fact, more often than not, family foundations that are associated with companies find themselves the subject of ideologically motivated, off-the-cuff comments and sweeping generalisations such as “tax planning device” or “instrument for the rich who want to perpetuate their wealth”.

II. Structure and target groups of the study

In view of these initial observations, a central concern of the present study is to steer the discussion towards a rational basis while also making it easier for anyone not involved in the

Further information on this topic can be found in the publication "Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens" published by NOMOS Verlag (Schriften der Stiftung Familienunternehmen; 2).

day-to-day practice of dealing with the special tax issues of family foundations to grasp this complex topic. The structure of this study is based on the typical life cycle of a family foundation. The term "life cycle" suggests that there is an end point, even though the nature of a foundation is to last forever. Despite the phenomenon of the family foundation arguably being set up for an indefinite period, the study focuses on the tax principles of the foundation phase, the ongoing taxation of family foundations, founders and beneficiaries, and the exit from the foundation, for example by dissolving the family foundation completely and/or by individual beneficiaries terminating their beneficiary status. A parallel publication is available that addresses special tax issues.[1]

Given the way the study is structured, its main target group is potential founders for whom the family foundation may be an option. The study therefore focuses on the central question of what a family foundation can achieve that a corporation cannot. But of course, the study is also aimed at professionals in the asset management business, such as tax consultants, notaries, lawyers, auditors and similar professional groups both within and outside Germany. Likewise, persons working with foundations in family offices, companies, authorities, courts and associations should be able to obtain useful information from the study. A number of illustrations and examples have been included to make the subject matter more accessible to the various target groups.

The study focuses on an international tax analysis of the phenomenon of family foundations. This can be explained, on the one hand, by the fact that there are virtually no family foundations in legal practice in which international tax aspects play only a minor role. On the contrary, it is often the case in economic and legal practice that central structural issues, distribution or benefit policies, as well as the management and organisation of family foundations, are heavily influenced by complex international tax issues.

Against this backdrop, the study aims to ease access to family foundations, primarily in terms of their tax functionality. Where appropriate, the study highlights the consequences of key economic decisions and explains the basic structures of civil law.

1 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025.

B. The decision-making environment of potential founders

I. In case of doubt: resist the herd instinct

It is beyond dispute that there are many reasons for setting up a domestic or foreign-domiciled family foundation. Moreover, there can be little doubt that the establishment of a family foundation is one of the most far-reaching strategic decisions imaginable in the life cycle of entrepreneurs and family businesses. A further factor is that this decision is largely irreversible – in other words, it is a decision for perpetuity. Metaphorically, it is reminiscent of the final sentence of the song Hotel California by the American rock band The Eagles: "You can check out any time you like, but you can never leave."

In view of this, as well as the now frequent use of family foundations in corporate and preventive law practice, it should be emphasised at this point that, in most cases, following the herd is not likely to prove to be an effective strategy. In other words, one should not set up a family foundation simply because many entrepreneur families among one's friends or acquaintances have done so. The opposite should be the case: Setting up and using a family foundation in an entrepreneurial context is a highly individual decision-making problem. A family foundation must suit the relevant circumstances down to the smallest detail, because otherwise there is a risk of establishing and potentially perpetuating inflexible corporate structures.

II. Reasons for setting up a family foundation

There are many reasons why someone might set up a family foundation for the purpose of structuring primarily business assets, but also non-business assets. They range from the founder's desire to have their will executed indefinitely, to the desire to provide for the family in the long term, or to give something back to society. In some cases, tax considerations may also point in favour of setting up a family foundation, for example to establish an exit-proof structure if there are shareholders within the family who are globally mobile. This is done primarily to avoid the crude legal consequences of exit taxation.

To the study "Die reformierte Wegzugsbesteuerung – Ökonomische, verhaltenssteuernde, verfassungsrechtliche und unionsrechtliche Aspekte" (2022)

Some of these reasons are discussed in great detail in the literature[2], while in other cases they are merely listed as bullet points[3]. The most relevant practical reasons for using a family foundation are explained below. The following will be discussed:

2 E.g. von Oertzen/Ponath, Asset Protection im deutschen Recht, 3rd ed., 2018.

3 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 22 et seq.

- Management and holding company for family businesses
- Protection against hostile takeovers
- Freedom from co-determination
- Avoiding disputes in family businesses
- Mitigating succession risks that could jeopardise the company
- Asset protection

1. Management and holding company for family businesses

Since family foundations[4] are not organised on a membership basis and are subject to few regulations, they are particularly suitable as holding companies for entrepreneur families. This applies all the more if – in terms of corporate and family strategy – it is deemed important to keep the family assets in one place and manage them with discretion across generations, while respecting the wishes and values of the founder.

In many medium-sized, owner-managed corporate structures, one or sometimes several corporations act as a management holding company that manages the operational group of companies. Within such family-owned corporate structures, the top management holding company often holds the shares in the downstream operating companies. In a domestic context, profit and loss transfer agreements are often concluded.

An alternative management concept is to use a family foundation. Here, the family foundation acts as the sole shareholder of the management holding company or takes on the role of a management holding company itself. As a side effect, this limits not only the entrepreneurial risk but also shields the foundation's assets from risks associated with the family. Additional assets, such as rental properties, can also be transferred to the family foundation without fear of incurring trade tax or exposing the hidden reserves to taxation. With the right legal precautions, a family foundation can also eliminate the need for otherwise common but only partly suitable safeguards against fragmentation and alienation, such as transfer restriction and succession clauses, restrictions on termination rights, and compensation clauses.

Another advantage could be seen in the high degree of discretion, since family foundations are not required to publish annual financial statements. Of course, when evaluating this option, the question of governance must also be considered on a case-by-case basis.

4 See Dahlmanns, RNotZ 2020, 417 (425); Sabel/Schauer ZStV 2018, 81 (93).

Due to its legal form, a family foundation gives the family neither co-determination rights nor economic participation rights. If such rights are desired, the contractual provisions need to be carefully drafted and flexibly adapted to the individual needs and wishes of the founders.

2. Protection against hostile takeovers

A family foundation solution can also help minimise or even completely eliminate the risk of a hostile or uncoordinated takeover. There is empirical evidence that such takeover strategies against the management's will also occur in family businesses. A family foundation that is set up as a holding company for the group can cushion this risk, since the foundation's governing bodies are bound by the founder's will as set out in the foundation's constitution. Moreover, the foundation itself has no shareholders by which an indirect acquisition of the company would be possible.

3. Freedom from co-determination

Some publications[5] indicate that, by using a (family) foundation as a holding company, under certain circumstances it may not be necessary to set up a supervisory board or to observe the principle of equal representation on the supervisory board, despite an increase in the number of employees. Corporations with more than 500 employees must generally set up a supervisory board. According to Section 1 of the One-Third Participation Act (Drittelbeteiligungsgesetz, DrittelbG), one-third of the members of this board must be employee representatives. If there are more than 2,000 employees, the law requires equal representation on the supervisory board (Section 1 (1) of the German Co-Determination Act (Mitbestimmungsgesetz; MitbestG)).

The literature[6] identifies the freedom from co-determination as "probably one of the main motives" for the use of family foundations. For example, in the case of a foundation or what is known in Germany as a Stiftung & Co. KG, there is no requirement for half of the supervisory board to be made up of employee representatives as stipulated by the MitbestG.[7] Not only does a foundation enable the founder to define values, goals and rules to which the governing bodies are permanently bound; the founder can also exempt the entity from employee co-determination regardless of the number of employees.[8] It is therefore not surprising that family foundations are considered an ideal way of avoiding co-determination.[9]

5 See Dahlmanns, RNotZ 2020, 417 (425); Theuffel-Werhahn, ZStV 2022, 43 (45).

6 See Theuffel-Werhahn, ZStV 2022, 43 (45).

7 See Theuffel-Werhahn, RFamU 2022, 67 (69).

8 See Dannecker, DStR 2023, 1057 (1059).

9 See Bayer, NJW 2016, 1930 (1933).

4. Dispute avoidance

The literature on the subject points out that family foundations can be a useful instrument for achieving long-term peace within the family and stable management of the business over the course of several generations.[10] There are two reasons for this: the greater flexibility that the legal form of a family foundation offers in terms of its constitution compared to the rules of corporation law, and the resulting ability to include strategic corporate policies holistically in the family foundation's constitution, alongside the family constitution. A notable feature of the family foundation is that it can clearly separate the two systems of business and family while simultaneously keeping the family community connected through a special body, the family assembly. Nevertheless, there are reports of generational transfers of family-run businesses failing despite the use of the family foundation instrument.[11]

Using a family foundation to structure the successorship of entrepreneurial family assets is thus no guarantee of success. It is, however, possible to develop plausible guidelines for successorship, which, if followed, increase the probability of achieving what are likely to be the primary objectives: securing peace within the family and avoiding family disputes.

The following points can help ensure success in this regard:

- Clear definition and pursuit of the purpose of the private-benefit family foundation to manage its assets for the benefit of one or more families or specific family members
- Establishment of a family foundation as a family holding company
- Exploitation of the freedom of design afforded by foundation law when drafting the foundation's constitution
- Clear description of the founder's original intentions as the basis for long-term acceptance of the rules
- Specific description of the group of beneficiaries by identifying the eligible family members

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10 See Kohler, Streitvermeidung in Familienunternehmen durch eine Familienstiftung, in Freiherr von Erffa/Lehleiter/Prigge (eds.), Streit und Streitvermeidung im Familienunternehmen, Festschrift für Lutz Aderhold zum 70. Geburtstag, Cologne 2021, 181 (185).

11 See Kohler, Streitvermeidung in Familienunternehmen durch eine Familienstiftung, in Freiherr von Erffa/Lehleiter/Prigge (eds.), Streit und Streitvermeidung im Familienunternehmen, Festschrift für Lutz Aderhold zum 70. Geburtstag, Cologne 2021, 181 (183). Real-life examples of failed succession structures despite the use of family foundations can also be found in business journalism.

5. Mitigation of succession risks that could jeopardise the company

With regard to the topic area of compulsory shares and family foundations, as well as the anticipatory management of claims for the augmentation of compulsory shares, some considerations are set out below. These may help to cushion existential threats to the continued existence of a group of companies.

In principle, an individual's right to use their assets as they wish is protected as a fundamental right. However, in the context of dispositions by will, this constitutionally protected guarantee is restricted to a certain extent. This restriction arises from the right to a compulsory share. According to the provisions of the German Civil Code (Bürgerliches Gesetzbuch, BGB) concerning inheritance, the next of kin of a testator, in particular their spouse or life partner and their children, are entitled to a compulsory share upon the death of the asset owner. The right to a compulsory share relates to money and amounts to one-half of the statutory share of the estate (Section 2303 BGB). Accordingly, the person entitled to a compulsory share can demand from the donee the amount by which the compulsory share is increased if the object given is added to the estate.[12]

If a testator excludes a descendant from succession by disposition mortis causa, the latter can demand the compulsory share from the heirs. To avoid the claim to a compulsory share being eroded by gifts made during the testator's lifetime, Section 2325 BGB provides for a claim for the augmentation of compulsory shares. If more than ten years have passed since the object was given, the gift is not taken into account. This claim for the augmentation of compulsory shares in accordance with Section 2325 (3) BGB is reduced by one-tenth for each full year that has passed between the time the assets were transferred to the foundation and the death of the testator.

The law governing compulsory shares does not grant any privileges to family foundations.[13] If, for example, six years have passed between the establishment and endowment of the family foundation and the death of the testator, only four-tenths of the original donation will be added when calculating the claim for the augmentation of the compulsory share.[14]

The regulatory framework outlined above means that a family foundation may be exposed to liabilities that, in the case of claims for the augmentation of compulsory shares under inheritance law, can take up a considerable portion of the assets.[15] It follows that potential

12 See Kirchdörfer, FuS 2012, p. 62.

13 See Oppel, NWB-EV 2018, 57.

14 See Kirchdörfer, FuS 2012, 62.

15 See Beyer, ZStV 2023, 126.

claims for compulsory shares and claims for the augmentation of compulsory shares must be managed with foresight right from the time the foundation is set up.

In view of this situation, it is worth mentioning that the establishment of a family foundation can be used to minimise or preclude claims to compulsory shares by children and spouses.[16]

One can easily see how the statutory right to a compulsory share can pose a considerable hurdle for medium-sized companies with regard to succession planning. If – as is often the case – the value of the estate is largely based on the value of the company without sufficient other assets to adequately cover the claims of persons entitled to a compulsory share, the statutory right to a compulsory share can quickly become a showstopper for the succession plan.

Consequently, an early transfer of assets to a family foundation can support the realisation of a succession plan due to the reduction rule that applies to claims for the augmentation of compulsory shares. This is because, given that the claim for the augmentation of compulsory shares decreases by ten percent annually from the time the assets are transferred to the family foundation, the claim effectively has a ten-year expiration date and will be completely void after this time. A viable strategy in such situations could therefore be to set up a family foundation during one's lifetime in order to reduce or completely exclude the right to a compulsory share after the founder's death. If, after the founder's death, the founder's descendants die as well, the assets transferred to the family foundation will have no influence on any claims to a compulsory share of the beneficiaries after the deceased descendant. This is because the assets of the family foundation do not form part of the estate of the descendant, nor have they ever done so.[17]

6. Asset protection

A wealth of literature[18] can be identified on the topic of asset protection through the use of a family foundation. The protective effect results from the fact that company shares can be seized by creditors, whereas creditors of beneficiaries of a foundation have no claim to foundation assets.[19] The reason is that claims to the foundation's profits are typically not legally enforceable. Thus, a family foundation can serve to protect the transferred assets from third-party access.

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16 See Demuth, KÖSDI 2018, 20909; this source also points out that the establishment of a foundation can reduce a spouse's claim to equalisation of accrued gains if the couple's marriage is subject to the statutory matrimonial property regime.

17 See Demuth, KÖSDI 2018, 20909.

18 See, for example, von Oertzen/Ponath, Asset Protection in German Law, 3rd ed. 2018; von Oertzen/Hosser, ZEV 2010, 168; Bisle, DStR 2012, 525.

19 See Stiftung Familienunternehmen (eds.)/Habersack, Stiftungsunternehmen 2021, 24.

The basic approach to achieve the objective of asset protection consists of transferring the assets of a person at risk of liability to an independent legal entity.[20] This independent legal entity often takes the form of a domestic family foundation, although the approach outlined can also work with a foreign-domiciled family foundation. The crucial point is that the assets dedicated to the purpose of the foundation no longer form part of the founder's assets. The assets are transferred to the foundation, i.e. they become the property of the independent family foundation by way of transfer of ownership. In accordance with Section 82a BGB, all claims, membership rights, industrial property rights and other transferable rights pass to the foundation by operation of law (legal assignment) upon the foundation being recognised.

When using a family foundation for asset protection purposes, it is essential to bear in mind that, while German law considers this to be permissible, it also sets limits on the corresponding organisational approaches.[21] Indeed, the protection of assets from enforcement goes hand in hand with a loss of legal power of disposal and influence. This means that founders seeking asset protection cannot use the instrument of a domestic family foundation and still have unrestricted control over the assets of the domestic family foundation after it has been established. In practice, too little attention is often paid to the fact, once the family foundation has been formally recognised, there is essentially no way of reversing or changing how the assets endowed to it are used. Once a certain portion of the founder's assets has been dedicated to the foundation's purpose, that portion will be protected by the family foundation's asset protection. The founder must be fully aware of the fact that they have relinquished control over the assets transferred to the family foundation.

Provided that this legal framework is accepted, the German domestic family foundation can be an attractive option for asset protection purposes. The same essentially also applies to foreign-domiciled family foundations because, as we have seen, once a family foundation has been set up, the assets of the family foundation are completely separate from the assets of the heirs and their descendants. Once the assets have been transferred to the family foundation in full compliance with civil law, neither the creditors of the founder (testator) nor the creditors of the heirs have access to the family assets. Consequently, the family foundation is a suitable asset protection instrument.[22]

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20 See Bisle, DStR 2012, 525.

21 See von Oertzen/Hosser, ZEV 2010, 168.

22 See, for example, Demuth, KÖSDI 2016, 20003.

III. Forms of family foundations

The term "family foundation" does not refer to a specific legal form.[23] A family foundation is a typical manifestation of the general concept of a foundation. The concept of a family foundation can be found in a wide range of forms, so the aim of the reflections below is to categorise and differentiate the most empirically relevant forms to provide an overview.

1. Family foundation having legal personality and subject to unlimited tax liability

With the latest reform of civil law as it pertains to foundations – set out mainly in Section 80 et seq. BGB – the legal construct of the foundation has been given a legal definition for the first time. Section 80 BGB defines it as a memberless legal entity endowed with assets intended to achieve an object specified by the founder, either on a long-term and sustained basis (perpetual foundation) or for a specific period (principal-depleting foundation). To qualify as a family foundation, further criteria must be met in addition to the general definition of a foundation. In legal practice, the term "family foundation" has proven to be extremely heterogeneous.[24]

A first attempt to define the term is that a family foundation is "established in the interest of one or more families or family members". With regard to a foundation established under German law, the provisions of Section 83a BGB stipulate that the administration of the foundation must be based in Germany. For tax purposes, a standard family foundation of this kind will typically also have its place of management[25] within the meaning of Section 10 of the German Tax Code (Abgabenordnung; AO) in Germany. Although terminologically not entirely precise, this study also uses the term "domestic family foundation" to describe such forms of family foundation.

2. Foundation operating a business and foundation participating in corporations and/or partnerships

It is important from both a business and legal perspective to distinguish between foundations operating a business and foundations participating in corporations and/or partnerships.[26] A (family) foundation operating a business runs this business itself under its own legal form. Preventive law practitioners tend to be rather hesitant about foundations operating a business.[27] Empirically, they are less significant than foundations participating in corporations and/or

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23 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 19.

24 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, pp. 29–40, bullet point B; Kraft, NWB Erben & Vermögen 2025, 51.

25 See Kraft, DStR 2024, 2154.

26 See Kraft, Die Familienstiftung als Erkenntnisobjekt der Betriebswirtschaftslehre, in Richter/Meyering/Sopp, Anwendungsorientierte steuerliche Betriebswirtschaftslehre – Festschrift zum 65. Geburtstag von Heinz Kußmaul, Berlin 2022, 605.

27 See Kraft, FR 2024, 541; Steiner, Betriebswirtschaftliche Beratung 2024, 24 (25).

partnerships. This could be due to the fact that foundations operating a business have proven to be less flexible in terms of structural options. In most cases, foundations participating in corporations and/or partnerships are considered preferable as they allow for a flexible response to business challenges, for example by adapting the articles of association.[28]

Below is an example of how a foundation operating a business is formed.

Example:

> Founder S operates a sole proprietorship with permanent establishments in Germany and in foreign countries. S transfers the sole proprietorship, with all its assets and liabilities, to a family foundation by way of an initial endowment. The family foundation thus becomes a foundation operating a business.

The majority of family foundations are foundations participating in corporations and/or partnerships. These hold one or more participations in a corporation or partnership – possibly in addition to other assets. In the case of a foundation participating in corporations and/or partnerships, a business is operated as a partnership or corporation. Such constellations offer a higher degree of flexibility. The business operated by the partnership or corporation is not subject to the somewhat more cumbersome regulations of foundation law. How a foundation participating in corporations and/or partnerships is set up is explained in the following example.

Example:

> Founder S, who is subject to unlimited tax liability in Germany, holds 100 percent of the limited partner's shares in SM-GmbH & Co. KG. Her husband M is the general partner. She also holds 100 percent of the shares in S-GmbH as part of her private assets.

By way of initial endowment, both the limited partner's shares in SM-GmbH & Co. KG and the S-GmbH shares are transferred to the domestic family foundation S-Familienstiftung. S-Familienstiftung has become the owner of both share classes as a result of the founder's commitment in the endowment transaction. As a foundation participating in corporations and/or partnerships, it holds both the 100 percent share in SM-GmbH & Co. KG and the 100 percent share in S-GmbH.

28 See Demuth, KÖSDI 2023, 23055 (23058).

3. Family foundation without legal personality (trust foundation)

In addition to foundations having legal personality, which are recognised as legal entities, the German legal system also recognises the legally dependent foundation, which does not have its own legal personality. This type of foundation is not subject to any specific civil law regulations. Legally dependent foundations are also referred to as trust foundations,[29] as foundations without legal personality or as fiduciary foundations. The civil law construct on which they are based is a fiduciary relationship. Typically, this relationship is established by way of a gift with conditions attached, a trust agreement, or by applying the criteria set out in mandate or agency law.[30]

A foundation without legal personality is not a legal form in the true sense of the word. Rather, the legal system treats such a foundation as a trust that is not regulated by law.[31] Since a foundation without legal personality is not a legal entity, it is not capable of holding rights and obligations. In terms of civil law, it can be described as a legal relationship between the founder and the entity holding the earmarked assets. Establishing a (family) foundation without legal personality results – under the law of obligations – in the separation of assets (special assets) and the earmarking of these special assets for a specific purpose.[32]

The dependent foundation therefore requires a legal entity (foundation sponsor) in order to act. The Reichsgericht (the highest court in the German Empire from 1879 to 1945) already defined[33] a foundation without legal personality (trust foundation) as a transfer of assets from a founder to a trustee with the condition that the transferred assets be used permanently to pursue a purpose specified by the founder. The Federal Court of Justice[34] uses a similar description: "A dependent foundation is one in which assets are transferred to a natural or legal person with the proviso that they be managed as separately-held special assets, distinct from the recipient's other assets, and used permanently to pursue the purposes specified by the founder."

Since family foundations without legal personality, from a tax perspective, offer no advantages over those with legal personality, they will not be examined further in this study. Both

29 See Krüsmann, ZStV 2023, p. 201.

30 See Stolte, BB 2023, 2755.

31 For more details, see Götz/Pach-Hanssenheimb, Handbuch der Stiftung, margin no. 336; Klinkner/Wagener, Familienstiftung, 3.

32 See Hübner/Currle/Schenk, DStR 2013, 1966.

33 See Reichsgericht ruling of 24 June 1916 – V 137/16, RGZ 88, 335 (339). The Federal Court of Justice (BGH) provided a similar description in its ruling of 12 March 2009 – III ZR 142/08, NJW 2009, 1738, margin no. 14.

34 See BGH ruling of 12 March 2009 – III ZR 142/08, NJW 2009, 1738.

types of foundation are treated identically with regard to income and gift tax.[35] However, the undeniable non-tax-related advantages of a family foundation without legal personality over a family foundation with legal personality certainly deserve to be mentioned – such as the fact that the former is easier to set up and manage, offers greater flexibility, is not subject to foundation supervision, will not be required to release any public records in the future, and also benefits from simplified accounting and auditing processes, all of which help to keep costs down. This type of foundation is therefore sometimes recommended for smaller estates.[36]

4. Foreign-domiciled family foundation (Section 15 AStG)

The legal type of foreign-domiciled family foundation, which may have neither its registered office nor its place of management in Germany, is a distinct and special regulatory area that has found its way into the law in Section 15 of the External Tax Relations Act (Außensteuergesetz, AStG). The section is divided into eleven paragraphs and is supplemented by extensive explanations by the tax authorities in the Application Decree for the External Tax Relations Act (Anwendungserlass zum Außensteuergesetz, AEAStG).

Its significance has increased markedly in recent years, which is also reflected in the dramatic increase in the number of cases concerning the legal phenomenon of foreign-domiciled family foundations being brought before the local tax courts and the German Federal Fiscal Court. The provisions of Section 15 AStG serve to prevent tax avoidance. This is expressed in the fact that para. 1 of this section stipulates – under certain conditions deemed objectionable by the legislature – that the income of a foreign-domiciled family foundation is attributable to the founder, if they are subject to unlimited tax liability, or to the transferee with unlimited tax liability who is entitled to a foundation's net worth or assets. The provision specifies that the assets and income of a family foundation are to be attributed first to the founder, provided that the founder is subject to unlimited tax liability. In the absence of a founder subject to unlimited tax liability, the assets and income of the family foundation are attributed to the beneficiaries with unlimited tax liability, who are described in the act as being entitled to benefits or remainder.

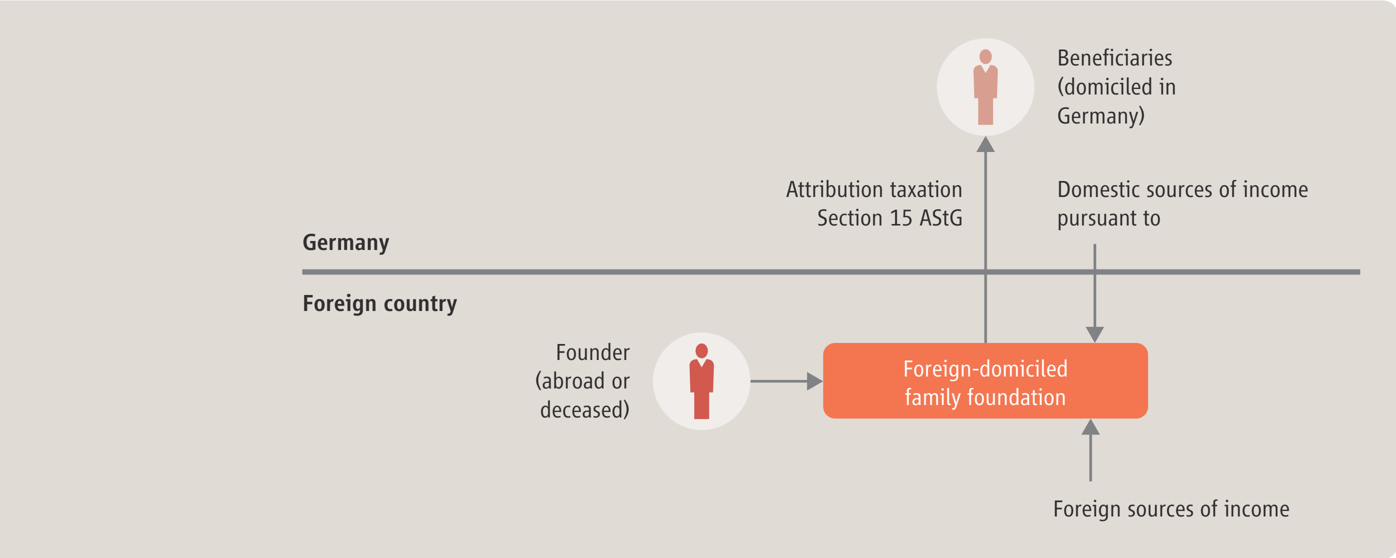
The figure below shows that the attribution of a foreign-domiciled family foundation's income to beneficiaries with unlimited tax liability, who are designated by law (Section 15 (1) AStG) as being entitled to receive benefits or remainder – or, in other words, transferees entitled to the foundation's assets or net worth – only applies secondarily if no founder with unlimited

35 The legal basis for the unlimited corporation income tax liability of a trust foundation can be found in Section 1 (1) no. 5 KStG. The corporation income tax liability presupposes that the fulfilment of the foundation's purpose is no longer dependent on the founder's will. See Gemmer, SB 2024, 29 (34); Rengers in Brandis/Heuermann, Ertragsteuerrecht, Section 1 KStG, margin no. 186.

36 See Gemmer, SB 2024, 115.

tax liability exists. Figure 1 is based on the assumption that the founders are not subject to unlimited tax liability because they are not resident in Germany or are already deceased.

Figure 1: Foreign-domiciled family foundation with domestic beneficiaries (own illustration)



IV. Family-run corporation versus family foundation

1. Classification and perspective of supreme civil and tax case law

While the family-run corporation is a familiar form of organising entrepreneurial activities for most protagonists, the family foundation often requires some explanation. These two legal institutions have both similarities and differences, which will be illustrated briefly below.

Recent rulings by the Federal Court of Justice (Bundesgerichtshof, BGH) show a clear and enlightening tendency towards closer alignment. In its landmark ruling in 2016, the BGH[37] pointed out, on the one hand, that the beneficiary of a foundation cannot be directly equated with the shareholders of a trading company, since the beneficiary is not an incorporated member of the foundation. On the other hand, however, even in the absence of an "internal relationship with a structure similar to one under company law", the purposes of a trading company and a foundation with regard to their shareholders or beneficiaries are so similar in nature[38] that – in analogous application of the principles of international company law – the legal relationship between the foundation and the (potential) beneficiary ought also to be

37 See BGH ruling of 8 September 2016 – III ZR 7/15, BB 2016, 2569, margin no. 14.

38 See Kraft, ISR 2020, 267 (269).

subject to the law governing the foundation[39]. The BGH concedes that a trading company is typically geared towards making a profit that will ultimately benefit its shareholders in the form of distributions. The purpose of a foundation, it reasons, is similar in that it aims to distribute its assets or the income generated therefrom directly or indirectly to the beneficiaries. Therefore, from this crucial point of view, the relationship between the beneficiaries and the foundation is comparable to the legal relationship between shareholders and the company.[40]

The tax case law of the German Federal Fiscal Court (Bundesfinanzhof, BFH) follows this tendency towards aligning (family-run) corporations and (family) foundations in some areas. However, an examination of tax case law also reveals areas in which the Federal Fiscal Court has ruled against aligning the tax treatment of (family-run) corporations and (family) foundations, backing its decisions with well-considered arguments. For example, in the opinion of the German Federal Fiscal Court, benefits paid by a private-law (family) foundation having legal personality to its beneficiaries count as income within the meaning of Section 20 (1) no. 9 of the German Income Tax Act (Einkommensteuergesetz, EStG).[41] Thus, private-benefit family foundations can indisputably grant benefits to their founders or beneficiaries that are comparable to profit distributions within the meaning of Section 20 (1) no. 9 EStG.[42] So, in this respect, the substance is the same as when a corporation pays dividends to its shareholders. On the other hand, the German Federal Fiscal Court,[43] in two recent landmark rulings, has denied family foundations subject to unlimited tax liability in Germany the right to maintain a tax deposit account. There is therefore no general tendency towards a full alignment of (family-run) corporations and (family) foundations in the case law of the highest financial courts. Instead, the Federal Fiscal Court applies the law differently depending on the area in question. This means that the tax treatment of (family-run) corporations on the one hand and (family) foundations on the other can be either the same or different depending on the area of regulation. At any rate, the case law of the First Senate of the Federal Fiscal Court favours a literal interpretation in the context discussed, insofar as it is possible to derive clear indications of the respective treatment from the positive legal situation.

Finally, some areas subject to regulation are still in need of clarification. For example, there is uncertainty regarding the tax consequences of a hidden transfer of assets[44] by a private-benefit

39 The law governing the foundation is also decisive for the legal status as a beneficiary and the resulting claims. In the case in question, the BGH ruled that this was Austrian law.

40 See Kraft, ISR 2020, 267 (269).

41 See BFH ruling of 3 July 2024 – I R 46/20, BFH/NV 2025, 102.

42 See Kraft, Ubg 2024, 319.

43 See BFH ruling of 17 May 2023 - I R 42/19, BStBl. II 2024, 381; BFH ruling of 17 May 2023 – I R 46/21, BFH/NV 2023, 1408.

44 For a detailed discussion of the issue, see Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, p. 160 et seq. See also Maciejewski, StuW 2024, 158 (174).

family foundation to its founders or beneficiaries.[45] By contrast, in the relationship between a corporation and its shareholders, well-established practices and legal consequences are in place for the legal concepts of hidden profit distribution and hidden contributions.

2. Similarities

Structural similarities between family-run corporations and family foundations include the following:

- Legal personality of family foundations and family-run corporations
- Separate spheres (suitable for asset protection)
- Comparable types of foreign institutions/forms of organisation
- Formal establishment procedure
- Suitable as a management tool for family business assets and as a tool for managing family business groups
- Corporation income tax liability for family-run corporations and family foundations subject to unlimited tax liability
- Treatment of benefits from a family-run corporation to its shareholders as dividends and from a family foundation to its beneficiaries as dividend-like income subject to income tax
- Possibility of the legal entity "piercing the corporate/foundation veil" if the family-run corporation or family foundation is established under foreign law
- Similar tax treatment when a family-run corporation or a family foundation is set up
- The term "private investor" as defined in the German Capital Investment Code (Kapitalanlagegesetzbuch, KAGB) covers both foundations and corporations[46]
- Identical principles for designating the place of management as the main centre of commercial control for family-run corporations and family foundations

3. Differences

Structural differences between a family-run corporation and a family foundation can be found in the following (non-exhaustive) list:

- Management processes may differ between family-run corporations and family foundations, for example with regard to the legally prescribed framework for decision-making

45 See the evidence, for example, in Schulz, Family foundations, 57.

46 See Zetzsche in: Assmann/Wallach/Zetzsche (eds.), KAGB Kommentar, Section 1, margin no. 227.

- Decision-making structures and decision-making competences are organised differently in the two legal forms
- Shareholders of family-run corporations and beneficiaries of family foundations have different co-determination and participation rights
- Lack of a legal definition of family-run corporations versus heterogeneous definitions of family foundations
- Regulations concerning the tax deposit account assessed differently by the highest courts
- Disposal rights differ insofar as the company share can be disposed of, whereas the beneficiary status is a highly personal right that cannot be sold
- Commercial purpose and pursuit of profit inherent in corporations, while in family foundations this depends on the purpose of the foundation
- Exit from the respective institution subject to different termination/dissolution regulations; the general liquidation taxation rules for corporations under Section 11 KStG do not apply to foundations
- Corporations are subject to more detailed and stricter institutional rules governing the supervision of day-to-day management
- Corporations are subject to stricter legal regulations regarding mandatory audits by independent auditors
- Relocation of the registered office is possible in the case of (family-run) corporations, whereas in the case of (family) foundations, relocation of the registered office constitutes a reason for dissolution[47]
- Foundations are prohibited from leaving the country under Section 83a BGB, whereas corporations in principle enjoy freedom of movement across the EU
- Applicability of gift tax law (Section 7 (1) no. 9 of the German Gift Tax Act) in the event of the dissolution, annulment, consolidation or merger of (family) foundations; applicability of income tax provisions for (family-run) corporations (e.g. corporation income tax provisions in the event of liquidation, conversion tax provisions in the event of a merger, demerger or change of legal form).

V. Governance in family foundations

The topic of governance is also relevant to family foundations. Based on theoretical groundwork and relevant insights in the field of corporate governance, the research field of foundation governance has now established itself as a separate discipline. Questions regarding

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47 See Hilser/Wagner/Wunderlich, RIW 2022, 796.

its meaningfulness, the necessity for regulation and compatibility with the nature of a family foundation are therefore of considerable importance.

Corporate governance is generally understood as the legal and factual framework for the management and supervision of a company.[48] This includes the organisation of the company's management, its competences and the objectives it is obliged to pursue. The need for external corporate governance is linked to the relationship between the company and its stakeholders. Corporate governance serves to improve corporate management and control with the underlying aim of protecting the company from the negative effects of conflicts of interest.[49] Governance thus generally contributes to improving decision-making structures in organisations.

While a full-scale incorporation of foundation governance rules into the law is regarded as utopian, at least for the time being,[50] the current state of research leaves little doubt that well-designed governance structures are fully justified in family foundations as well. One important argument in favour of this is the information needs of stakeholders and other parties (especially beneficiaries, business partners, potential donors, foundation supervisory authorities, contributors, tax authorities and interested members of the public, to name just a few). Whether this requires the establishment of a dedicated Foundation Governance Code is another matter. At any rate, there is no denying that corporate and foundation governance are rooted in different legal and economic dimensions, which is why simply transferring provisions from one entity to the other would be a questionable move.

It should be noted that family foundations do not finance themselves through capital markets. Consequently, in contrast to capital-market-financed companies, family foundations are not subject to capital market control, so that the associated disciplining effect is absent for institutional reasons. As a result, the vast majority of family foundations are not subject to any kind of effective capital market control.[51] Family foundations have no tradable shares, nor do their boards have to fear a takeover. This means that there are no market sanctions for mismanagement. In other words, market control is not an option for family foundations, and there is often a lack of market interest in the activities of most foundations. Going by the theory, this kind of situation could make players more likely to act opportunistically, making it all the more important to establish independent guidelines for foundation governance.

48 See Hippeli in: Achleitner/Block/Strachwitz, Stiftungsunternehmen, 126.

49 See Schmidt-Schmiedebach, Stiftung und Governance Kodex, Wiesbaden 2016, 56.

50 See Schmidt-Schmiedebach, Stiftung und Governance Kodex, Wiesbaden 2016, 436.

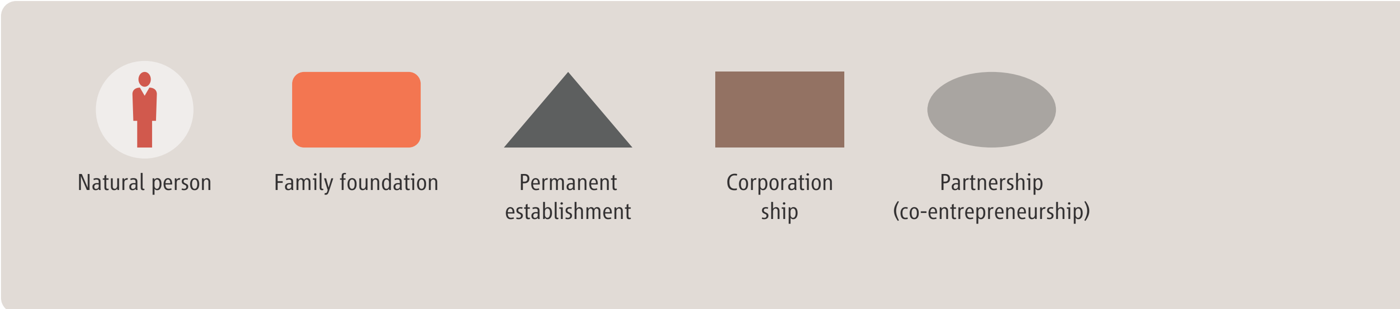
51 See Lange, AcP 2014, 511 (522).

C. Establishing a family foundation

I. Preliminary remarks and symbols used

The considerations below are supplemented by diagrams for the purposes of visualisation and easier comprehension. The symbols used consistently throughout are shown in Figure 2.

Figure 2: Symbols used (own illustration)



The following discussion is based on the assumption that a founder subject to domestic tax is able to endow a family foundation (with legal personality) that has been established under domestic law or a foreign-domiciled family foundation within the meaning of Section 15 AStG with assets. The founder can theoretically choose from an unlimited number of assets or asset classes to be contributed to the family foundation. From a tax perspective, it is useful to first categorise the assets as either private assets or assets with a business relevance. The list below provides an overview of possible assets, but is by no means exhaustive.

Examples of assets that can be contributed as taxable private assets:

- Cash assets
- Jewellery
- Free float shares
- Securities accounts
- Works of art
- Wine collection
- Shares in corporations
- Real estate held as private assets
- Assets associated with a high standard of living (vintage cars, yachts, wine cellars, hunting equipment)

- Shares in corporations (Sections 17, 20 (2) EStG)

Examples of assets that can be contributed as taxable business assets:

- Sole proprietorships (businesses)
- Co-entrepreneurial interests, including separate business assets (caution with parts of a co-entrepreneurial interest)
- Parts of a business
- Shares in corporations held as business assets

The endowment of a private-benefit family foundation upon its establishment gives rise to tax questions for both the foundation and the founder.[52] As a rule, it is necessary to take into account the tax implications when endowing a private-benefit family foundation with assets, particularly with regard to inheritance tax, gift tax, taxes on income (individual income tax, corporation income tax, trade tax), as well as value added tax and land transfer tax. The discussion below focuses on the implications in terms of inheritance and gift tax as well as taxes on income.

II. Endowment of a domestic family foundation

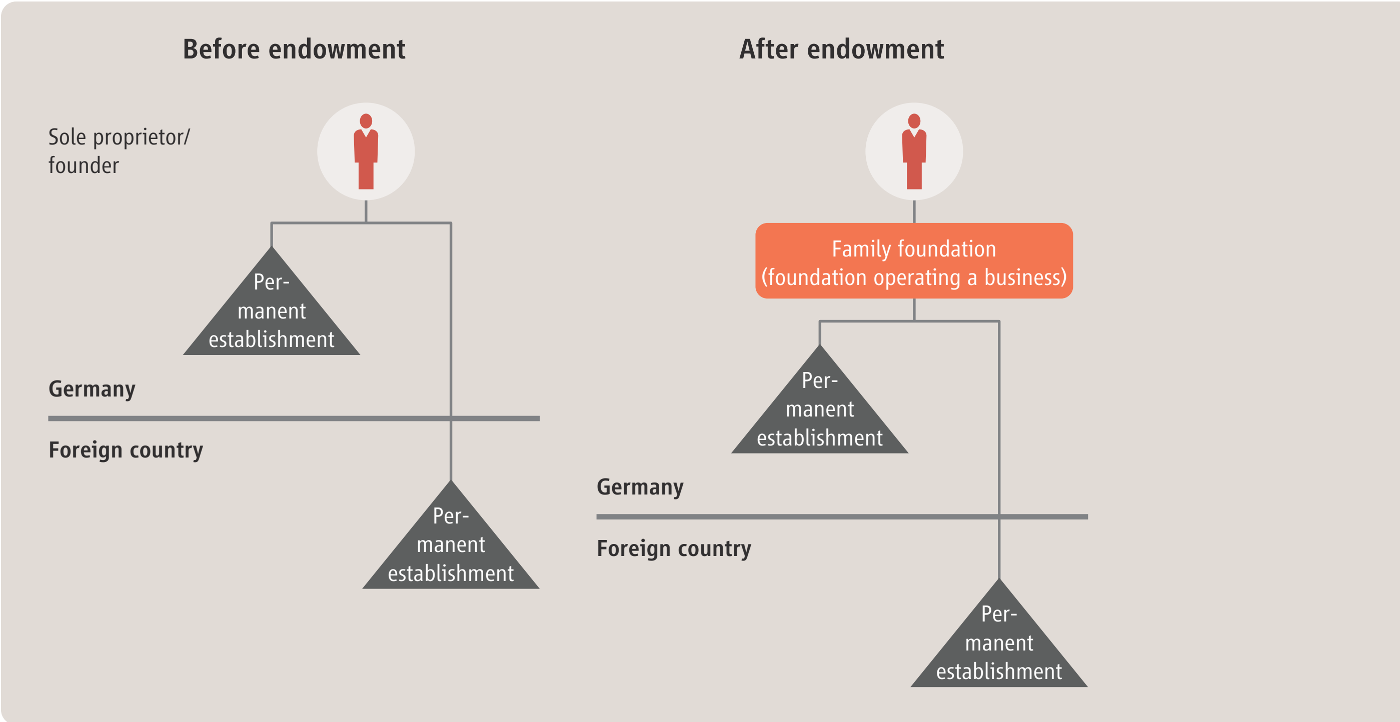
1. Structuring the endowment

The discussion below is based on the assumption that the private or business assets of a natural person, the founder, are transferred to a family foundation. This transaction is referred to in technical jargon as an endowment. Structurally, founders divest themselves of the assets they have contributed to the family foundation, as illustrated in the overview below, which depicts the endowment of a family foundation with business assets. The diagram illustrates a situation in which a family foundation is endowed with a sole proprietorship previously operated by an entrepreneur – the founder. This sole proprietorship held both domestic and foreign business assets; in tax terminology, these are permanent establishments within the meaning of Section 12 of the German Tax Code (Abgabenordnung; AO).

As can be seen from Figure 3, the founder and former sole proprietor no longer has any legal access to the company after the endowment of the family foundation. The family foundation has become the legal entity operating the business as a result of the endowment transaction.

52 See Weiten, ZEerb 2023, 241.

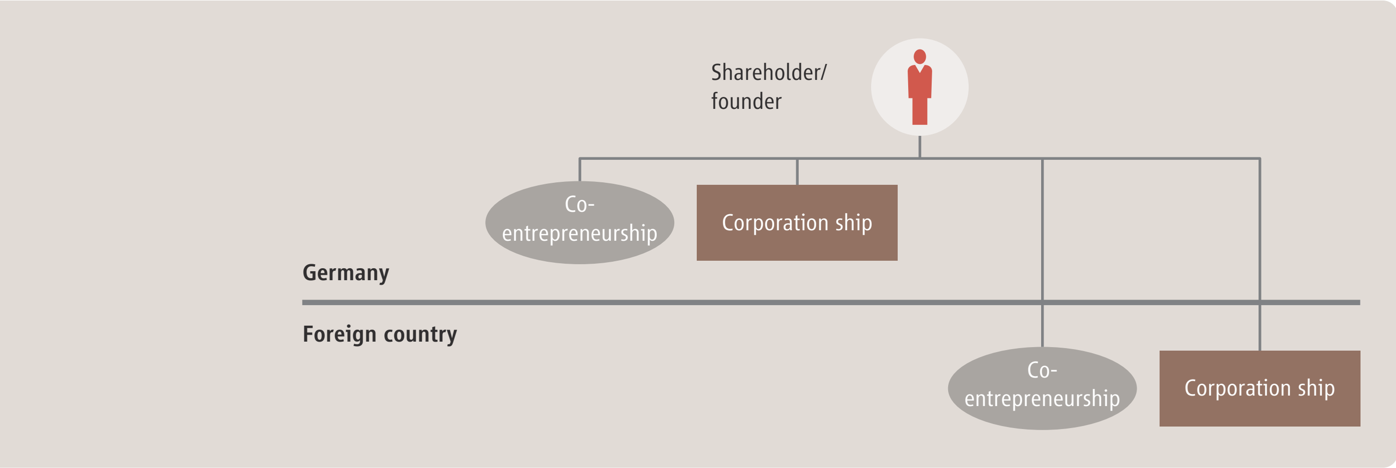
Figure 3: Endowment of a domestic family foundation through the contribution of a sole proprietorship with domestic and foreign permanent establishments (own illustration)



When a family foundation is endowed with business assets, the endowment often involves the transfer of shares in partnerships or corporations to the family foundation. For tax purposes, a partnership generally constitutes a co-entrepreneurship – subject to pure asset management – which is why the overviews use this term. The corresponding transaction structures are illustrated in the diagrams below.

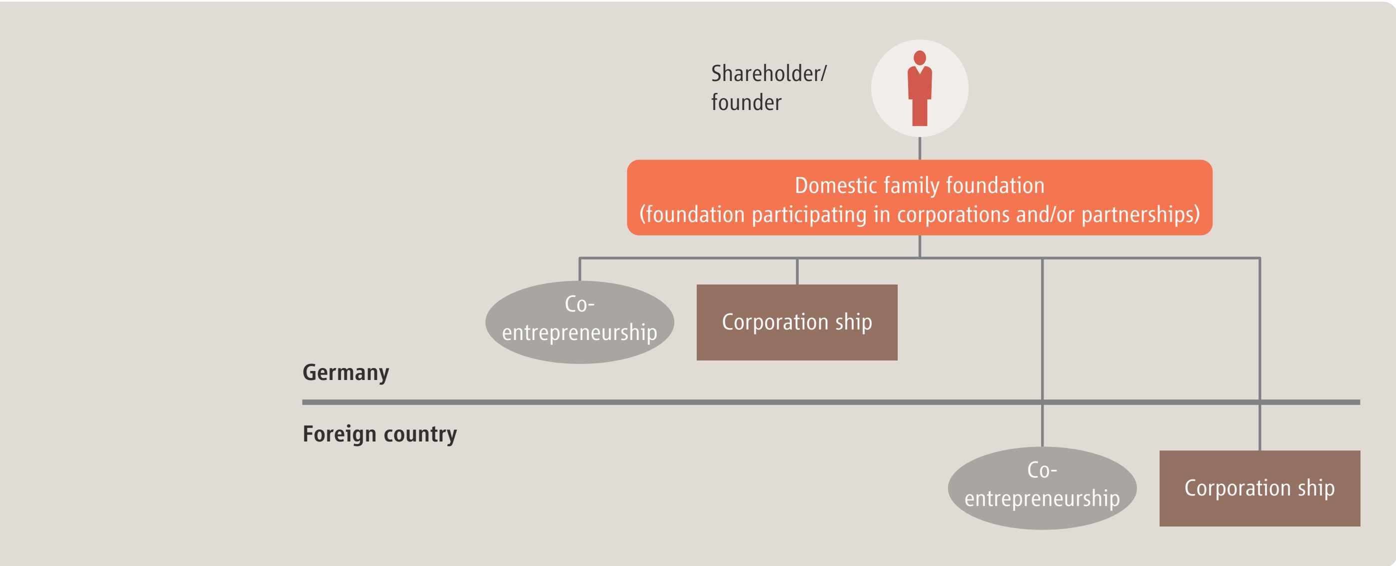
Figure 4 shows the current owner of domestic and foreign co-entrepreneurial interests and participations in corporations. If, in the endowment transaction, the founder/shareholder undertakes to contribute their domestic and foreign co-entrepreneurial interests and participations in corporations to a family foundation, this results in an ownership structure of the companies as shown in Figure 4.

Figure 4: *Before the endowment of a domestic family foundation through the contribution of participations in partnerships and corporations (own illustration)*



After the endowment of the family foundation, the ownership structure under company law will be as shown in Figure 5.

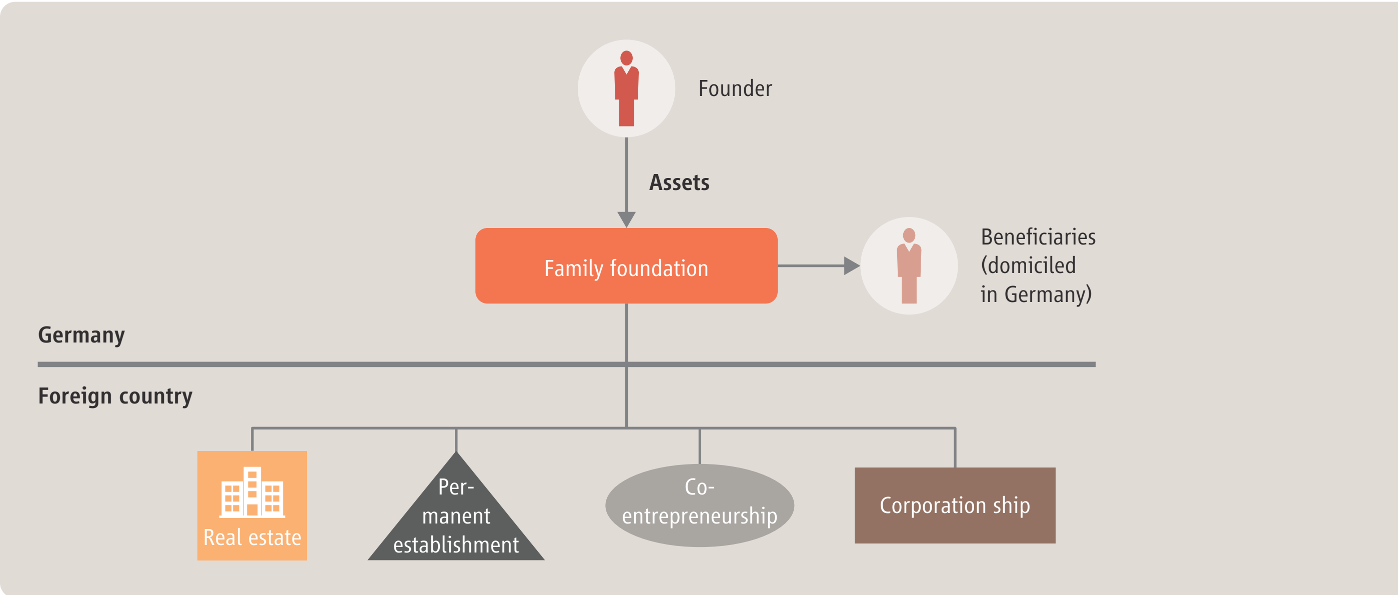
Figure 5: *After the endowment of a domestic family foundation through the contribution of participations in partnerships and corporations (own illustration)*



In this structure, too, the former shareholder has lost the legal power of disposition over the companies held by virtue of their former shareholder status, because after the endowment of the family foundation, the latter now has the status of shareholder in the respective partnerships or corporations.

In view of the increasing internationalisation of the asset structures of domestic family foundations, suffice it to say that their endowment is very often achieved by means of foreign assets. Figure 6 below presents the properties, sole proprietorships, co-entrepreneurial interests and participations in corporations that have been contributed.

Figure 6: *Typical forms of cross-border investment by a family foundation subject to unlimited corporation income tax liability (own illustration)*



2. Inheritance and gift tax

An endowment associated with the establishment of a private-benefit family foundation requires the relevant provisions of inheritance and gift tax law to be taken into account in the analysis of the tax burden. Of particular relevance are the provisions of Section 3 (2) no. 1 and Section 7 (1) no. 8 of the German Inheritance Tax Act (Erbschaftsteuergesetz, ErbStG). Pursuant to Section 3 (2) no. 1 ErbStG, the transfer of assets by the founder is subject to inheritance tax in the event of a donation upon death. Section 7 (1) no. 8 ErbStG, meanwhile, stipulates that gift tax is to be levied in the event of a lifetime gift.

a) Outline of tax exemption and tax relief provisions

Pursuant to the basic inheritance and gift tax principle of Section 10 (1) ErbStG, the assets received by a private-benefit family foundation are deemed to be taxable acquisitions, unless they are tax-exempt. However, the ErbStG also contains a wide range of tax exemptions that can be applied to donations to a private-benefit family foundation (Section 13 (1) nos. 1–18 ErbStG).

The transfer of works of art and art collections can thus be exempt from inheritance and gift tax under the conditions set forth in Section 13 (1) no. 2 ErbStG.[53] Section 13 (1) no. 2a ErbStG may become relevant in this context. If, in accordance with this section, property or parts of a property, works of art, art collections, scientific collections, libraries or archives are transferred to a family foundation, then under certain further conditions, 60 percent or 85 percent of these assets are exempt from tax. According to the cited provision, the conditions are that their preservation is in the public interest on account of their significance for art, history or science, that the annual costs generally exceed the income generated and that the objects are made available for research or public education purposes to an extent appropriate to the circumstances.

Far more important than these tax exemptions are the tax relief rules for business assets. The provisions of Sections 13a, 13b, 13c and 28a ErbStG, in particular, apply if the family foundation is endowed with tax-privileged business assets for the purpose of regulating corporate succession. In addition, this also applies to participations in corporations if the founder directly held more than 25 percent of the nominal capital of this corporation at the time the tax was incurred (minimum participation).

In some respects, tax law treats EEA countries the same as EU countries.

It is of considerable importance that the tax-privileged assets are geographically limited.[54] For example, in order for agricultural and forestry assets, as well as business assets, to be tax-privileged, they must be located in Germany or serve a permanent establishment in an EU or EEA member state.

Example:

> Founder S (natural person) has contributed his agricultural business, along with all of the associated assets and liabilities, to a domestic family foundation subject to unrestricted corporation income tax liability. The agricultural business has permanent establishments in Germany, in foreign EU countries and in what are known as third countries. Only the permanent agricultural and forestry establishments in Germany and in foreign EU countries are eligible for tax privileges.

If a domestic family foundation subject to unlimited corporation income tax liability is endowed with one or more shares in a corporation, this transaction qualifies for preferential tax treatment if the company has its registered office or place of management in Germany or in an EU or EEA member state. On the other hand, since the location of the corporation's

53 See Weiten, ZEerb 2023, 241.

54 See Hannes/Holtz in: Meincke/Hannes/Holtz, Section 13b margin no. 3.

assets is not relevant, this may open up interesting tax planning options with regard to the endowment of the family foundation.

Example:

> Founder S (natural person) runs a sole proprietorship with permanent establishments in Germany, in other EU countries and in third countries. There are long-term plans to contribute the business assets to a family foundation with unlimited corporation tax liability in Germany. The permanent establishment assets, which are located in different countries, are therefore transferred to a corporation (S-GmbH) subject to unlimited corporation tax liability in Germany.

At a later point in time, the family foundation is endowed with the shares in S-GmbH. While the permanent establishments located in third countries would not have been eligible for preferential treatment in terms of gift tax if they had been transferred directly to the family foundation, endowing the family foundation with the shares in S-GmbH – due to the irrelevance of the location of the permanent establishment assets – does not jeopardise the eligibility for preferential treatment, even though the value of the GmbH shares can be attributed to the permanent establishments in third countries.

In the third-country context, it is generally advisable to carefully follow the rulings of the European Court of Justice (ECJ) regarding the interpretation of the free movement of capital (Art. 63 (1), Art. 65 of the Treaty on the Functioning of the European Union (TFEU)). The ECJ has traditionally not seen any violation of Union law in the fact that shares in third-country corporations are excluded from inheritance and gift tax relief.[55] However, in a later decision[56] in connection with real estate situated in a third country (Canada), the ECJ ruled that the unequal treatment[57] of domestic and third-country real estate resulting from the ErbStG was not compatible with the free movement of capital. This suggests that the ECJ's case law on this issue is not yet final. Depending on the case material submitted to the ECJ, it is possible that the court could take a differentiated view of the inheritance and gift tax treatment of third-country assets based on the free movement of capital.

55 See ECJ ruling of 19 July 2012 – C-31/11 - Marianne Scheunemann DStR 2012, 1508.

56 See ECJ ruling of 12 October 2023, C-670/21 – BA/Finanzamt X, BStBl. II 2024, 576.

57 For let residential property situated in Germany or EU/EEA countries that did not belong to the tax-privileged business assets as defined in Section 13a ErbStG, the ErbStG used to provide for a discount of 10 percent of the fair market value (Section 13c (1) and (3) no. 2 ErbStG 2009, now Section 13d ErbStG). Residential properties located in third countries, on the other hand, were to be recognised at their full fair market value when calculating inheritance tax. In the meantime, the legislator has reacted to the ECJ ruling.

The basic tax relief no longer applies if a family foundation acquires tax-privileged assets worth more than 26 million euros. However, such large acquisitions may instead be privileged under the Inheritance Tax Act through the reduction model (Section 13c ErbStG) or the remission model (Section 28a ErbStG). The reduction model reduces the tax relief by one percentage point for every (full) 750,000 euros above the threshold of 26 million euros, with no tax relief being granted for acquisitions of 90 million euros or more.

inheritance tax abatement model remedy test

In such cases, the family foundation may be able to use what is known as the remission model. Under this model, the inheritance or gift tax is initially levied on the foundation's tax-privileged assets. Upon application, the foundation is then remitted the inheritance or gift tax imposed in accordance with Section 28a ErbStG. The prerequisite for this regulation, which is based on the remission provision of Section 227 AO, is that the foundation must prove that it is unable to pay the tax out of its disposable assets. In technical jargon, this regulatory system is referred to as "need-based exemption assessment". According to Section 28a (2) ErbStG, disposable assets include 50 percent of the non-tax-privileged assets that the family foundation receives when the inheritance or gift is transferred or that already belong to the foundation at the time the tax arises. Under Section 28a (4) ErbStG, the remission of tax is subject to the condition subsequent that the family foundation, following the inheritance or gift, complies with the periods for retention and wage payments in accordance with the provisions on optional relief. In addition, within ten years of incurring the tax liability, it may not receive any further assets by way of gift or inheritance that constitute disposable assets within the meaning of Section 28a (2) ErbStG.

Thus, the current regulation on the need-based exemption assessment also enables family foundations to take advantage of the structuring benefits of Section 28a ErbStG. The family foundation, as a largely asset-less (legal) entity, acquires the business assets contributed to it. This means that shares in companies can be transferred to a family foundation without incurring inheritance or gift tax. As this regulation is not dependent on value, it also applies far beyond the 90-million-euro threshold. However, the prerequisite is that the company, after passing the administrative and financial resources test, consists exclusively of assets eligible for tax relief. Accordingly, the need-based exemption assessment is one of the few reasons that can be cited in favour of using a family foundation from a tax perspective.

b) Tax class privilege

When it comes to the applicable tax class, a special feature generally referred to as the tax class privilege applies to the taxation of a family foundation's initial endowment. Pursuant to Section 15 (2) sentence 1 ErbStG, taxation is based on the degree of kinship of the most distant beneficiary under the foundation deed to the founder as the testator or donor. If this provision did not exist, the most unfavourable tax class III would always be applied in the absence of a personal relationship between the founder and the foundation. This would mean a tax-free allowance of 20,000 euros at tax rates between 30 and 50 percent.

The Second Senate[58] of the Federal Fiscal Court has issued a ruling regarding the determination of the most distant beneficiary: In the headnotes of this decision, the court emphasised that, when assets are transferred to a family foundation, the person to be regarded as the beneficiary most distantly removed from the donor for the purposes of determining the applicable tax class and the tax-free allowance is the person who, according to the foundation's constitution, could potentially receive financial benefits from the foundation. In addition, the Senate stressed that it should be irrelevant whether the person had already been born at the time of the endowment transaction, whether they would ever be born or whether they would actually receive financial benefits from the foundation.

In this context, it should be noted that the wording of Section 15 (2) sentence 1 ErbStG is highly controversial in terms of EU law.[59] The provision bases taxation (tax class and inheritance tax rate) on the kinship of the most distant beneficiary. The ECJ ruling that is expected in response to the referral from the Cologne Fiscal Court may also have to concern itself with the concept of family foundations under inheritance tax law. It is therefore advisable to monitor the legal developments.

As it is currently worded, Section 15 (2) sentence 1 ErbStG only affords preferential tax treatment to domestic family foundations. This has sparked doubts at the Cologne Tax Court, which believes that transferring assets to family foundations falls within the scope of the free movement of capital. The proceedings pending before the ECJ are listed under case number C-142/24. The legal question, which can be accessed in the Court's database, reads as follows: "Must Article 40 of the Agreement on the European Economic Area (EEA Agreement) of 2 May 1992 be interpreted as precluding a Member State's national legislation on the levying of inheritance and gift tax which applies the highest tax class (III) for the taxation of an inter vivos transfer of assets to a foundation established abroad even where the foundation is established essentially in the interests of a family or certain families (family foundation), whereas for a family foundation established on national territory in an equivalent situation, the tax class depends on the relationship between the most distantly related beneficial owner under the foundation's articles of association and the donor (founder), which results, for family foundations established on national territory, in the application of the more favourable tax classes I or II?"

58 See BFH ruling of 28 February 2024 – II R 25/21, BFH/NV 2024, 993.

59 See Cologne Tax Court ruling of 30 November 2023 – 7 K 217/21, EFG 2024, 882 (ECJ C-142/24).

c) Incurrence of tax

Section 9 ErbStG governs the incurrence of tax as follows: in the case of a lifetime establishment of a family foundation, gift tax is incurred upon the execution of the donation; see Section 9 (1) no. 2 ErbStG. This means that the tax can be incurred at the earliest when the family foundation is recognised by the foundation supervisory authorities,[60] since the transfer of the assets promised in the endowment transaction can only take place at or after this point in time.

When a family foundation is set up by will and designated as the heir or legatee, inheritance tax is incurred in accordance with Section 9 (1) no. 1 letter c ErbStG at the time of its official recognition by the foundation authorities.[61]

3. Taxes on income

In line with customary terminology, the section below uses the term "taxes on income" to cover individual income tax, corporation income tax and trade tax. The main focus is on the endowment with taxable private assets and business assets.

a) Endowment with so-called private assets

When endowing a family foundation that is subject to unlimited tax liability, the founder can transfer assets to the foundation largely without incurring taxes on income.[62] This is because, in principle, the transfer of private assets to the family foundation upon its establishment does not result in the founder realising any taxable gains.

Example:

> Founder S, who is subject unlimited tax liability in Germany, establishes the family foundation S-Familienstiftung, which is likewise subject to unlimited tax liability in Germany. In the endowment transaction, she has undertaken to donate cash assets and savings deposits to S-Familienstiftung.

Logically, neither cash assets nor savings deposits can contain hidden reserves. From an individual income tax point of view, the gratuitous donation of private assets to S-Familienstiftung – which is subject to unlimited tax liability in Germany – does not fulfil any relevant criteria. Neither the cash assets nor the savings deposits are subject to individual income tax upon their gratuitous transfer to the legal entity of a family foundation.

60 See Weiten, ZEerb 2023, 241.

61 See Weiten, ZEerb 2023, 241.

62 See Weiten, ZEerb 2023, 241.

The exemption of the family foundation's endowment from taxes on income is a legitimate principle even if the founder transfers private assets that are subject to tax. For example, the provisions of Sections 17, 20 (2) and 23 EStG, which relate to transfers of ownership of taxable private assets, refer specifically to a sale. These private assets are, in principle, amenable to the realisation of inherent hidden reserves. With regard to individual income tax implications, the question is therefore whether the endowment of a domestic family foundation leads to a sale that is relevant to taxes on income at the level of the founder.

Example:

> Founder T, who is subject to unlimited tax liability in Germany, establishes the family foundation T-Familienstiftung, which is likewise subject to unlimited tax liability in Germany. In the endowment transaction, she has undertaken to donate several assets associated with a high standard of living to T-Familienstiftung. These are exclusively privately used items, including jewellery, various vintage cars, a yacht, an extensive art collection and a wine cellar with wines that are sometimes sold at collector's prices well above the original purchase price. In addition, the endowment transaction includes several holiday properties in different countries and an extensive stock portfolio.

There may be a legal basis for recognising realised increases in the value of private assets under the provisions of Section 17, Section 20 (2) and Section 23 EStG. Whilst the first of these provisions may give rise to realisation or disclosure relevance if the assets qualify as shares in corporations, the time periods specified in more detail in the latter provision (Section 23 EStG) form the factual basis for the recognition of taxes on income.

However, all of the provisions cited – Section 17 EStG, Section 20 (2) EStG and Section 23 EStG – require that a sale has actually taken place. The question is therefore whether the endowment of T-Familienstiftung by way of an initial endowment or the subsequent donation of privately owned assets by the taxpayer constitutes a sale within the meaning of these provisions.

A sale liable to individual income tax generally requires the transfer of (at the very least) the economic ownership of an asset from one person to another in return for payment.[63] A gift – as a transfer without any form of consideration – is not a sale; with regard to shares in corporations, established case law can be cited in support of this.[64]

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63 See Levedag/Schmidt, EStG, Section 17 margin no. 21; see also BFH ruling of 27 July 1988 – I R 147/83, BStBl II 1989, 271.

64 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 94 with numerous references.

Accordingly, none of the assets contributed in the example case constitute a sale. The endowment of T-Familienstiftung therefore remains irrelevant with regard to taxes on income.

In the present case, it is therefore inconsequential whether or not the endowment of the assets in the example took place within the time periods specified in Section 23 EStG. This point bears emphasising as it is often relevant in real-life legal practice, namely in cases where properties held as taxable private assets, for which the ten-year exemption period for private capital gains under Section 23 EStG has not yet expired, are transferred to a family foundation. Similarly, neither the conditions of Section 17 EStG nor those of Section 20 (2) EStG are met, as the definition of a sale is not fulfilled under either provision.

If the private assets were subject to tax, the law applies what is known as the "footstep theory", as set out in Section 20 (4) sentence 6 EStG and Section 17 (2) sentence 5 EStG regarding shares in corporations, as well as in Section 23 (1) sentence 3 EStG regarding other assets, in particular real estate. In terms of taxes on income, the family foundation thus follows in the footsteps of the founder and takes over the founder's tax valuation basis if the private assets are subject to taxation.

Accordingly, Section 17 (2) sentence 5 EStG stipulates that, for any shares that the family foundation has acquired without consideration, the acquisition costs of the legal predecessor who last acquired the shares for consideration are decisive. Pursuant to Section 23 (1) sentence 3 EStG, in the case of an acquisition without consideration, the acquisition by the legal predecessor is to be attributed to the individual legal successor.

b) Endowment with business assets

When a founder contributes business assets to a family foundation that is subject to unlimited tax liability in Germany by way of an endowment to the family foundation (establishment, subsequent donation), the situation will need to be considered on a case-by-case basis. This is because the law distinguishes between the endowment of stand-alone individual assets and groupings of individual assets that qualify as part of a business or as a business. If, in the context of an initial endowment or a subsequent donation, assets are transferred to the family foundation that are to be regarded as individual assets included in business assets, this transaction is treated as a withdrawal for the purposes of individual income tax. The withdrawal must be valued by the founder at its going-concern value in accordance with Section 6 (1) sentence 1 no. 4 EStG. Consequently, the gain from the withdrawal, calculated as the difference between the going-concern value and the book value, is subject to taxation for the founder. An example of assets relevant in this context would be commercial properties with low book values and high market values. Participations in corporations that are classified as business assets and carry hidden reserves are another possible example. Pools of business assets that do not qualify as part of a business can also be considered as objects of an endowment. If these pools of assets that do not qualify as part of a business contain hidden reserves, this also results in realisation due to withdrawal.

Example:

> Founder P, who is subject to unlimited tax liability in Germany, transfers a commercial property of her sole proprietorship located in a non-DTA country and a commercial property located in a DTA country to the family foundation P-Familienstiftung, which is subject to unlimited tax liability in Germany, in accordance with her commitment in the endowment transaction. Both commercial properties are valuable and have significant hidden reserves.

Insofar as the property located in the DTA country is concerned, no hidden reserves were subject to taxation in Germany under a comparable provision modelled on Article 6 of the OECD Model Tax Convention. The endowment therefore has no realisation consequences.

The commercial property located in a non-DTA country was previously subject to taxation in Germany in respect of hidden reserves. Consequently, the endowment of the foreign-domiciled family foundation is logically preceded by a withdrawal that is subject to realisation. Any taxes incurred abroad could be offset against the domestic tax liability in accordance with Sections 34c and 34d EStG.

If, on the other hand, a domestic family foundation is endowed with sole proprietorships as a whole or co-entrepreneurial interests, this type of endowment is generally more favourable from the perspective of taxes on income. This applies to cases in which the founder of the family foundation donates a business, part of a business or a co-entrepreneurial interest. Section 6 (3) EStG allows such transactions to be treated as neutral with regard to taxes on income. This section covers the transfer of businesses, parts of businesses and co-entrepreneurial interests without consideration, requires the book value to be carried forward and thus prevents the transferor from realising a profit through the cessation of business within the meaning of Section 16 (3) EStG (i.e. no taxable disclosure of hidden reserves). The founder does not realise any profit because the assets must be recognised at their book values in accordance with Section 6 (3) sentence 1 EStG. Pursuant to Section 6 (3) sentence 3 EStG, the book value is carried forward by the receiving family foundation. It is important to keep in mind the risk of subsequent taxation of retained earnings that were previously taxed at a reduced rate under Section 34a EStG.[65]

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65 See Weiten, ZEerb 2023, 241 (243).

According to the Federal Ministry of Finance's[66] correct interpretation of Section 6 (3) EStG, the endowment of a family foundation with business assets in the form of businesses, parts of businesses or co-entrepreneurial interests must always result in the book value being carried forward, provided that the taxation of hidden reserves is ensured.

Example:

> Founder N operates a sole proprietorship with permanent establishments in Germany as well as in foreign countries. N transfers the sole proprietorship, with all its assets and liabilities, to the family foundation N-Familienstiftung, which is subject to unlimited tax liability in Germany, by way of an initial endowment.

N-Familienstiftung thus becomes a foundation operating a business, with the endowment effected in accordance with Section 6 (3) EStG, which requires that the book value be carried forward. The prerequisite is that the taxation of hidden reserves is ensured.[67] Therefore, a distinction must be made in the present case. Insofar as the taxation of hidden reserves is ensured by the transfer of domestic permanent establishment assets, N-Familienstiftung is a taxable foundation in the sense of the terminology used by the tax authorities.[68] Where foreign permanent establishment assets are transferred to a foreign-domiciled family foundation, it is necessary to differentiate as follows: If the foreign permanent establishment assets are located in a country covered by an exemption-method DTA, Germany cannot lose its right to tax the hidden reserves, as no such right existed in the first place. If, on the other hand, the assets are attributable to a permanent establishment in a non-DTA country or in a country with a credit-method DTA, Germany's right to tax the hidden reserves would not be guaranteed, since Germany would have no access to the hidden reserves of the permanent establishment located abroad that will be maintained by the foreign-domiciled family foundation in the future. These basic structures must be kept in mind with regard to the tax neutrality of the endowment.

In the reality of everyday tax practice, foundations participating in corporations and/or partnerships are encountered much more frequently than foundations operating a business.[69] For this reason, foundations participating in corporations and/or partnerships, as a special form of business-affiliated foundations[70], require closer examination with regard to their endowment by the founder.

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66 See BMF interpretation of 20 November 2019 – IV C 6 - S 2241/15/10003, BStBl. 2019 I, 1291, para. 3.

67 See Härtling/Tolksdorf, IStR 2023, 717 (725); Schienke-Ohletz/Mehren, ZStV 2022, 1 (4); Richter, StiftungsR-HdB/Richter, Section 23 margin no. 48.

68 See BMF interpretation of 20 November 2019 – IV C 6 - S 2241/15/10003, BStBl. 2019 I, p. 1291, para. 3.

69 See Steiner, Betriebswirtschaftliche Beratung 2024, 25.

70 See Schauhoff/Mehren, Stiftungsrecht nach der Reform, 29.

Example:

> Founder M, who is subject to unlimited tax liability in Germany, holds 100 percent of the limited partner's shares in M-GmbH & Co. KG and all shares in the general partner GmbH of M-GmbH & Co. KG. The business assets of M-GmbH & Co. KG are attributable exclusively to a domestic permanent establishment.

In addition, the founder has transferred to M-GmbH & Co. KG a property located in Germany, including a building that is used partly for the production activities of M-GmbH & Co. KG and partly as a warehouse for intermediate products. The property and building therefore indisputably constitute separate business assets. Based on her commitment in the endowment transaction, M allocates the entire limited partner's share to M-Familienstiftung, which is subject to unlimited tax liability in Germany. The GmbH share and the property are also transferred to M-Familienstiftung.

In essence, the individual income tax implications are identical to those of endowing a family foundation with a sole proprietorship. However, certain details must be taken into account in order to claim tax neutrality under Section 6 (3) EStG. For example, it may prove essential in terms of taxes on income to endow the entire co-entrepreneurial interest, including separate business assets and the share in the general partner GmbH, to the family foundation. This depends on whether, in the specific circumstances of the case in question, the property and the GmbH share can be regarded as functionally essential operating assets.[71]

Endowing a family foundation subject to unlimited tax liability in Germany with shares in a corporation that form part of business assets must be treated in accordance with the structures for the transfer of an individual asset included in business assets.

Example:

> Founder L holds 40 percent of the shares in L-GmbH as part of the business assets of her sole proprietorship. These are contributed to the family foundation L-Familienstiftung, which is subject to unlimited tax liability in Germany, by way of an initial endowment. The acquisition costs for L amount to 25,000 euros, and the fair market value of the share package is 10,000,000 euros.

With a view to taxes on income, the shares in L-GmbH are deemed to have been withdrawn. This treatment, as set out in Section 4 (1) sentence 2 EStG, applies regardless of the

71 See Higher Regional Tax Office of North Rhine-Westphalia, 21 June 2016, DB 2016, 1907; new regulation by the Higher Regional Tax Office of North Rhine-Westphalia, 22 March 2023, S 2241-2020/0006-ST 115 (not published).

endowment of L-Familienstiftung with the shares in L-GmbH, which occurs later, both in terms of time and logic. The subsequent contribution to L-Familienstiftung by way of endowment means that, for a legal second, the shares are attributable to L's taxable private assets. Profit is therefore realised at the time of withdrawal.

4. Transaction-related taxes

Due to the study's focus on analysing inheritance and gift tax, as well as taxes on income, other taxes incurred when establishing a private-benefit family foundation will only be discussed briefly here. An endowment is only subject to value added tax if the founder qualifies as an entrepreneur under Section 2 (1) of the German Value Added Tax Act (Umsatzsteuergesetz, UStG). If, in such a constellation, individual assets of the company are transferred to the foundation without consideration, this constitutes a benefit in kind subject to value added tax pursuant to Section 3 (1b) no. 1 UStG. However, if a business that is managed separately within the structure of the company is transferred in its entirety, for VAT purposes, this qualifies as a non-taxable disposal of a business as a whole pursuant to Section 1 (1a) UStG.

If domestic properties are transferred by the founder when endowing a private-benefit family foundation, this transaction does not normally incur real estate transfer tax. Although such a transaction is subject to real estate transfer tax pursuant to Section 1 (1) of the German Real Estate Transfer Tax Act (Grunderwerbsteuergesetz, GrEStG), both the acquisition of real estate mortis causa and the donation of real estate inter vivos, pursuant to Section 3 no. 2 sentence 1 GrEStG, are exempt from real estate transfer tax if the real estate is transferred without any consideration.[72]

III. Endowment of a foreign-domiciled family foundation

The endowment of a foreign-domiciled family foundation by founders resident in Germany has been discussed in considerable detail in recent literature. This study will therefore only provide a brief overview of some of the key points.[73]

Figure 7 below shows the structure of the business assets transferred to a foreign-domiciled family foundation. It is based on a sole proprietor (natural person) subject to unlimited tax liability in Germany transferring his business with domestic and foreign permanent establishments to a foreign-domiciled family foundation. Prior to the endowment, the natural person has legal ownership of the business; after the endowment, the foreign-domiciled family foundation owns the assets of the permanent establishments in Germany and abroad.

72 See Weiten, ZEerb 2023, 241.

73 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 91 et seq.; Kraft, FR 2024, 541.

As a result, a foreign-domiciled family foundation in the form of a foundation operating a business has been created.

Figure 7: *Endowment of a foreign-domiciled family foundation through the contribution of a sole proprietorship with domestic and foreign permanent establishments (own illustration)*

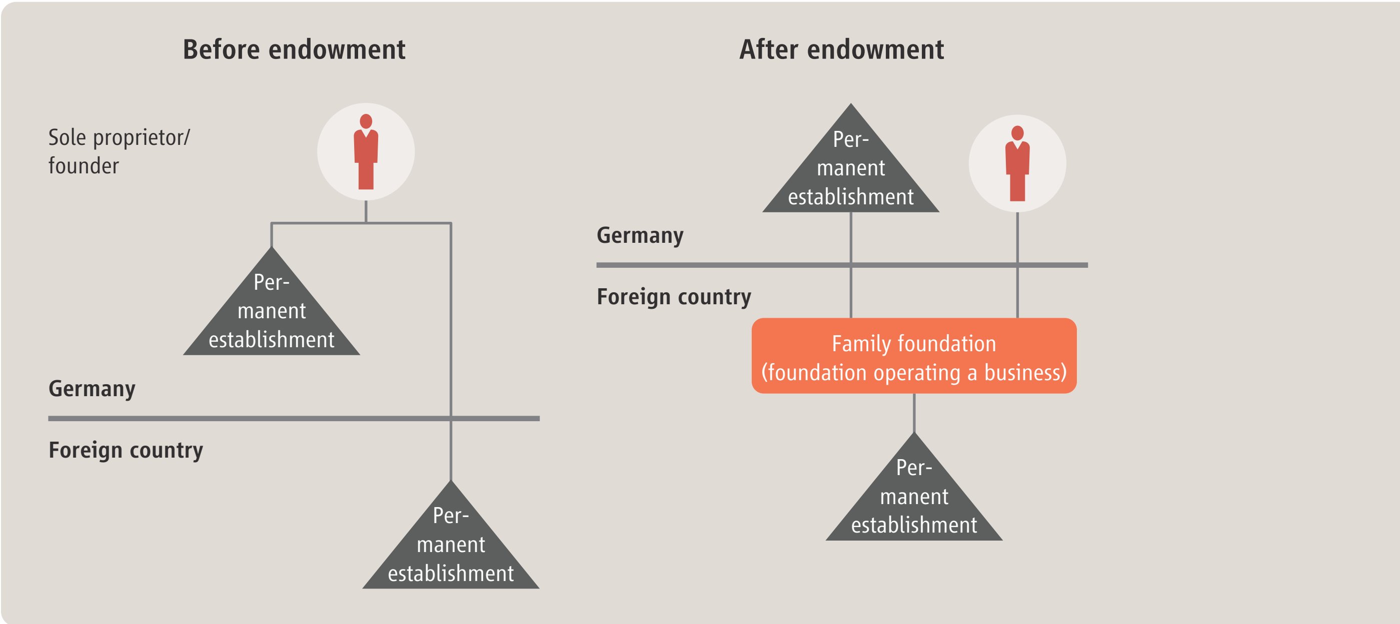

Figure 8: *After the endowment of a foreign-domiciled family foundation through the contribution of participations in domestic and foreign partnerships (co-entrepreneurships) and corporations (own illustration)*

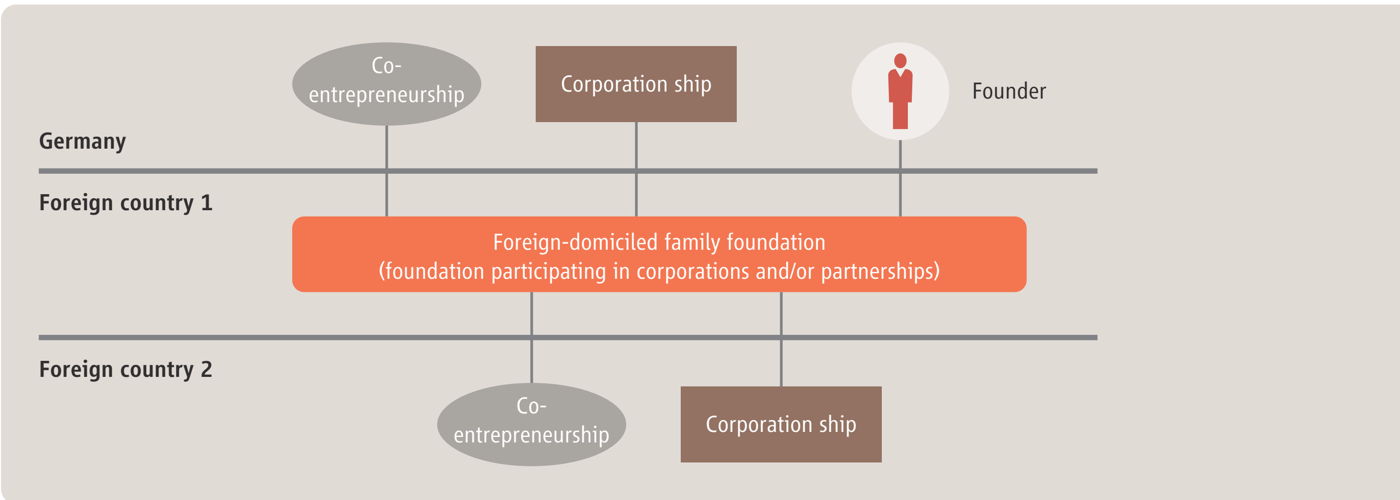

Figure 8 illustrates the more common form of a foundation participating in corporations and/or partnerships. It shows the final structure in which a founder, as the owner of shares in domestic and foreign partnerships (co-entrepreneurships) and corporations, has endowed his participations to a foreign-domiciled family foundation. As a result, a foreign-domiciled family foundation in the form of a foundation participating in corporations and/or partnerships has been created.

In general, the endowment of private assets without hidden reserves is unproblematic from the perspective of taxes on income. Accordingly, if the founder of the foreign-domiciled family foundation transfers assets from their private assets to the foundation on the basis of the endowment transaction, but these assets cannot logically contain hidden reserves, the endowment transaction is straightforward as far as taxes on income are concerned.

If any assets are transferred to the foreign-domiciled family foundation that are fundamentally capable of realising inherent hidden reserves, the question is whether the endowment of the foreign-domiciled family foundation should be treated as a sale subject to taxes on income. Sections 17, 20 (2) and 23 EStG, for example, refer to a sale.

A sale liable to individual income tax generally requires the transfer of (at the very least) the economic ownership of an asset from one person to another in return for payment.[74] A gift – as a transfer without any form of consideration – is not a sale.[75] When applied to the transfer of private assets to a foreign-domiciled family foundation by a founder subject to unlimited tax liability in Germany, this means that the transfer does not constitute a sale. The endowment of the foreign-domiciled family foundation with the aforementioned assets is therefore not relevant for purposes of taxes on income. In particular, it is irrelevant whether or not the endowment is made within the time periods specified in Section 23 EStG. Similarly, neither the conditions of Section 17 EStG nor those of Section 20 (2) EStG are fulfilled, as the definition of a sale in both provisions is not met.

Where the founder transfers business assets to the family foundation by way of endowment (establishment, subsequent donation), the tax treatment depends on the assets being endowed.

Individual assets included in business assets, such as commercial properties, participations in corporations allocated to business assets or movable assets classified as non-current or current assets, give rise to withdrawal taxation in the same way as an endowment to a family foundation subject to unlimited tax liability. The reason is that there is a transfer of ownership and no legal provision provides for a deferral of realisation.

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74 See Levedag/Schmidt, Section 17 EStG margin no. 21; see also BFH ruling of 27 July 1988 – I R 147/83, BStBl II 1989, 271.

75 See Levedag/Schmidt, Section 17 EStG, margin no. 25.

Since the endowment of a foreign-domiciled family foundation with a domestic commercial property is a transaction that occurs with some frequency in taxation practice, an example is provided below.

Example:

> Founder R, who is subject to unlimited tax liability in Germany, contributes a commercial property of her sole proprietorship located in Germany to the foreign-domiciled R Family Trust in accordance with her commitment in the endowment transaction. The valuable commercial property has considerable hidden reserves. R Family Trust is undisputably classified as a foreign-domiciled family foundation within the meaning of Section 15 AStG.

The endowment of R Family Trust with an individual asset, namely the commercial property, constitutes a transfer without consideration. For individual income tax purposes, this constitutes a withdrawal within the meaning of Section 4 (1) sentence 2 EStG if R has withdrawn the commercial property for a non-business purpose. The term "non-business purpose" is used to describe the release of an asset from business assets. It refers to a change in the allocation of the asset to the taxpayer's asset sphere. This happens when the asset is removed from the taxable sphere of the individual business through a deliberate act or coherent sequence of actions on the part of the taxpayer.[76] Based on this reasoning, it must be assumed that the endowment of R Family Trust serves a non-business purpose and thus constitutes a withdrawal subject to realisation. As there is no provision that would preclude the general realisation obligation, the endowment constitutes a transaction relevant for the purposes of taxes on income, with the result that the hidden reserves in the property must be treated as realised.

According to the Federal Ministry of Finance's[77] correct interpretation of Section 6 (3) EStG, the endowment of a foreign-domiciled family foundation with business assets must result in the book value being carried forward, provided that the taxation of hidden reserves is ensured. The same applies to the endowment of a foreign-domiciled family foundation through the transfer of a co-entrepreneurial interest for no consideration. Here, too, the book value must be carried forward provided that the taxation of hidden reserves is ensured.

The endowment of a foreign-domiciled family foundation with shares in corporations by a natural person as the founder who is subject to unlimited individual income tax liability in Germany takes place without consideration. If the shares are classified as taxable private assets prior to the endowment, the conditions for a sale are not met. Where the shares are

76 See Vögele/Fischer in Vögele/Borstell/van der Ham, Verrechnungspreise, margin no. 46 with references from case law.

77 See BMF interpretation of 20 November 2019 – IV C 6 - S 2241/15/10003, BStBl. 2019 I, 1291, para. 3.

classified as taxable business assets prior to the endowment, the endowment is preceded by a withdrawal transaction giving rise to realisation, with the result that, in this case, the hidden reserves in the shares are subject to taxation.

D. Taxation of family foundations

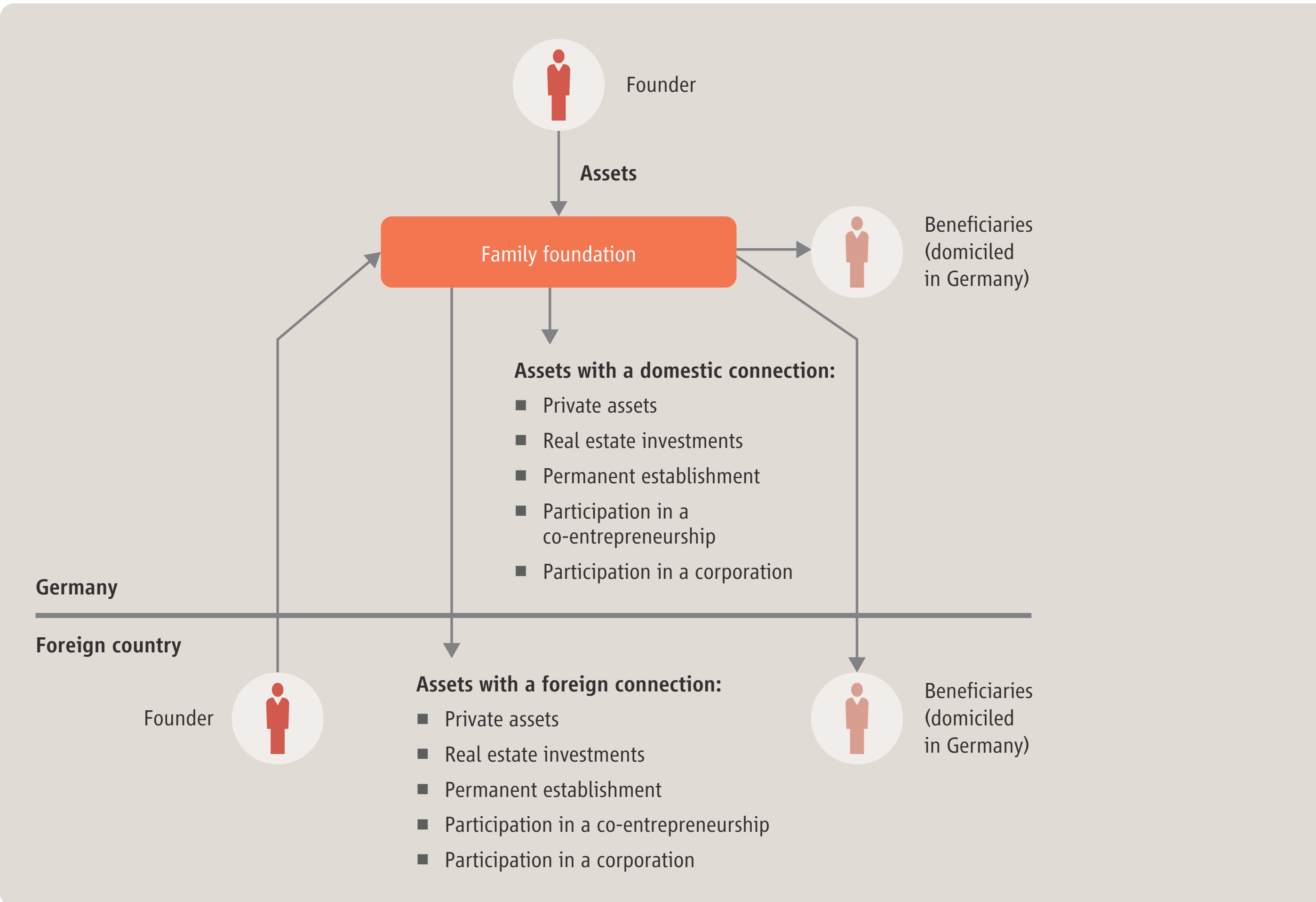
I. Domestic family foundations

1. Basic structures (overview)

Almost all major tax laws contain relevant provisions on the tax treatment of family foundations. It should be emphasised here that, contrary to popular belief, family foundations are not a tax planning device. Nor are they suitable – as ideologically motivated media reports sometimes claim – for use as a tax-efficient structural model for the rich. This is because, unlike charitable foundations in particular, family foundations do not enjoy tax privileges. There is no question that, as with any legal form available under the legal system, tax-efficient structures may be possible depending on the type, size and structure of the foundation's assets.

The ongoing tax treatment of a family foundation subject to unlimited tax liability is based on the basic model of corporation income taxation.

Figure 9: Basic structure of a family foundation subject to unlimited tax liability with domestic and foreign connections (own illustration)



There is empirical evidence that, in terms of their place of residence, the founders and beneficiaries of domestic family foundations are often scattered around the world, either temporarily or permanently. The same applies to the assets held by family foundations. As a rule, these too have strong transnational ties, as shown in Figure 9.

With regard to ongoing taxation, a private-benefit family foundation with legal personality is treated as an independent entity for corporation income tax purposes. That also holds true for private-benefit foundations without legal personality, which are not discussed in detail here. Depending on the nature of its activities, a private-benefit family foundation with legal personality may be subject to trade tax, value added tax or property tax. It is important to note that, in the case of a family foundation with legal personality pursuant to Section 1 (1) no. 4 ErbStG, substitute inheritance tax must be considered separately.[78]

a) Corporation income tax

According to the central provision of Section 1 (2) KStG, a private-benefit family foundation with legal personality must pay corporation income tax on all its income if it has its registered office and/or place of management in Germany. This basic legislative principle, also known as the worldwide income principle, means that regardless of where the family foundation earns income subject to corporation income tax, the provisions of the German Corporation Tax Act apply to the relevant income.

The basis for assessing corporation income tax is the taxable income. The taxable income is determined in accordance with the provisions of the EStG, see Section 7 (1) and (2) and Section 8 (1) KStG. The corporation income tax rate is 15 percent (Section 23 (1) KStG), plus a 5.5 percent solidarity surcharge. This results in an effective income tax rate of 15.825 percent (15 percent* (1+0.055)).

Since the legal fiction of exclusively commercial income pursuant to Section 8 (2) of the Trade Tax Act (Gewerbesteuergesetz, GewStG) does not apply to foundations, a private-benefit family foundation may also generate income other than commercial income. In contrast to corporations, a family foundation is not considered a commercial enterprise by virtue of its legal form. Leaving aside income from employment, a family foundation can therefore, in principle, generate six types of income. It is therefore entirely possible, and indeed common in practice, for a family foundation to generate what is known as surplus income, such as income from capital assets pursuant to Section 20 EStG or rental and leasing income pursuant to Section 21 EStG.

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78 See Weiten, ZEerb 2023, 241 (244).

The literature points out that institutional investors such as insurance companies, pension funds and foundations, in particular, are increasingly using investment funds and thus generate income from capital assets.[79]

Example:

> For the purposes of taxes on income, a domestic family foundation acting as an investor under investment law, with its investment income from fund participations, realises "income from capital assets" (Section 16 InvStG in conjunction with Section 20 EStG in conjunction with Section 8 (1) KStG), as Section 20 (1) no. 3 EStG states that income from capital assets also includes investment income within the meaning of Section 16 InvStG.[80]

The taxation of rental and leasing income is subject to the same principles.

Example:

> A domestic family foundation owns a multi-family house. The family foundation rents out several flats. With the rent it receives, the family foundation generates income that falls under the category of "rental and leasing income" (Section 21 EStG within the meaning of Section 8 (1) KStG).

If a foundation holds a participation in a corporation, the provisions of Section 8b KStG apply. When applying this tax relief provision, it is necessary to make two distinctions: between dividends and gains on the sale of shares, and, with regard to the receipt of dividends, between shareholdings of at least 10 percent and smaller shareholdings. The provision exempts all sales of shareholdings (Section 8b (2) and (3) KStG) from corporation income tax at an effective rate of 95 percent; income from shareholdings – typically in the form of dividends – is likewise exempted at a rate of 95 percent pursuant to Section 8b (1) and (5) KStG (known as intercompany dividends) if the family foundation directly holds at least 10 percent of the shares in a domestic or foreign-domiciled corporation at the beginning of the calendar year. Income from investments in corporations below the 10 percent shareholding threshold is subject to full corporation income tax pursuant to Section 8b (4) KStG (free-float dividends).

While, in the case of shareholdings of at least 10 percent, foreign capital gains tax cannot be offset against the tax payable by the family foundation, due to the full corporation income tax liability of free-float dividends (shareholding of less than 10 percent), foreign capital

79 See Sedlmaier in: Kretzschmann/Schwenke/Behrens/Hensel/Klein, InvStG, introduction (before Section 1, margin no. 29).

80 See Hasbach in: Kretzschmann/Schwenke/Behrens/Hensel/Klein, InvStG, appendix 1 Einkünfte aus Kapitalvermögen (Section 20 EStG), margin no. 1.

gains tax amounts levied on dividend income are creditable against the corporation income tax liability by way of the family foundation's corporation income tax assessment (Section 26 (1) KStG in conjunction with Section 34c EStG).

b) Trade tax

A private-benefit family foundation is subject to trade tax if it operates a commercial enterprise in accordance with Section 2 (1) GewStG. This type of activity, sometimes referred to as an "original commercial enterprise", requires that the criteria for commercial activity of Section 15 (2) EStG are met. Such a (taxable) "commercial enterprise by virtue of commercial activity" is only deemed to exist if the business operated by the family foundation fulfils four positive criteria and three negative criteria. Under these conditions, a private-benefit family foundation is subject to trade tax if, for example, it operates a sole proprietorship in its capacity as a foundation operating a business.

Example:

> Founder S (natural person) has transferred a sole proprietorship she operated, along with all of the associated assets and liabilities, to a domestic family foundation subject to unlimited corporation income tax liability. As long as the sole proprietorship was operated by S, it was subject to trade tax. For individual income tax purposes, S generated income from a commercial enterprise in accordance with Section 15 (1) sentence 1 no. 1 EStG with her sole proprietorship.

The business will continue to be operated by the family foundation, thereby creating a "foundation operating a business" within the meaning of the category outlined above. Accordingly, this business meets the criteria for commercial activity (for the purposes of taxes on income). This means that the family foundation realises income of the type "income from a commercial enterprise" for corporation income tax purposes and is subject to trade tax by virtue of its original commercial activity.

The trade tax treatment of a family foundation as a legal entity requires that the relevant provisions be applied. As a result, the family foundation is subject to the corporation income tax procedure with a tax rate of 3.5 percent in accordance with Section 11 (2) GewStG, as well as to the municipal assessment rate of the municipality in which the sole proprietorship operated by the family foundation is located. The tax-free allowance under Section 11 (1) GewStG is reserved for natural persons and partnerships and cannot be utilised by the family foundation operating the sole proprietorship.

Section 2 (3) GewStG further stipulates that activities of other legal entities under private law, insofar as they engage in an economic activity (excluding agriculture and forestry), are also considered commercial enterprises.[81] Since family foundations are classified as other legal entities under private law, they are subject to trade tax if they engage in an economic activity.

Pursuant to Section R 2.5 (3) of the Trade Tax Regulations (Gewerbesteuer-Richtlinien, GewStR), other legal entities under private law – including private-benefit family foundations – become liable for trade tax once they take up an economic activity or a commercial activity within the meaning of Section 15 (2) EStG, assuming all other requirements are also met. As a rule, this coincides with the date of recognition by the competent foundation authority. The term "economic activity" is legally defined in Section 14 sentence 1 of the German Fiscal Code (AO). According to this, an economic activity is an independent sustainable activity from which revenue or other economic benefits are derived and which comprises more than mere asset management. The intention to realise a profit is not required.[82]

Lastly, whether a foundation participating in corporations and/or partnerships is subject to trade tax depends on the legal form of the corporation in which it holds its participation. A participation in a commercial partnership always constitutes an economic activity. However, there is an exception to this rule if a partnership that only manages assets is considered commercial solely by virtue of its commercial nature (Section 15 (3) no. 2 EStG).[83]

On the other hand, a participation in a corporation generally falls within the scope of asset management. The participation therefore does not give rise to trade tax.[84] However, there are two highly relevant exceptions to this general rule. For one thing, if there is a company split-up between the family foundation and an asset management company, an economic activity may exist.[85] The second case, which occurs frequently in practice but is sometimes misjudged in terms of its consequences, is the influence exerted on the day-to-day management of a subsidiary corporation. If a family foundation exercises a significant influence on the day-to-day management of a subsidiary corporation, there is a risk that an economic activity may be deemed to exist. This is because – according to case law,[86] the tax authorities[87] and the prevailing opinion in the literature[88] – the participation of a corporate entity exempt from

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81 See Kraft, DStR 2016, 2825 (2827).

82 See Kraft, DStR 2016, 2825 (2827).

83 See BFH ruling of 25 May 2011 – I R 60/10, BStBl. II 2012, p. 858; BFH ruling of 18 February 2016 – V R 60/13, BStBl. II 2017, 251.

84 See Weiten, ZEerb 2023, 241 (244).

85 See Weiten, ZEerb 2023, 241 (244).

86 Evidence in BFH ruling of 25 August 2010 – I R 97/09, BFH/NV 2011, 312.

87 See KStR 2022, H 5.7.

88 Numerous references in BFH ruling of 25 August 2010 – I R 97/09, BFH/NV 2011, 312.

corporation income tax in a corporation is generally to be classified as asset management. However, a different assessment may apply if the corporate entity, through a combination of several participations in a holding company, purposefully pursues a corporate policy or otherwise exercises a decisive influence over the management of the corporation and thus directly participates in general business dealings through it. A decisive influence over the day-to-day management is not presumed merely because the foundation exercises its statutory shareholder rights and obligations.[89] Rather, there must be some form of active involvement in day-to-day operations.[90]

With regard to trade tax, it should be noted that the cross-shareholding limit is 15 percent, see Section 9 no. 2a GewStG for profits from shares in domestic corporations and Section 9 no. 7 GewStG for profits from shares in foreign corporations.

c) VAT

The decisive factor for the VAT treatment of a family foundation is whether it qualifies as a taxable business (Section 2 (1) of the German VAT Act (Umsatzsteuergesetz, UStG)). This requires that the foundation itself carries out a commercial or freelance activity. In contrast to the definition of a commercial enterprise under Section 15 (2) EStG, a business activity within the meaning of Section 2 (1) UStG exists if a sustainable activity is carried out for the purpose of generating income, even if there is no intention to make a profit or if an association of persons only acts towards its members and is therefore not involved in general business dealings. If the family foundation qualifies as a business for VAT purposes, the services it provides in Germany within the scope of its business (supplies and other services) are subject to VAT. Input services for the business that are subject to VAT logically lead to an input tax deduction.

d) Property tax

Where a family foundation owns real estate, such real estate is subject to property tax; see Sections 2, 13–15 and 25 of the Property Tax Act (Grundsteuergesetz, GrStG).

e) Substitute inheritance tax

For private-benefit family foundations having legal personality, the German legislature has enacted a special substitute inheritance tax regime. This regime applies if the family foundation is established "essentially in the interests of a family or certain families" in accordance with the wording of Section 1 (1) no. 4 ErbStG. The legal consequence of this provision is that the family foundation as such is subject to what is known as substitute inheritance tax every 30 years, without there being a transfer of ownership, as is otherwise the case with inheritances

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89 See Weiten, ZEerb 2023, 241 (244).

90 See Kraus/Mehren, DStR 2020, 1593 (1594).

and gifts (Section 1 (1) no. 4 in conjunction with Section 2 (1) no. 2 in conjunction with Section 9 (1) no. 4 ErbStG).

The decisive criterion for determining whether the foundation is subject to substitute inheritance tax is the essential family interest. The tax authorities[91] affirm such an interest if, according to the foundation's constitution, the founder, their relatives, and their relatives' descendants (beneficiaries) are entitled to more than 50 percent of the foundation's assets or net worth. Where the percentages are lower and additional criteria are met, the tax authorities assume that an essential family interest may already be affirmed if the persons mentioned above are only entitled to 25 percent of the foundation's assets or net worth. One example cited is if the family has a significant influence on the management of the foundation. In the current opinion of the tax authorities, if the family receives less than 25 percent of the benefits, this is not considered to be a family foundation.

2. Special provisions for transnational sources of income

a) World income principle and double taxation agreements

As already explained, a private-benefit family foundation having legal personality and established under German law is subject to corporation income tax on all its income pursuant to Section 1 (2) KStG. The prerequisite is that the family foundation has its registered office and/or place of management in Germany (see Section 1 (1) no. 4 KStG).

While the registered office is a purely legal category, the place of management is a question of fact.[92] According to Section 11 AO, a corporation, association of persons or pool of assets has its registered office at the place which is determined by law, articles of association, constitution, endowment transaction or similar provisions. In contrast to Section 10 AO, the wording of the law does not contain any business activity as a prerequisite. Nor does the wording imply any restriction to corporations, associations of persons or pools of assets established under domestic law.[93]

In the context of family foundations, the general tax law concept of the "place of management" is particularly important for categorising family foundations as domestic or foreign-domiciled family foundations and for determining the scope of taxation in Germany.[94] It has recently regained considerable importance because the tax authorities have, for the first time, included

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91 See RE 1.2 (2) sentence 1 ErbStR; see also BFH ruling of 18 November 2009 – II R 46/07, BFH/NV 2010, 898; BFH ruling of 10 December 1997 – II R 25/94, BStBl II 1998, 114.

92 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 73.

93 See Gersch in: Klein, AO, Section 10 margin no. 2.

94 See Kraft, DStR 2024, 2154 et seq. for details.

comments on this legal concept in the Fiscal Code Application Decree in a letter by the Federal Ministry of Finance[95] dated 5 February 2024. Although the Federal Ministry of Finance's statements refer primarily to corporations, there is no question that the place of management is naturally also important in the area of private-benefit family foundations.[96]

It can be concluded that a private-benefit family foundation having legal personality pursuant to Section 1 (2) KStG is typically subject to unlimited corporation income tax liability on all income, i.e. its worldwide income. The private-benefit family foundation is obliged to declare its worldwide income. For this purpose, the income must first be determined and then submitted to the relevant tax office via a corporation income tax return so that the tax office can start the tax assessment process.

Because of how cross-border income sources are taxed in an international context, double taxation of this income can arise if the other country also taxes the same income of the foundation.[97] The typical case is that a domestic family foundation generates income from foreign sources and the foreign source state taxes this income under a tax regime comparable to the German limited corporation income tax liability. It is important to note that some provisions of the double taxation agreements (DTAs) concluded by Germany relativise the worldwide income principle.

There are numerous examples of this. Some typical scenarios, along with their structural effects both domestically and abroad, are illustrated below. The decisive factor here is whether or not a DTA exists. Where a DTA has been concluded, the application of the exemption method as a bilateral method for avoiding double taxation limits the worldwide income principle in the context of the following cross-border investment structures:

- Real estate income
- Permanent establishment (DTA/non-DTA)
- Participation in partnerships
- Participation in corporations – dividends and capital gains (free float/cross-shareholding – Section 8b KStG)

In the case of real estate located abroad that is included in business assets, its location according to double taxation agreements is relevant. The corresponding structure is visualised in

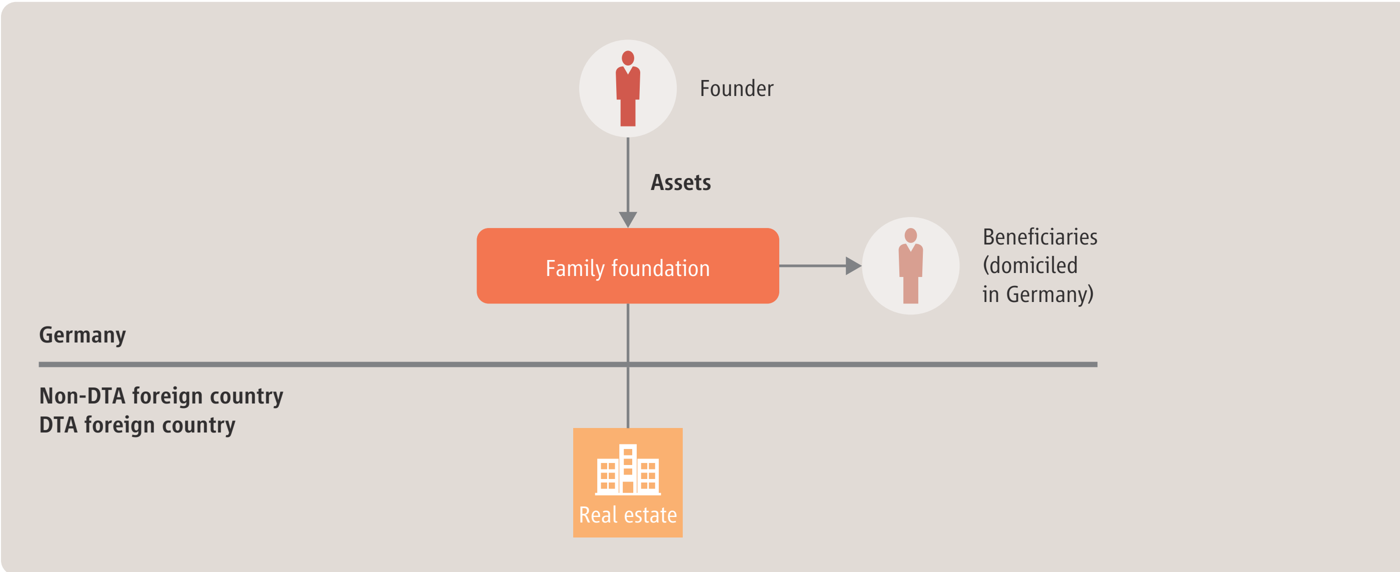
95 See BMF ruling of 5 February 2024, BStBl. I 2024, 177.

96 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 73.

97 See Richter, StiftungsR-HdB/Specker, Section 28 margin no, 9.

Figure 10 below. Real estate located abroad was transferred to a domestic family foundation and is assumed to have previously been a part of business assets. The real estate may be located in a non-DTA country or in a DTA country.

Figure 10: Cross-border real estate investment of a family foundation subject to unlimited corporation income tax liability (own illustration)



As a rule, the family foundation subject to unlimited corporation income tax liability will pay tax on income abroad, i.e. in the country where the commercial real estate is located, to an extent comparable to the limited corporation income tax liability in Germany. This implies that income generated by the property is subject to double taxation. The relevant methods for avoiding double taxation depend on whether or not a DTA applies.

If a domestic family foundation generates income from foreign real estate, in the absence of a DTA, the real estate income is included in the domestic corporation income tax base. To avoid double taxation, the unilateral provision of Section 26 KStG in conjunction with Section 34c EStG allows family foundations to credit foreign corporation income tax. This means that domestic family foundations must first include income on which corporation income tax is levied in another country in their income calculation and subject it to German corporation income tax. They can then credit the foreign corporation income tax they have actually paid against the German corporation income tax up to the amount that is attributable to the foreign income (maximum credit amount). As a result, the foundations' foreign income is then taxed at least in the amount of the domestic corporation income tax. Because, at 15 percent, the corporation income tax rate is relatively low by international standards, in many cases there is an additional burden equal to the foreign corporation income tax that exceeds this rate but is no longer creditable.

Figure 11: *Foreign permanent establishment of a family foundation subject to unlimited corporation income tax liability (own illustration)*

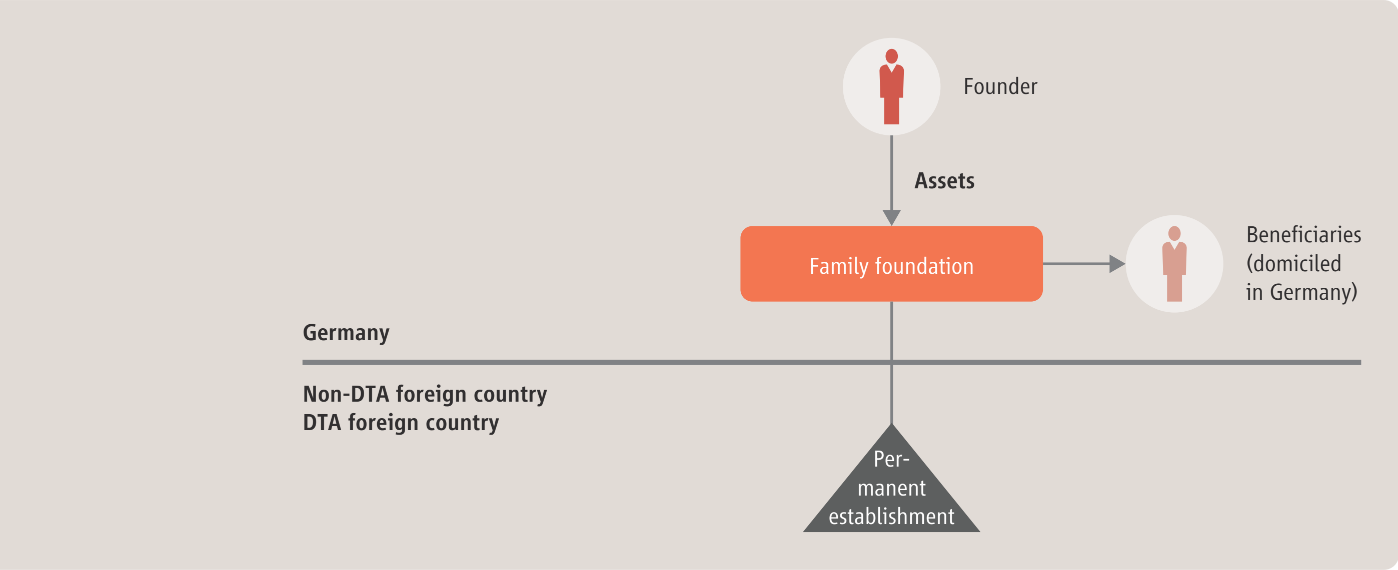
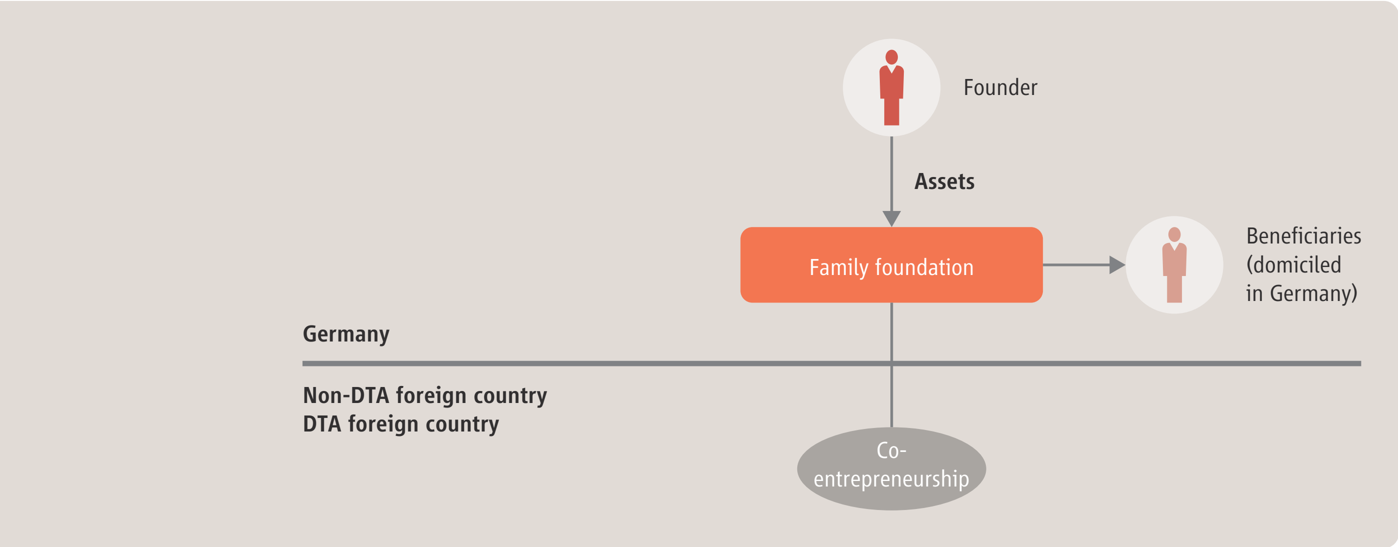


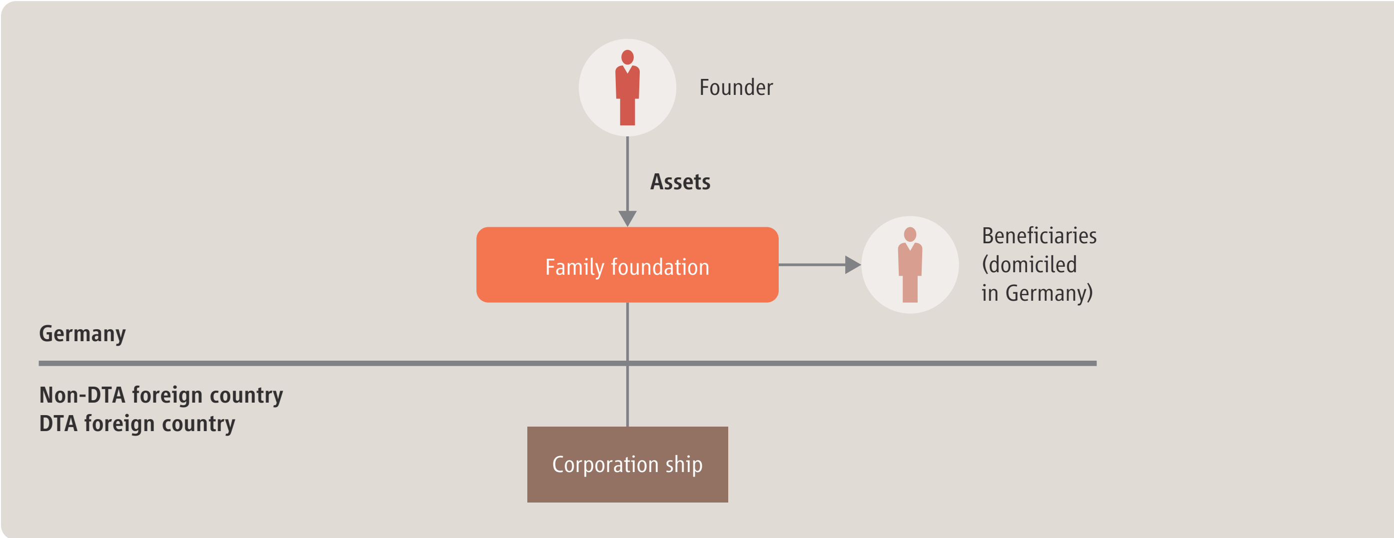
Figure 12: *Participation of a family foundation subject to unlimited corporation income tax liability in a foreign co-entrepreneurship (own illustration)*



If a domestic family foundation is subject to trade tax, in the absence of a double taxation agreement, trade tax is also levied, as the Trade Tax Act does not contain any exemption or reduction provisions.

Where a DTA exists, real estate income may generally be taxed in the country where the property is located in accordance with the provisions of Article 6 in conjunction with Article 23 of the OECD Model Tax Convention; the country of residence is generally obliged to exempt the real estate income.

Figure 13: Participation of a family foundation subject to unlimited corporation income tax liability in a foreign-domiciled corporation (own illustration)



Example:

> A domestic family foundation generates rental and leasing income by letting holiday properties. The properties are located in countries with which Germany has concluded a DTA based on the OECD Model Tax Convention. In such a case, Germany is obliged to exempt the foreign real estate income, and the country in which the properties are located may tax the income.

If a domestic family foundation operating a business has a permanent establishment abroad, the income is taxed in the same way as for real estate. Only the terminology changes slightly: instead of the location principle, it is now referred to as the permanent establishment principle. In the absence of a DTA, the income generated by the foreign permanent establishment is included in the domestic tax base, and any foreign corporation income tax levied on this income can be credited up to the maximum creditable amount. In terms of trade tax, a foreign permanent establishment's income is subject to a tax reduction in accordance with Section 9 no. 3 GewStG. Where a DTA is in place, the provisions modelled on Articles 7 and 23 of the OECD Model Tax Convention mean that no domestic taxation is permitted from the outset, whether for corporation income tax or trade tax.

The tax treatment of a domestic family foundation's participation in a foreign partnership (co-entrepreneurship) with a foreign permanent establishment and in a domestic partnership (co-entrepreneurship) with a foreign permanent establishment follows the same pattern. This is because the partnership, which is treated as transparent for the purposes of taxes on income, provides the family foundation with a proportionate permanent establishment on account of its transparency.

With regard to the investment structure of a "participation in a foreign corporation", please refer to the explanations above regarding Section 8b KStG. Gains on the sale of shares are subject to Section 8b (2) and (3) KStG – unlike dividends, regardless of the shareholding– with the result that 95 percent of such gains are tax-exempt, while 5 percent qualify as non-deductible operating expenses.

b) Add-back tax subject

If, pursuant to Section 7 (1) sentence 1 AStG, a taxpayer with unlimited tax liability controls a corporation, association of persons or pool of assets within the meaning of the Corporation Tax Act which has neither its place of management nor its registered office in Germany and which is not exempted from corporation income tax pursuant to Section 3 (1) of the Corporation Tax Act (foreign company), then such a taxpayer is liable for tax on the income for which this company is an intermediate company in accordance with the stake attributable to them in the company's nominal capital. Put simply, this results in what is known as dry income taxation at the level of the person subject to unlimited tax liability.

A family foundation that is subject to unlimited corporation income tax in Germany qualifies as a "taxpayer with unlimited tax liability" within the meaning of Section 7 (1) sentence 1 AStG. This is because, based on the domestic nexus criteria discussed above – i.e. the registered office or place of management – the family foundation is subject to unlimited corporation income tax liability and is therefore a potential addressee of the add-back tax provisions of Sections 7 et seq. AStG.

Without going into detail on the extremely complex add-back taxation rules here, this much can be said: The status of a domestic family foundation as an entity subject to add-back taxation entails a highly complex set of obligations for the foundation's Executive Board. If a domestic family foundation holds direct or indirect participations in foreign companies, it is incumbent upon the foundation's Executive Board to obtain clarity at every level of the corporate group ultimately held by the family foundation regarding the control structure, the realisation of any passive income within the meaning of Section 8 AStG by any associated company down to the lowest group level, and the possibility of low taxation of the income in question. As long as the extended add-back taxation provisions of Section 13 AStG are still in force, the list of obligations of the foundation's Executive Board expands even in the absence of a controlling interest, if a participation within the corporate network abroad below the domestic family foundation generates "income of a capital investment nature" within the meaning of Section 13 (2) AStG. This very broad provision defines income of a capital investment nature as income derived from holding, managing, preserving or increasing the value of cash, receivables, securities, participations or similar assets. Capital gains from investments that lead to income of an investment nature also count as such.

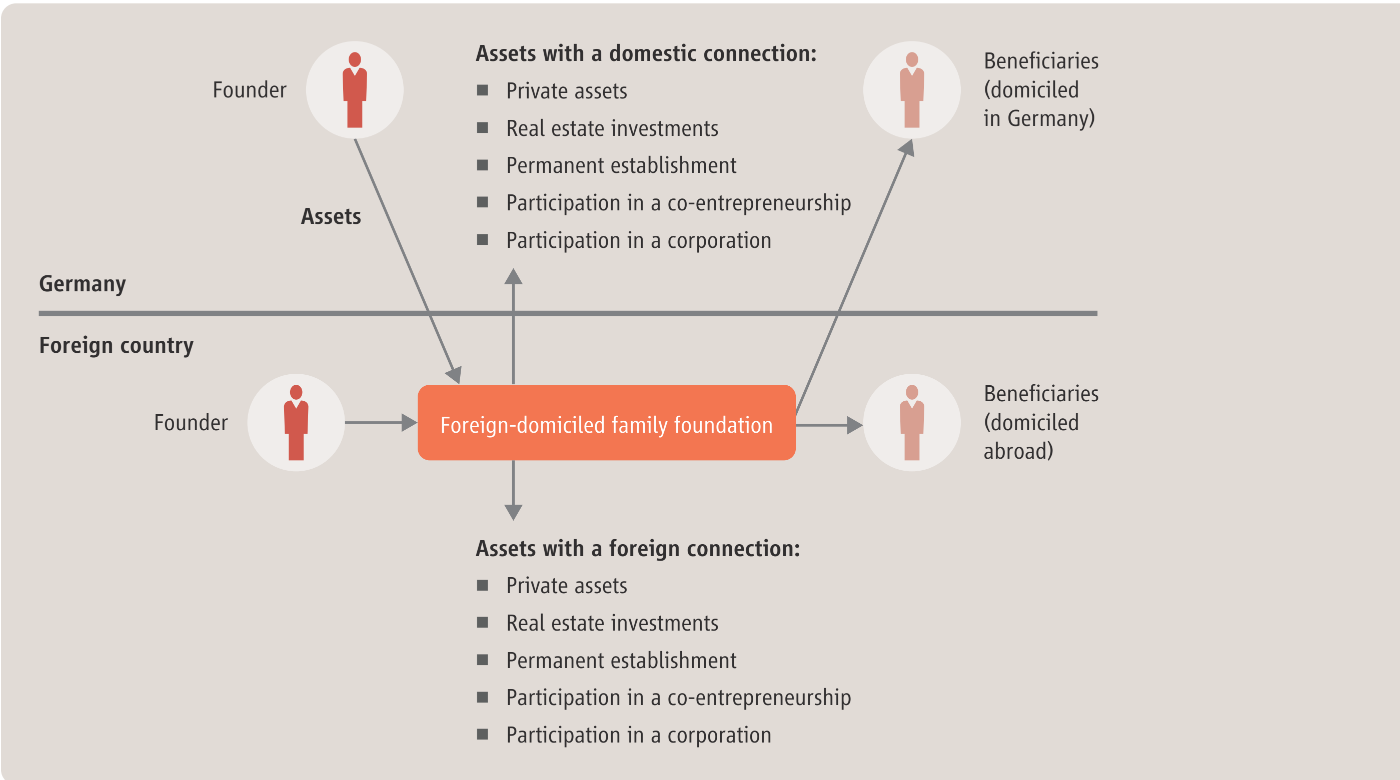
II. Foreign-domiciled family foundation

1. Basic structure

In theory, and indeed often also in practice, a foreign-domiciled family foundation will be the owner of a wide variety of assets with either a domestic or a foreign connection. In view of increasingly globalised family structures, both the founders and the beneficiaries will be resident in Germany and abroad. This fact alone suggests that the tax analysis of a foreign-domiciled family foundation with domestic founders, internationally dispersed beneficiaries and, in some cases, globalised assets is a highly complex problem.

Figure 14 below provides a visual impression of this.

Figure 14: Basic structure of a foreign-domiciled family foundation with persons and assets connected to Germany (own illustration)



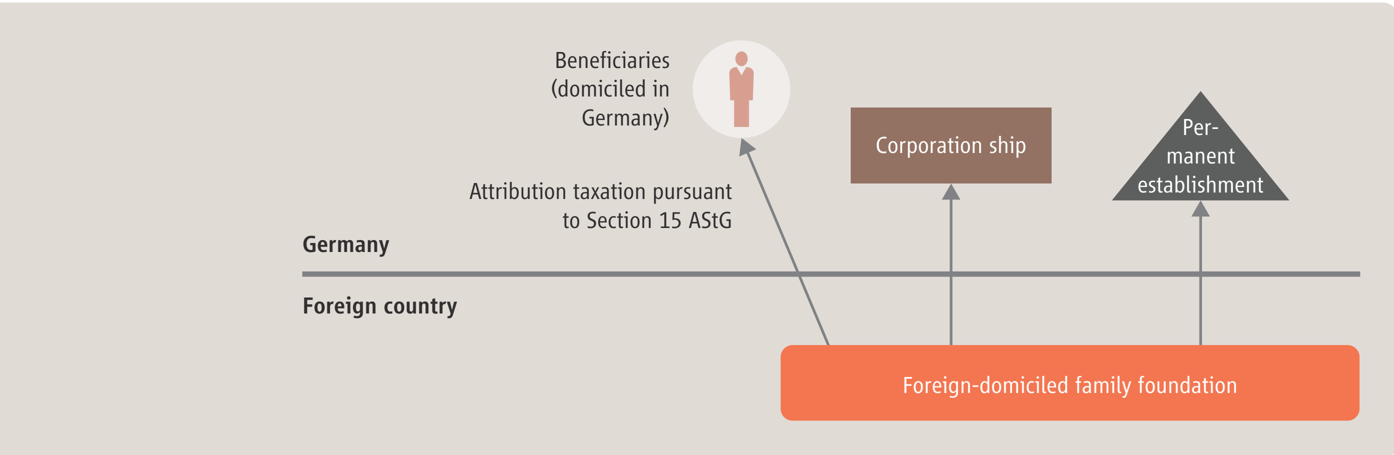
In view of globally structured family businesses, their shareholding structures and the underlying asset portfolios, Figure 14 above is likely to represent the empirical rule rather than the exception.

A foreign-domiciled family foundation may be subject to limited corporation income tax liability in Germany.

2. Limited corporation income tax liability

Like any entity incorporated under foreign law, a foreign-domiciled family foundation within the meaning of Section 15 AStG may also be subject to limited corporation income tax liability in Germany pursuant to Section 2 no. 1 KStG due to its domestic activities. The tax authorities[98] are also of this opinion, explicitly stating in the Application Decree for the External Tax Relations Act (AEAStG) that Section 15 AStG does not affect the limited tax liability of foreign-domiciled family foundations with regard to their domestic income. This is actually a relatively common case for domestic founders who, among other things, have transferred domestic business assets or shares in corporations subject to unlimited corporation income tax liability to a foreign-domiciled private-benefit family foundation within the meaning of Section 15 AStG.

Figure 15: Limited corporation income tax liability of a foreign-domiciled family foundation due to domestic investments (own illustration)



Example:

> Some years ago, a foreign-domiciled family foundation was established by the founders, who have since passed away. The endowment at that time consisted of shares in corporations subject to unlimited corporation income tax liability that were previously held by the founders. In addition, domestic business assets of a sole proprietorship previously operated by the founders were transferred to the foundation upon its establishment.

The transfer structure means that the foreign-domiciled family foundation is subject to limited corporation income tax liability with respect to the dividends it receives from the corporations subject to unlimited corporation income tax liability in Germany. The same applies to any gains from the sale of shares in the corporation, although the limited corporation income tax

98 See AEAStG 2023, para. 780.

liability in Germany may be eliminated due to the applicability of a DTA (see Art. 13 (5) of the OECD Model Tax Convention).

The permanent establishment structure created by the transfer of the former sole proprietorship also results in the foreign-domiciled family foundation being subject to limited corporation income tax liability on the income generated by the permanent establishment. In addition, the foreign-domiciled family foundation is subject to trade tax on the trade income resulting from the presumed commercial activity of the domestic permanent establishment.

3. Determination of income

a) Application of German tax law

Pursuant to Section 15 (7) sentence 1 AStG, the income of the foreign-domiciled family foundation is determined in accordance with the provisions of the Corporation Tax Act and the Income Tax Act.[99] This determination is used to calculate the amount to be attributed for the purposes of assessing the tax base of the domestic attributees. The reference to the income determination provisions of Section 10 (3) sentences 3–6 AStG relevant in the context of add-back taxation results, among other things, in the possibility of loss carry-forwards at the foundation level; loss carry-backs are excluded. Furthermore, any net wealth tax levied abroad can be credited in Germany; Section 10 no. 2 KStG – the prohibition on the deduction of personal taxes – is suspended in this respect. Similarly, conversion tax provisions are inapplicable, as are provisions that presuppose a domestic connection. Moreover, Section 15 (7) sentence 2 clause 2 AStG excludes the application of Section 8b KStG at the level of foreign-domiciled family foundations. A loss incurred at the foundation level will not be taken into account for domestic taxation purposes of the attributee in accordance with Section 15 (7) sentence 3 AStG.

b) Dividend collection at the foundation level

In the context of foreign-domiciled family foundations, the treatment of income from participations is of particular practical importance. The seemingly obvious application of Section 8b KStG at the level of foreign-domiciled family foundations is excluded by law in Section 15 (7) sentence 2, clause 2 AStG. The reason for this is to prevent potential for tax avoidance.

Example:

> The foreign-domiciled family foundation X-Trust, with A as an attributee who is subject to unlimited individual income tax liability in Germany, holds a 100% interest in a

99 See Kraft, IWB 2024, 319.

> corporation called Y-Inc. Y-Inc. distributes dividends to X-Trust. There are no visible indications that A's status as a beneficiary is in any way related to business assets.

The non-applicability of Section 8b KStG at the level of the foreign-domiciled family foundation means that the income from the participation is initially included in the assessment basis for the purposes of determining the amount to be attributed. However, since in the present case the attributee A is a natural person, Section 15 (8) sentence 2 clause 2 AStG requires that the provision of Section 32d EStG be applied, as this provision would be applicable if the dividends were received directly by A as the attributee.

c) Sale of participations

Just like dividends received, gains from the sale of participations at the foundation level can have repercussions for the attributee.

Example:

> The foreign-domiciled family foundation L-Foundation sells a 50 percent stake in M-Inc. The beneficiary of L-Foundation is the domestic company N-GmbH.

The question to be clarified is how any gains from the sale of the participation are recognised at the level of L-Foundation and taxed within the framework of the domestic taxation of attributee N-GmbH.

At the level of L-Foundation, the applicability of Section 8b KStG is suspended. Accordingly, Section 8b KStG does not apply at the level of the company foundation pursuant to Section 15 (7) sentence 2 AStG. The gains from the sale of the participation must first be recognised and will be relevant for determining the attributable amount. In the second step, it must be taken into account that the attributee N-GmbH is a corporation that would be entitled to apply Section 8b KStG if it were to receive the gains from the sale of the participation directly. For this reason, Section 15 (8) sentence 3 clause 2 AStG and Section 8b (2) and (3) KStG must be applied, insofar as these paragraphs of the provision would be applicable in the case of capital gains by attributees. Section 8b (3) KStG does not specify a minimum threshold for gains from the sale of participations, unlike dividends. As a result, the attributable amount of 95 percent of the total capital gains remains exempt from tax at N-GmbH.

4. Tax credit for attributees

a) Limited tax liability of foreign-domiciled family foundations

Family foundations associated with companies exist both in the form of foundations operating a business and in the form of foundations participating in corporations and/or partnerships. If a foreign-domiciled family foundation has business assets located in Germany, it is generally subject to limited corporation income tax liability. The Application Decree for the External Tax Relations Act (AEAStG) also recognises the possibility of limited tax liability for foreign-domiciled family foundations when it decrees that Section 15 AStG does not affect the limited tax liability of foreign-domiciled family foundations with regard to their domestic income.[100]

If the foreign-domiciled family foundation has domestic attributees, the question arises as to whether the German corporation income tax levied in the context of the legal jurisdiction of the foreign-domiciled family foundation can be taken into account at the level of the attributees when calculating the income tax on the attributed amount.

Example:

> The foreign-domiciled family foundation S-Foundation holds the entire co-entrepreneurial interest in S-KG. S-KG has not opted to pay corporation tax in accordance with Section 1a KStG. Due to its co-entrepreneurial interest, S-Foundation pays corporation income tax on income of 1,000,000 euros in assessment period 01. The trade tax base of S-KG is also 1,000,000 euros. The corporation income tax payable amounts to 150,000 euros, and a solidarity surcharge of 8,250 euros is levied. The trade tax amounts to 140,000 euros.

The family foundation's income of 1,000,000 euros is attributable to beneficiary D, who is resident in Germany.

This raises the question of how the attributed amount should be treated and whether any taxes should be credited against D's tax liability.

D must declare and pay tax on the amount attributed in assessment period 01 as part of his individual income tax assessment. The legal basis for crediting German taxes against D's income tax liability is Section 15 (5) sentence 1 AStG. According to this provision, the income tax levied on the attributable income at the expense of the foreign foundation is credited against the individual income tax of the transferee entitled to a foundation's net worth or assets. The tax authorities interpret this provision to mean that the German tax levied in accordance with Section 15 (5) AStG is credited against the tax payable on the attributable amount.[101] Paragraph 815 AEAStG clarifies how domestic and foreign taxes on income levied on the attributable income at the expense of the foreign-domiciled family foundation are credited against the individual or corporation income tax of the attributees.

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100 See AEAStG 2023, para. 780.

101 See AEAStG 2023, para. 780.

The fact that Section 15 (5) sentence 2 AStG stipulates that, for the purposes of crediting, the provisions of Section 34c (1) EStG and Section 26 (1) and (2) sentence 1 KStG are to be applied could cast doubt on this interpretation.[102] This is because both Section 34c EStG and Section 26 KStG presuppose foreign income on which foreign taxes have been levied. However, in situations of the type described above, no foreign income is present; the income of the foreign-domiciled family foundation constitutes domestic income within the meaning of Section 49 (1) EStG. According to the tax authorities' correct interpretation, the application of the crediting provisions therefore relates to the crediting method.

Nevertheless, the Federal Ministry of Finance raises no further concerns and interprets Section 15 (5) sentence 1 AStG as described above. The AEAStG does not indicate whether trade tax may be credited. This would not seem unreasonable, as German trade tax is ultimately a tax on income levied at the expense of foreign-domiciled family foundations. As the tax authorities are generally rather sceptical about the possibility of crediting trade tax – for example, in the context of add-back taxation – it appears unlikely that they will allow reverse crediting of German trade tax against the German individual income tax of the beneficiary. However, this would not be unreasonable either, because the legislature expressly provides for crediting in Section 35 EStG.

b) Time differences in the context of crediting

In taxation practice, discrepancies between the assessment period in Germany and the tax payment abroad have sometimes caused problems in the past. This can be illustrated by the following case.

Example:

> Domestic beneficiary D is attributed income from the family foundation in the amount of 1,000,000 euros for assessment period 01. The tax payment by the foreign-domiciled family foundation is not made until assessment period 03, which is identical to the calendar year.

This raises the question of whether the corporation income tax which is only paid by the foreign-domiciled foundation in assessment period 03 can be credited against the beneficiary's individual income tax assessment in Germany.

102 Paragraph 818 AEAStG stipulates that the crediting of domestic and foreign taxes is governed by Section 12 AStG in conjunction with Section 34c EStG and Section 10 (1) AStG.

The 2004 Application Decree for the External Tax Relations Act contained the following provision on this issue in paragraph 15.5.2, sentence 4: “Taxes can only be credited for the years in which they were paid.” In the present case, this would have meant that, in the absence of a payment in assessment period 01, no crediting would have been possible.

The tax authorities have now apparently recognised the problem posed by such a strict legal provision and have adopted a more practical rule. Paragraph 815 AEAStG now contains the following provision: “Tax crediting takes place in the assessment period in which the income of the family foundation is recorded and for which the taxes are levied. When the taxes are paid is not relevant.”

With this approach, the tax authorities have now significantly mitigated the problem in an appropriate manner. In terms of procedural law, the subsequent payment of tax abroad represents a retroactive event within the meaning of Section 175 (1) no. 2 AO.

E. Taxation of beneficiaries

I. Beneficiaries of a domestic family foundation

1. Taxation of payments to beneficiaries

With regard to the ongoing taxation of beneficiaries, the principle applies that payments made by a foundation to its beneficiaries qualify as income from capital assets pursuant to Section 20 (1) no. 9 EStG and are therefore subject to individual income tax if they are economically comparable to profit distributions (Section 20 (1) no. 1 EStG). The question of whether profit distributions and contributions made by a (family) foundation to its beneficiaries are "economically comparable" has now been settled by the highest courts.[103]

However, the literature[104] correctly points out that, for a long time, it was not clear when a payment was economically comparable to a profit distribution within the meaning of Section 20 (1) no.1 EStG. In particular, there was some confusion about whether a key requirement for this should be that the recipient of the payment had to be able to directly or indirectly influence the foundation's "distribution policy". In an earlier ruling, the First Senate of the Federal Fiscal Court had stated that payments made by a (family) foundation to its beneficiaries constitute income from capital assets within the meaning of Section 20 (1) no. 9 EStG if the beneficiaries of a foundation can directly or indirectly influence the distribution policy of the foundation.[105] In a recent ruling, the Eighth Senate of the Federal Fiscal Court[106] clarified this position in three concise headnotes.

Although the current ruling of the Eighth Senate of the Federal Fiscal Court[107] was issued in relation to a foreign-domiciled family foundation, it can be readily applied to payments made by family foundations subject to unlimited tax liability to their beneficiaries. Accordingly, in order for a foundation payment to be economically comparable to a profit distribution, the position of the recipient of the payment must be economically equivalent to that of a shareholder. The payment must also constitute a distribution of the surplus generated.[108] The ruling then specified that the position of the recipient of a foundation payment is economically

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103 See BFH ruling of 1 October 2024 – VIII R 25/21, BFH/NV 2025, 24; BFH ruling of 28 February 2018 – VIII R 30/15, BFHE 261, 47; BFH ruling of 3 November 2010 – I R 98/09, BStBl. II 2011, 417.

104 See Barche, EFG 2022, 245.

105 See BFH ruling of 3 November 2010 – I R 98/09, BStBl. II 2011, 417.

106 See BFH ruling of 1 October 2024 – VIII R 25/21, BFH/NV 2025, 2. In an earlier ruling, the competent Senate had already pointed out that, at least in cases where the recipient of the payment could directly or indirectly influence the foundation's distribution behaviour, the position of the recipient was economically comparable to that of a shareholder. See BFH ruling of 28 February 2018 – VIII R 30/15, BFHE 261, 47, regarding the taxation of liquidation payments following the dissolution of a foundation.

107 See BFH ruling of 1 October 2024 – VIII R 25/21, BFH/NV 2025, 24.

108 This positioning confirms an earlier ruling by the competent Senate, see BFH ruling of 28 February 2018 – VIII R 30/15, BFHE 261, 47.

equivalent to that of a shareholder if the recipient personally fulfils the conditions for receiving payments set out in the foundation's constitution. In the opinion of the Federal Fiscal Court, this requires that the recipient belongs to the group of persons eligible for benefits and that no consideration is to be provided in return. The Federal Fiscal Court also clarified that it is not necessary for the foundation's constitution to grant any property or organisational rights that would bring the legal position of the beneficiary closer to that of a shareholder in a corporation.

If – based on these criteria established by the highest court in financial matters – income from capital assets exists at the beneficiary level, this income is subject to capital gains tax at a rate of 25 percent in accordance with Section 43 (1) no. 7a and Section 43 (1) no. 1 EStG. In addition, a solidarity surcharge and, if applicable, church tax are payable. Capital gains tax must be withheld by the family foundation upon payment and paid to the tax office. In this respect, the procedure corresponds to the distribution of profits by a corporation to its shareholders. The capital gains tax withheld and paid by the family foundation generally has a discharging effect on the individual income tax of the beneficiaries, see Section 43 (5) EStG. However, if the beneficiary submits an application for a favourable tax treatment in accordance with Section 32d (6) EStG, a lower progressive individual income tax rate may apply.[109]

2. De facto capital repayments

The current legal situation regarding repayments of endowment capital to founders or beneficiaries is highly unsatisfactory.

If there are no payments that are economically comparable to profit distributions within the meaning of Section 20 (1) no. 9 EStG, it is possible that the payment to the beneficiary may be considered comparable to a capital repayment within the meaning of Section 20 (1) no. 3 sentence 3 EStG. This raises the question of whether such a payment should still be covered by Section 20 (1) no. 9 EStG. If so, it would be treated as taxable. Alternatively, on systematic grounds, it does not seem unreasonable to subject such payments to taxation in a manner comparable to the repayment of amounts from the tax contribution account under Sections 27 (1) and (7) KStG.[110]

The First Senate of the Federal Fiscal Court[111] has clarified this issue in two precedent-setting decisions. According to the headnotes, the court ruled as follows: "Since the wording of Section 27 (7) KStG does not refer to pools of assets, there is no legal basis for the separate determination of the existence of a tax deposit account of private foundations having legal personality under civil law." With this ruling, the Senate denies private foundations the right

109 See Weiten, ZEerb 2023, 241 (246).

110 For more details, see Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 129 et seq.; see also Kraft, ISR 2020, 267 (269).

111 See BFH ruling of 17 May 2023 – I R 42/19, BStBl. II 2024, 381; BFH ruling of 17 May 2023 – I R 46/21, BFH/NV 2023, 1408.

to maintain a tax deposit account, despite this being widely demanded in legal literature.[112] However, the Senate points out that a separate determination in accordance with Section 27 (7) KStG is not necessarily required in order to render Section 20 (1) no. 1 sentence 3 EStG applicable to the beneficiaries. This would mean that, even without a tax deposit account at the foundation level, it is possible to achieve a tax exemption at the beneficiary level for payments that are comparable to a repayment of endowment capital.

The tax authorities have now expressly opposed this legal opinion. They do not agree with the passage in the two rulings of the Federal Fiscal Court, whereby the applicability of Section 20 (1) no. 1 sentence 3 EStG at the beneficiary level does not necessarily require a separate determination as per Section 27 (7) KStG.[113] The brief comments of the tax authorities are based on the categorical assertion that a return of deposits at the level of the beneficiaries of a foundation cannot be assumed because no tax deposit account is established at the level of the foundation and, consequently, no amounts from the deposit account can be used. This view clearly contradicts the understanding of the Federal Fiscal Court outlined above.

The consequences of the tax authorities' stance on the Federal Fiscal Court ruling described above should definitely be taken into account in practice, because it could mean that later payments by a family foundation to the beneficiaries of an originally tax-neutral endowment might become taxable at the beneficiary level.

Example:

> A family foundation subject to unlimited tax liability is endowed with 10 million euros in foundation capital by its founder, who is subject to unlimited tax liability in Germany. According to the foundation's constitution, the transferee entitled to the foundation's assets is the founder's son. Contrary to the founder's wishes, the family foundation has remained inactive since his death. After a prolonged period of time, it is therefore dissolved. The foundation capital is transferred to the founder's son – i.e. the transferee entitled to the foundation's assets – who is subject to unlimited tax liability in Germany.

According to the tax authorities' opinion as set out in the aforementioned letter from the Federal Ministry of Finance, the family foundation is not permitted to maintain a tax deposit account. It therefore has no legal means of documenting that the payment to the transferee entitled to the foundation's assets is in fact comparable to a capital repayment. In the absence of alternative exemption provisions, it must therefore be assumed that, in the opinion of the

112 See Kraft, Ubg 2024, 319.

113 See BFH ruling of 17 May 2023 – I R 42/19, BStBl. II 2024, 381, margin no. 21.

tax authorities, the capital originally transferred to the family foundation as an endowment and subsequently repaid to the recipient of the payment, i.e. the transferee entitled to the foundation's assets, is to be treated as subject to individual income tax on the basis of Section 20 (1) no. 9 EStG.

In view of this completely unsatisfactory conclusion and the clearly divergent opinions of the Federal Fiscal Court and the Federal Ministry of Finance on this issue, it seems highly likely that the financial judiciary will once again be called upon to rule on this matter. In any case, it seems advisable to take appropriate precautions in practice. At the very least, it should be possible to prove, by means of a subsidiary or shadow account, that the payments in question are to be regarded as capital repayments for economic purposes.

In terms of procedural law, relevant rulings should be kept under review, as it is to be expected that the issue will once again be brought before the tax courts.

II. Beneficiaries of a foreign-domiciled family foundation

1. Basic concept of dry income taxation under Section 15 AStG

The taxation of dry income poses difficult liquidity management challenges at the beneficiary level.

Section 15 (1) AStG stipulates that the assets and income of a family foundation whose place of management and registered office are outside the jurisdiction governed by this Act are attributed to the founder, if the founder is subject to unlimited tax liability, or otherwise to the persons subject to unlimited tax liability who are entitled to benefits or remainder in accordance with their share. According to the wording of the provision, the attribution is made regardless of whether the persons concerned actually received any payments from the foundation during the relevant period. The purpose of this attribution taxation under Section 15 AStG is to counteract the transfer of income to foreign-domiciled foundations that are predominantly established in territories where no or only minimal taxes are levied on the foundation's assets and income. In the opinion of the legislature, such a taxation regime in connection with foreign-domiciled family foundations is justified in the interests of uniform taxation, all the more so since foreign-domiciled foundations often have structures that are not comparable with domestic foundations.[114] There may even be extreme cases in which the attribution taxation under Section 15 AStG applies at the level of the attributee, even though they have not received any inflows and possibly never will. The attributees therefore have to pay tax on income without any inflow of liquidity (dry income).

The taxation effects of Section 15 AStG may therefore prove to be crude in individual cases. It is hardly surprising, therefore, that the provision is viewed critically in the literature as

114 For more details, see Kraft, AStG, Section para. 90 et seq.

failing to meet the standards of higher-ranking law, in particular constitutional law, EU law and international tax law in the form of double taxation agreements (treaty override).[115]

2. Remedies for excessive tax burdens

The legislature has partly accepted the criticism and provided for appropriate mitigation. Noteworthy in this regard are the attribution provision of Section 15 (5) AStG, the motive test based on EU law set out in Section 15 (6) AStG and the rule for avoiding multiple taxation in cases where the tax base has already been increased by way of dry income attribution[116].

Section 15 (5) AStG allows foreign taxes to be credited at the level of the founder/beneficiary.[117] As explained above,[118] this provision can be used as the legal basis for crediting German taxes against the individual income tax liability of the domestic transferee entitled to a foundation's net worth or assets. Accordingly, taxes on income levied on the attributable income at the expense of the foreign-domiciled foundation are credited against the German individual income tax of the transferee entitled to the foundation's net worth or assets. The tax authorities interpret this provision to mean that the German tax levied in accordance with Section 15 (5) AStG is credited against the tax payable on the attributable amount.[119] The author of this study fully agrees with this interpretation.

Under certain conditions, Section 15 (6) AStG permits an exception to the application of the provision for family foundations domiciled in EU/EEA member states. As a result, the application of subsection 1 is suspended for family foundations whose place of management or registered office is located in an EU member state or a contracting state to the EEA Agreement.[120]

Section 15 (11) AStG serves to avoid double taxation in the event of an actual distribution by a foreign-domiciled family foundation to its beneficiaries resident in Germany. The prerequisite is that the income was previously attributed in accordance with Section 15 (1) AStG and therefore already subject to German taxation.[121] Ultimately, the provision in Section 15 (11) AStG implements the view of the Federal Fiscal Court that amounts fictitiously attributed under Section 15 AStG cannot be taxed as income again upon actual distribution.[122]

115 See BFH ruling of 28 June 2007 – II R 21/05, BStBl. II 2007, 669; Kraft, AStG, Section 15, para. 44.

116 Dry income refers to income that is taxable although no cash inflow occurs.

117 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 42.

118 D.II.3

119 See AEAStG 2023, para. 780.

120 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 42.

121 See Kraft, AStG, Section 15 para. 495.

122 See BFH ruling of 02 February 1994 – I R 66/92, BStBl. II 1994, 727 (731).

III. Transfers in kind

1. Domestic family foundations

Transfers in kind from a family foundation to its beneficiaries require careful planning.

In the relationship between a family foundation and its beneficiaries, there may be situations in which distributions in kind or transfers in kind are made. For example, the foundation's constitution may stipulate that certain beneficiaries are entitled to the transfer of shares in companies after a specified period of time. In such cases, the question arises as to how the transfers in kind from the family foundation to the beneficiaries are to be treated in terms of taxes on income.

At the level of a family foundation, not all assets are necessarily business assets. The family foundation may also have taxable private assets from which it generates income within the scope of surplus income types. This means that not all assets legally owned by the family foundation are subject to tax, and there is therefore no general withdrawal rule in the event of a transfer of ownership from the family foundation to other legal entities, such as the beneficiaries.

Therefore, when it comes to the income tax treatment of transfers in kind from a family foundation to the beneficiaries, it is necessary to look at whether the assets transferred to the beneficiaries come from the family foundation's taxable business assets or its taxable private assets. If the transferred assets are part of the family foundation's taxable business assets, a transfer in kind to the beneficiaries results in the realisation of the hidden reserves tied up in the transferred asset. In such cases, they are valued at the going-concern value, see Section 6 (1) no. 4 sentence 1 clause 1 EStG.

If operational units covered by Section 6 (3) EStG are transferred from the family foundation to the beneficiaries by way of a transfer in kind, the provision's requirement to carry forward the book value also applies to the transfer of these operational units.

If assets allocated to a family foundation's taxable private assets are transferred from the family foundation to the beneficiaries by way of a transfer in kind, their tax treatment at the level of the recipients, i.e. the beneficiaries, is generally based on their treatment at the level of the foundation.[123] When such assets which do not form part of the family foundation's business assets are transferred, the book values of the foundation must be carried forward;

123 See Richter, StiftungsR-HdB/Richter, Section 26 marginal no. 18 in the context of the dissolution of a family foundation.

see the relevant provisions in Section 17 (2) sentence 5, Section 20 (4) sentence 6, Section 23 (1) sentence 3 EStG and Section 11d (1) EStDV.[124]

2. Foreign-domiciled family foundation

The issue of realising hidden reserves in the context of transfers in kind from a foreign-domiciled family foundation to beneficiaries resident in Germany must first be assessed at the level of the foundation in accordance with foreign tax law. Whether such transfers are subject to final taxation can only be determined on a case-by-case basis by analysing the legal provisions applicable in the foreign country.

Since, for the purposes of attribution taxation pursuant to Section 15 (7) AStG, the income of a foreign-domiciled family foundation is determined in accordance with the provisions of the Corporation Tax Act and the Income Tax Act, the same principles apply as for transfers in kind made by family foundations subject to unlimited tax liability to their beneficiaries. It is therefore necessary to determine whether the assets transferred previously belonged to the family foundation's taxable private assets or to its taxable business assets.

IV. Remaining assets upon dissolution of a family foundation

In contrast to the legal situation applying to corporations, the dissolution of a family foundation does not result in special liquidation taxation. In particular, Section 11 KStG does not apply to foundations, whether or not they have legal personality. This clear viewpoint follows from the wording of Section 11 (1) sentence 1 KStG, which limits the scope of application of the provision governing the liquidation of corporations (Section 11 (1) sentence 1 KStG) to taxpayers with unlimited tax liability within the meaning of Section 1 (1) nos. 1–3 KStG. As family foundations having legal personality are subject to unlimited corporation income tax liability under the provisions of Section 1 (1) no. 4 KStG, private-benefit family foundations having legal personality are not subject to liquidation taxation.[125]

The taxation of a family foundation upon liquidation is not entirely the same as the taxation of a corporation upon liquidation.

In principle, upon dissolution of the foundation, the foundation's assets pass to the transferee entitled to the foundation's assets as specified in the constitution, in accordance with Section 87c BGB. Pursuant to Section 7 (1) no. 9 sentence 1 ErbStG, such remaining assets are subject to gift tax. The literature[126] supports the reasonable view that the founder is deemed to be the donor (Section 15 (2) sentence 2 ErbStG), so that – depending on the degree of kinship – tax class I (Section 15 (1) ErbStG: 7–30 per cent) should generally apply.

124 See Richter, StiftungsR-HdB/Richter, Section 26 marginal no. 18.

125 See Richter, StiftungsR-HdB/Richter, Section 26 margin no. 13; Weiten, ZEerb 2023, 241 (247).

126 See Weiten, ZEerb 2023, 247.

In the opinion of the tax authorities[127], the remaining assets upon dissolution of the family foundation can – under the same conditions as the ongoing payments of a foundation – additionally lead to income from capital assets within the meaning of Section 20 (1) no. 9 EStG. This would give rise to individual income tax, meaning that the distribution of the foundation's assets would no longer be subject to gift tax alone. The resulting double taxation in the form of income tax and gift tax is considered questionable in the literature for constitutional reasons.[128] For reasons of risk management, it is advisable to distribute retained earnings to the beneficiaries before the dissolution or termination process begins, if possible.[129]

127 See BMF ruling of 27 June 2006 – IV B 7-S 2252-4/06, BStBl. I 2006, 417.

128 See Weiten, ZEerb 2023, 246.

129 See Weiten, ZEerb 2023, 246 with further references.

F. Final thoughts: The family foundation – an instrument halfway between additional tax burden and tax structuring

Family foundations are often associated with the morally objectionable practices of tax structuring and tax avoidance,[130] giving rise to the widespread impression that this legal institution is a tax planning device for the wealthy. Such ideologically motivated (mis)judgements warrant a brief concluding appraisal of the legal concept of the family foundation.

A family foundation represents neither a tax planning device nor a tax loophole.

We should start by acknowledging that, in the context of succession, family foundations are suitable for transferring business assets to the next generation of the family, thanks to the rules governing the need-based exemption assessment. Essentially, the tax privileges granted to business assets in the context of business succession are in line with the view of the Federal Constitutional Court. Strict retention rules must be taken into account in this respect, and it must also be borne in mind that assets transferred to a family foundation by way of business succession are, in principle, permanently bound within the legal framework of the family foundation.[131] In addition, we have found that the rules on the need-based exemption assessment apply to business assets in general. They are by no means unique to family foundations or give them any special privileges.

It is also undeniable that, under certain highly complex conditions, the use of a family foundation can mitigate the crude and extremely questionable rules on exit taxation. Careful tax structuring, typically accompanied by the costly process of obtaining binding information in multiple jurisdictions, is therefore strongly recommended.

To the contribution by Kirchdörfer, including on exit taxation, in: "Europa zukunftsfähig machen – Jahresheft des Wissenschaftlichen Beirats der Stiftung Familienunternehmen" (2025), p. 87 et seq.

It should also be noted that, unlike family foundations subject to unlimited tax liability, foreign-domiciled family foundations are not subject to substitute inheritance tax every 30 years.

That said, there are hardly any real-life situations where it makes sense to set up a family foundation just for tax reasons.[132] On the whole, after weighing up all the pros and cons, a family foundation might be a good vehicle for holding business assets. But there are no standard solutions, and creating the right structures always requires a highly complex analysis of the advantages in each individual case.

130 See Dannecker, DStR 2023, 1057.

131 See Schienke-Ohletz/Mehren, ZStV 2022, 1 (8).

132 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 183 et seq.

It is important to bear in mind that family foundations can sometimes have major tax drawbacks. This is obvious when you look at the consequences of the highest courts and tax authorities denying them the right to hold a tax deposit account.

Finally, a factor that must be taken into account in the discussion of advantages and disadvantages is that substitute inheritance tax falls due every 30 years. In view of the drastic increase in life expectancy among the population, a 30-year interval no longer seems appropriate. According to legislative documents,[133] this is intended to reflect the "time intervals of a typical generational change estimated to take place every 30 years" and thus eliminate an unjustified tax advantage for family foundations. But in light of demographic change, social developments and longer life expectancies, the 30-year period can no longer be rationally justified; any arguments in favour of retaining it are purely of a fiscal nature. Some experts have already proposed increasing the substitute inheritance tax period to 40 years, assuming that the tax itself remains in place at all.[134]

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133 See BT-Drs. 7/1333, 4. This is dated 3 December 1973!

134 See Kraft, Steuerliche Problembereiche von Familienstiftungen als Träger unternehmerischen Vermögens, 2025, 17 et seq. and 184 et seq.

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List of abbreviations

AcP	Archiv für die civilistische Praxis (journal)
AEAStG	Anwendungserlass zum AStG (Application Decree for the External Tax Relations Act)
AEAO	Anwendungserlass zur Abgabenordnung (Fiscal Code Application Decree)
TFEU	Treaty on the Functioning of the European Union
AO	Abgabenordnung (German Fiscal Code)
Art.	Article(s)
AStG	Außensteuergesetz (External Tax Relations Act)
ed.	edition
BB	Betriebs-Berater (journal)
BFH	Bundesfinanzhof (Federal Fiscal Court)
BFH/NV	Collection of unofficially published decisions of the Federal Fiscal Court
BGB	Bürgerliches Gesetzbuch (German Civil Code)
BGH	Bundesgerichtshof (Federal Court of Justice)
BMF	Bundesministerium der Finanzen (Federal Ministry of Finance)
BStBl.	Bundessteuerblatt (Federal Tax Gazette)
BT	Bundestag (German Federal Parliament)
Co. KG	Compagnie Kommanditgesellschaft (limited partnership)
DTA	Double taxation agreement
i.e.	that is
DrittelbG	Gesetz über die Drittelbeteiligung der Arbeitnehmer im Aufsichtsrat (German Act on One-Third Participation of Employees in Supervisory Boards)
Drs.	Drucksache (printed document)
DStR	Deutsches Steuerrecht (journal)
EFG	Entscheidungen der Finanzgerichte (journal)
EStDV	Einkommensteuerdurchführungsverordnung (Income Tax Implementation Regulation)
EStG	Einkommensteuergesetz (German Income Tax Act)

ErbStG	Erbschaft- und Schenkungsteuergesetz (Inheritance and Gift Tax Act)
EU	European Union
ECJ	European Court of Justice
EAA	European Economic Area
et seq.	and the following [page(s)]
FG	Finanzgericht (German Fiscal Court)
FR	Finanz-Rundschau (journal)
FuS	Zeitschrift für Familienunternehmen und Strategie (journal)
GewStG	Gewerbesteuergesetz (Trade Tax Act)
GmbH	Gesellschaft mit beschränkter Haftung (limited liability company)
ed.	editor
Inc.	Incorporated (addition after the name of a US company with the legal form of a corporation)
InvStG	Investmentsteuergesetz (Investment Tax Act)
ISR	Internationale Steuer-Rundschau (journal)
IStR	Internationales Steuerrecht (journal)
IWB	Internationale Wirtschafts-Briefe (journal)
KAGB	Kapitalanlagengesetzbuch (Capital Investment Code)
KÖSDI	Kölner Steuerdialog (journal)
KStG	Körperschaftsteuergesetz (Corporation Tax Act)
MitbestG	Gesetz über die Mitbestimmung der Arbeitnehmer (Employee Co-Determination Act)
NJW	Neue Juristische Wochenschrift (journal)
no.	number
n. p.	not published
NWB	Neue Wirtschafts-Briefe (journal)
NWB-EV	Erben und Vermögen (journal)
OECD	Organisation for Economic Co-operation and Development
RE	Rechtsentscheid (legal decision)
RFamU	Recht der Familienunternehmen (journal)
RG	Reichsgericht (supreme court of the German Reich)

RNotZ	Rheinische Notarzeitung (newspaper)
RIW	Recht der Internationalen Wirtschaft (journal)
p.	page
SB	Stiftungsbrief (journal)
StiftungsR	Stiftungsrecht (foundation law)
StuW	Steuern und Wirtschaft (journal)
Ubg	Die Unternehmensbesteuerung (journal)
UStG	Umsatzsteuergesetz (Value Added Tax Act)
et al.	and others
e.g.	for example
ZErB	Zeitschrift für die Steuer- und Erbrechtspraxis (journal)
ZEV	Zeitschrift für Erbrecht- und Vermögensnachfolge (journal)
ZStV	Zeitschrift für Stiftungs- und Vereinswesen (journal)

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Foundation for Family Businesses
(Stiftung Familienunternehmen)

Prinzregentenstrasse 50
80538 Munich
Germany

Phone + 49 (0) 89 / 12 76 400 02
Fax + 49 (0) 89 / 12 76 400 09
E-mail info@familienunternehmen.de

www.familienunternehmen.de/en

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