

RIISING COMPANY VALUES AND INSUFFICIENT ALLOWANCES – NEED FOR REFORM OF INHERITANCE AND GIFT TAX EXEMPTION RULES

Lena Petra Lanz

PhD Student at

University of Library Studies and Information Technologies

Abstract: *Rising company values coupled with unchanged allowances are increasing the tax burden on small and medium-sized enterprises in the event of business succession. This paper analyses the existing exemption rules in German inheritance and gift tax law from a constitutional, tax and socio-political perspective. The focus is on unequal treatment through valuation procedures, exemption limits and the wage bill rule. The study combines legal analysis with statistical evaluation and shows that large corporate assets benefit in particular, while small and medium-sized enterprises are disproportionately burdened. International comparative models, particularly from Austria and Switzerland, show alternative approaches to fair and efficient design. The results demonstrate the need for reform with regard to constitutionally compliant equal treatment, social balance and tax precision. Recommendations for action for fairer corporate taxation are derived.*

Keywords: *inheritance tax, corporate succession, exemption rules, tax law, SMEs*

INTRODUCTION

Rising company values coupled with unchanged tax allowances highlight the need for political action on business succession in German SMEs. Given the role of SMEs in employment, training and innovation, it is important for the German economy to find ways of securing the long-term future of SMEs while maintaining the constitutional and economic policy framework. The exemption rule in inheritance and gift tax law is intended to provide relief for company transfers by way of gift or inheritance, thereby enabling businesses to continue operating when they pass from one generation to the next. Due to increased asset values and unchanged allowances, this rule in the Inheritance and Gift Tax Act is becoming increasingly problematic from a constitutional perspective and is sometimes criticised as insufficiently effective. The study therefore focuses on the question of the extent to which the current exemption rules can ensure tax-neutral and constitutionally compliant business succession in small and medium-sized enterprises and where there is still a need for action.

Individual provisions of German inheritance and gift tax law that are intended to benefit companies are examined. The current situation regarding exemption rules is presented, along with criticisms of their design, the question of whether the valuation approaches and allowances are appropriate in light of market

developments, and whether business assets are treated differently from other assets. A particular focus is placed on the principle of equality under Article 3(1) of the German Basic Law and the fair distribution of the tax burden. The thesis aims to provide a scientific basis for this and to derive recommendations for policy action.

The work will draw on literature and include a statistical analysis using selected data. An analysis of the current legal provisions will be carried out. Quantitative and qualitative evaluations will be used to shed light on the impact of the exemption rules on business succession, wealth distribution and employment in the " " sector. Current work on the topic, for example by the DIW and IW, decisions on exemption rules and international comparison models will be evaluated. Current developments in case law and academia will also be included and analysed. The focus will be on the interactions between taxation, business practice and social development.

The current state of research clearly highlights the tension between the need to relieve small and medium-sized enterprises of the tax burden when transferring businesses and the criticism of preferential treatment for large fortunes. Criticism is levelled in particular at the incentive effect of distribution factors, the failure to adjust allowances, the inadequate adjustment of the valuation mechanism and the fact that constitutionality is not always guaranteed. These key issues are addressed and examined with regard to the level of burden in the area of business succession and the constitutionality of the current regulations.

The introduction is followed by an analysis of the current exemption rules in the area of inheritance and gift tax. This is followed by a presentation of problem areas arising from rising company values in conjunction with the applicable allowances. Finally, the most important findings of the study are presented and recommendations for improving the exemption rules are derived.

RESEARCH METHODOLOGY

Current exemption rules in inheritance and gift tax law

On closer inspection, the current exemption rules in inheritance and gift tax law reveal various imbalances. Tax-free business transfers are a special privilege that should be critically examined. Even after the 2016 reform, 87 per cent of business asset transfers worth €20 million or more are still exempt from tax, and this applies in particular to larger estates (Bach 2022; Rietzler 2023). This results in a significant loss of revenue for the state, while inheritance and gift tax also affects small estates.

Particularly striking is the tax-free transfer of large assets to minors. Between 2009 and 2020, the volume of transfers to minors amounted to 58 billion euros, of which 42 billion euros alone went to children under the age of 14 (cf. Bach 2022).

The concentration of wealth in individual families over several generations and the associated scarcity of financial resources are likely to have significant socio-political consequences. In addition, the federal

states are losing out on significant tax revenue. For example, tax-free transfers of assets worth €20 million or more between 2009 and 2020 cost the federal states around €70 billion (Rietzler 2023).

Small and medium-sized enterprises are subject to relatively high taxes. The proportion of exemption rules is also significantly lower in the SME sector. As a result, tax revenue is not distributed evenly across different levels of wealth.

Under the wage bill rule, it must be demonstrated that jobs will continue to be maintained for a certain period of time after the transfer of the company. This wage bill rule often does not apply to small and medium-sized enterprises at all, as in over 90 per cent of all cases, the company is not obliged to comply with these wage bill requirements because it either has relaxed requirements () or, fortunately, no requirements at all (Wachter 2018). The Federal Constitutional Court criticised this broad formulation and the associated dispersion of tax revenue (cf. *ibid.*). In some cases, the wage bill rule does not accurately reflect company structures. In holding structures with few employees, the lack of wage allocation often means that it is not possible to prove that jobs have been retained (cf. *ibid.*).

Furthermore, the wage bill rule does not guarantee job preservation and also stands in the way of the desired goal of promoting job preservation. Even after receiving tax relief, job preservation may demonstrably fail to materialise, e.g. in smaller companies.

Another critical point in the current design of the exemption rules is the limited debt deductibility that results from the two-account model. In practice, this causes problems above all when debts have to be allocated qualitatively to individual assets because the business loan is not fully covered by the (exempt) business assets (cf. Seer 2021). This raises considerable constitutional concerns, for example because of the principle of equal treatment. Furthermore, it is advisable to set the threshold for administrative assets at a level that leads to full tax liability if it is exceeded by a minimum of 50 per cent. This situation does not do justice to the principle of ability to pay, as the circumstances of the recipient are no longer adequately taken into account (cf. *ibid.*).

The business valuation approaches in tax law and the allowance rules contribute to imbalances in the area of inheritance and gift taxation. The simplified income approach and the reduction in capitalisation factors in 2016 lead to low tax values (cf. Bach 2022). However, for many companies, the tax values do not keep pace with market price increases in the SME sector (cf. Beznoska/Hentze 2021). Due to inflation and other increases in wealth, the allowances have become less significant on average and are no longer comparable with the average value of a small business. This means that small and medium-sized enterprises are subject to tax burdens that are significantly related to their assets, while in absolute terms these are in the very low single-digit percentage range for very large assets. For gifts of €20 million or more, the effective tax burden is only 0.8 per cent (cf. Thiemann et al. 2021). Schmitt considers the EU-law structure of the allowance, with the deduction of debts and liabilities in the limited tax liability through the reduction

rules to be applied, to be in need of improvement, since the reduction rule in borderline cases, where debts are related to the inherited assets, is to be regarded as an arbitrary reduction rule and results in different taxation of similar cases (cf. Schmitt 2022).

In addition to preserving jobs, the exemption rules also lead to higher concentrations of wealth. Studies show that family-internal business transfers with tax relief create on average 4.6 per cent fewer jobs (cf. Riedle 2018). The richest tenth of households already own more than two-thirds of the national net wealth (cf. Thiemann et al. 2021; cf. Rietzler 2023). Tax relief therefore promotes greater inequality.

Furthermore, exemption rules influence tax payment behaviour. Since many taxpayers optimise their tax situation and can, for example, make arrangements in their wills or plan gifts in advance (Glogowsky 2020), behavioural adjustments remain limited, but over time this leads to a reduction in the tax base. There are also some pitfalls in the international arena, particularly with regard to trusts and foundations (ICAEW Tax Faculty 2025).

The existing exemption rules undoubtedly reduce the tax burden in the event of business succession, but at the same time there are concerns about the social, economic and constitutional implications. The analysis has shown that there are many weaknesses in this legal provision.

CHALLENGES POSED BY RISING ASSET VALUES

The problem of valuation methods and capitalisation factors in inheritance and gift tax law is a key challenge. Distortions arise in the simplified income approach used to calculate the tax burden, as the values determined often fall short of the actual market values. The reduction of the capitalisation factor from just under 18 to 13.75 in 2016, which corresponds to an expected return of 7.3 per cent, primarily benefits large companies (Bach 2022). In this case, the inequality resulting from the valuation privileges constitutes a violation of the principle of equal treatment for tax purposes. In 2015, the difference between tax value and market value was measured at around 60 per cent overvaluation (cf. Beznoska/Hentze 2021). Rising company values have turned this into an undervaluation, which poses not only fiscal but also social challenges. Companies in the IT sector and service providers in particular benefit little from these privileges. This constitutes selective tax relief that lacks transparency.

The continuously rising company values in Germany, which are the result of inflation, concentration and market changes, contrast with the fact that the allowances are not adjusted and therefore remain constant (cf. Kraft 2024; cf. Beznoska/Hentze 2021). The majority of small and medium-sized enterprises therefore have to contend with a disproportionately high tax burden. The high tax burdens associated with business succession mean that many small and medium-sized companies are either sold or have to be dissolved. The reason for this is that many of them cannot meet the tax liabilities from their current income. Since this adjustment does not take place automatically, for example in line with inflation, the Inheritance and Gift

Tax Act leads to unequal treatment of small and medium-sized enterprises. In other countries, such as Austria, there is an indexation mechanism whereby allowances are automatically adjusted in line with wage and profit developments (Drüen 2021). This would ease the financial situation of many smaller companies.

Large fortunes are the main beneficiaries of tax breaks. For example, company transfers worth more than 20 million euros are subject to only minimal taxation in Germany (Bach 2022; Rietzler 2023). A particular problem here is the large amount of assets transferred involving minors, as these are often tax-free (Bach 2022). While small and medium-sized businesses have to pay, most larger business successions remain completely untouched by the tax authorities. The progression of inheritance and gift tax is greatly reduced. The state benefits only to a limited extent from the high wealth of its citizens.

As already mentioned, international comparisons reveal the weaknesses and potential for improvement in the inheritance and gift tax law. Austria and Switzerland, for example, use dynamic, multi-stage concepts that are geared to economic reality (cf. Drüen 2021). Switzerland also links tax relief to the creation or preservation of jobs and thus to strengthening the country as a business location. Furthermore, the tax-free allowance for heirs increases with the rising assessment basis. These approaches can serve as sources of inspiration for modifying the existing German system.

The increase in company values also leads to increased attempts to avoid taxes. This is done, among other things, through the use of tax-efficient gifts, wills, trusts or foundations (cf. Shin 2020; cf. Saymaz/Lambert 2019). This development also influences the effectiveness of the current tax system. Many beneficiary companies profit from the growth in corporate value, which expands the possibilities for tax-reducing arrangements. These mechanisms deprive the German state of tax revenue and thus undermine the effectiveness of the taxation system.

In addition, the exemption rules contribute to the concentration of corporate assets. Already today, the wealthiest 10 per cent of the population own more than two-thirds of net assets (cf. Rietzler 2023; cf. Bach 2022). The government will continue to favour this trend in the future. This not only has negative effects on the middle class, but may also jeopardise social cohesion and trust in the fairness of the tax system in the future. It restricts the economic freedom of all people through competitive disadvantages and may limit economic innovation. In order to create a forward-looking tax policy, exemption rules must take social aspects into account alongside economic considerations.

CONCLUSION

The aim of this paper is to analyse the effectiveness and fairness of the current exemption rules in inheritance and gift tax law with regard to business succession, particularly in small and medium-sized enterprises. In addition, it will be examined whether the existing law ensures tax-neutral and constitutionally compliant business succession and what effects the current tax privileges have in times of steadily rising

company values. This question will be examined in more detail on the basis of current specialist literature and existing statistics in order to critically assess the fiscal, socio-economic and constitutional implications.

This shows that the current exemption rules are very favourable to large corporate assets. The taxation of companies has been specifically regulated by law for small and medium-sized enterprises, but in practice it is mainly very wealthy companies and families that have benefited, some of which have been able to obtain a 100% exemption from inheritance and gift tax. Tax-free business successions worth millions, even in the case of minors, are leading to ever greater concentration of wealth and large tax losses. Small and medium-sized enterprises, on the other hand, are much more severely affected. The legislators' intention to secure jobs by means of the wage bill regulation has had little success in practice, as it is only mandatory for relatively large companies and hardly affects the majority of all companies that benefit from it. The deductibility of debt and the rigid regulation of thresholds for administrative assets lead to unequal treatment of otherwise equal companies, which entails constitutional risks. The valuation rules for corporate assets and the limitation of allowances are hardly sufficient to compensate for increases in the value of companies. Small and medium-sized enterprises in particular have to accept a high tax rate. Large fortunes, on the other hand, are subject to a very low effective tax rate, which in turn contributes to social inequality.

With reference to the research context, the key findings of the current literature can be affirmed, according to which the current provisions are unconstitutional and violate the principle of equal treatment under Article 3(1) of the German Basic Law (). If this situation continues, it is inevitable that even more wealth and power will be concentrated in the hands of a few families. On the other hand, the state's fiscal leeway will be further restricted by high tax losses. A comparison with countries such as Switzerland or Austria shows that more flexible regulations have a more socially beneficial impact there.

The findings contribute to the current literature on this topic. Particular emphasis is placed on the constitutional, fiscal and social implications.

The analysis and the conclusions based on it offer clear perspectives for future research. It is obvious that this work is subject to empirical limitations, as only secondary statistical and text analysis data were used. It should be noted here that more in-depth empirical research on company transfers, specific industry analyses or the effects of different exemption rules is still pending. Questions such as the dynamisation of allowances, wage regulations and company valuation need to be clarified. In practice and tax policy, the next step could be to pursue alignment with internationally comparable tax systems and to design targeted relief measures in order to reduce the tax burden on small and medium-sized enterprises in particular in the context of business succession.

An examination of the subject matter shows how important it is to take a holistic view of the issue of business succession and to combine legal, economic and social aspects.

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