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Stößel, Johannes; Schneidereit, Julian; Stockburger, Sonja

Veröffentlichungsversion / Published Version
Zeitschriftenartikel / journal article

Empfohlene Zitierung / Suggested Citation:
Stößel, J., Schneidereit, J., & Stockburger, S. (2020). Inheritances and gifts: Possibilities for a fair taxation of intergenerational capital transfers. *Intergenerational Justice Review*, *6*(2), 52-62. https://doi.org/10.24357/igjr.6.2.830

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https://nbn-resolving.org/urn:nbn:de:0168-ssoar-71005-9

Inheritances and gifts: Possibilities for a fair taxation of intergenerational capital transfers

by Johannes Stößel, Julian Schneidereit and Sonja Stockburger

Abstract: In Germany, transfers of assets between generations are subject to inheritance and gift tax.[1] However, there are different views on whether or not the present level of taxation is high enough. Our study looks at the potential for applying increases. We show that the constitutional framework does indeed allow for higher taxation in the case of intergenerational property transfers. We identify the essential points in current German inheritance and gift tax law, which make it possible to transfer large assets with no or low inheritance tax burden. For these points as well as the determination of tax rates, we propose reform approaches and present options for the use of possible additional income.

Keywords: *Inheritance and gift tax; Intergenerational property transfers; Fair taxation*

Legitimacy and the necessity of reforming the taxation of intergenerational capital transfers

Wealth transfers between generations can have implications for both intergenerational and intragenerational justice. Such transfers may replicate or strengthen wealth inequalities and thus an unequal distribution of wealth may endure from one generation to the next. There are various positions as to whether such unequal distribution of wealth is permissible (e.g. Osterloh-Konrad 2017: 310-319; Rawls 1970; Dworkin 2000; Piketty 2020; Nozick 1974; Murphy/Nagel 2002). The possible effects of the unequal distribution of wealth, for example on health, political participation, social mobility, education, economic growth and social cohesion (e.g. Stiglitz 2012; OECD 2015; Osterloh-Konrad 2017: 310; WSI Distribution Monitor 2016: 19; Lampert et al. 2005: 7; Fratzscher 2016: 117 ff.; Öchsner 2016; Piketty 2020: 1198; Cingano 2014; Murphy 2015: 615; Nagel 2009: 117-118; Fratscher 2016: 91-92) can, in our view, be assessed as socially negative and unfair. Furthermore, we consider this to be a violation of equal opportunities, which are necessary within a well-functioning meritocracy. If this view is followed, the intergenerational transfer of wealth offers one of many possible starting points for using taxation to mitigate the prolonged unequal distribution of wealth and make a contribution to reallocation. This can be achieved by inheritance and gift tax. On the one hand, large assets may be reduced by tax at the time of transfer. On the other hand, tax revenues in particular can be used to mitigate wealth inequality and social injustices or a resulting lack of equal opportunities. From the point of view of intergenerational justice, an increased inheritance tax could also be justified by helping to hold the national debt at a moderate level for future generations. We start by setting out the constitutional limits of an inheritance and gift tax burden in Germany. Based on this, the most important components of current inheritance and gift tax law that prevent effective or higher taxation are shown and reform approaches are proposed.

The intergenerational transfer of wealth offers one of many possible starting points for using taxation to mitigate the prolonged unequal distribution of wealth and make a contribution to reallocation.

If a view is taken that unequal distribution with its consequences has to be accepted, or if inheritance and gift tax is considered as the wrong starting point for a more comprehensive intervention (e.g. Birk 2005: 348; Eckhoff 2016: 224), then we consider there to be two reasonable options for the taxation of intergenerational asset transfers. Due to the high degree of complexity as well as regular constitutional criticism coupled with the relatively (very) low[2] tax revenue, inheritance and gift tax should either be abolished or, in the case of low tax rates, significantly simplified (as a proposal for this, see Kirchhof 2011: 582 ff.).

Constitutional framework of inheritance and gift tax

General information

Any (tax) legislation is bound by the constitutional order (Article 20 (3), Basic Law). In this context, the German Basic Law (Grundgesetz/GG), which came into force on 23 May 1949, sets the benchmark and basis for the legality of parliamentary laws which have been adopted, hence forming the cornerstone and framework for all positive law. Accordingly, tax law science can to a large extent be regarded as constitutional law science (cf. Seer 2018: §1 Rz. 3). Whatever objectives are pursued in the context of tax policy decisions, the constitutional basis thus always remains the same and must inevitably be considered.

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If a reformed inheritance and gift tax system wants to accord with legal requirements, it is above all necessary to analyse judgements explicitly declaring the *Erbschaftsteuer- und Schenkungsteuergesetz*, or ErbStG (German inheritance and gift tax law), as unconstitutional.[3] Specifically, this must be done so as to fulfil demands made by the *Bundesverfassungsgericht*, or BVerfG (German Federal Constitutional Court), for an inheritance and gift tax law that conforms with the Basic Law. As described earlier, this is one of the highest premises of tax law science, since above all the basic rights (Article 1 to Article 19, Basic Law), which are provided with the so-called eternity clause, must be regarded as an institution of legislation which cannot become subject to reform. In addition to the judgements mentioned above, even though in-

heritance and gift tax law has been featured in several decisions by the Federal Constitutional Court,[4] it is nevertheless the three explicitly mentioned rulings (see endnote 3) that define constitutional requirements and thus the scope for a new inheritance and gift tax system. Hence, in what follows these three relevant judgements (with corresponding references to further jurisprudence) are placed in a logical context so as to deduce the lines of argumentation developed by the constitutional judges. The aim here is to create the constitutional prerequisites for an inheritance and gift tax system that optimally bridges the gap between principles that the authors believe to be decisive for inheritance and gift tax law within the framework set by the BVerfG. As mentioned earlier, these are: (1) the principle of taxation on the basis of ability-to-pay (derived from the principle of equality (Article 3, Basic Law)); (2) the family principle (Article 6, Basic Law); (3) the protection of property and the right of inheritance (Article 14, Basic Law); and (4) the welfare state principle (Article 20 (1), Basic Law).

Three rulings define constitutional principles and thus the scope for a new inheritance and gift tax system. The principles are: (1) taxation on the basis of ability-to-pay; (2) the family principle; (3) the protection of property and the right of inheritance; (4) the welfare state principle.

Inheritance law and tax rate

Article 14, Basic Law provides a constitutional guarantee for the right to inherit. This principle, which is fundamental to inheritance law, also directly affects inheritance and gift tax law due to the fact that inheritance law is authoritative for inheritance and gift tax law. Article 14, Basic Law implies that it is possible to deduce from the right "to inherit something" that a complete "taxing away" of the inheritance cannot be permissible. The BVerfG itself deals with this Article exclusively in the first decisions from 1995 mentioned above. However, it is only in an abstract formulation that the limit of tax access is where an "excessive burden" occurs and the "accrued assets would be fundamentally impaired".[5] This is followed by the concrete formulation that the "tax burden must not make the inheritance appear economically senseless from the point of view of an economically thinking owner."[6] This chain of unspecific formulations leaves things open as to where exactly a constitutional maximum limit for inheritance tax rates lies.
Based on the considerations above, it can thus be concluded that no concrete limitation of the tax rate can be ascertained from Article 14, which explicitly concerns inheritance tax law, unless the inheritance is fully "taxed away". This is also reflected in the jurisprudence. Thus, the BVerfG considered a tax burden of 62% not to be unconstitutional, just as the German Federal Court of Finance (BFH) did not consider a tax burden of almost 70% to have a "strangling" effect.[7] If the inheritance tax burden is considered in isolation, this represents an incomplete recording. If, under the current system, a sale is made later than five years[8] after the transfer date relevant for inheritance tax, this may possibly result in a (substantial) double burden of inheritance and income tax (Stahl 2011: §35b EStG Rz. 10). Thus, a reformed inheritance tax system must also take into account interdependencies between income tax and inheritance tax. In this respect, the Federal Court of Finance grants a certain leeway in regard to its rulings on the latter. For example, in a ruling of 17 February 2010, the second senate[9] considered a burden of 33% inheritance tax and subsequently 46% income tax to be "no confiscatory"[10] burden.[11] Against the background of a maximum constitutional burden which is not explicitly specified, Articles 3, 6 and 20 of the Basic Law mentioned above are now becoming relevant when considering to what extent their partly conflicting and partly harmonising principles can create a framework for a constitutional and universally acceptable inheritance tax system.

Justification and necessity for tax exemptions: Basic information

The basic principle of Germany's tax system, taxation on the basis of ability to pay, is derived from Article 3 (1) of the Basic Law and can also readily be seen in the context of inheritance tax law. The only people to be taxed are those who actually have an increase in financial capacity through an inheritance or gifts. Moreover, this gain in financial capacity is taxed based on progressive tax rates.[12] However, in addition to taxation according to financial capacity, fulfilling the principle of equality (Article 3, Basic Law) also requires consideration being given to the general public and overall uniformity. Thus, tax has to be levied irrespective of characteristics such as origin, religion, profession and the like; furthermore, all economically identical circumstances have to be treated equally. Thus, the following question arises for an inheritance tax system:
In line with the principle of equality, can favouring different categories of assets ((residential) real estate, cash assets, business assets, etc.) and transfers depending on family relationships to different extents be justified from a tax perspective?
With this consideration it must be noted that questions regarding German valuation law, *Bewertungsgesetz* (BewG), which precedes the ErbStG, are excluded here. According to §9 BewG, common value is defined as the valuation principle. It is intended that this should reflect the value of common property as realistically as possible across all economic assets, pursuant to the BVerfG resolutions of 22 June 1995[13] and 7 November 2006.[14] In our opinion, this can be considered reasonable, albeit a more consistent implementation would be desirable here.
In principle, Article 3 (1) of the Basic Law (commonly referred to as the principle of equality) requires that all persons have to be treated equally before the law. Thus, essentially equal things are to be treated equally and essentially unequal things are to be treated unequally. This applies to unequal burdens and unequal privileges[15] and in particular does not require that everyone should make an equal contribution to financing the community. Hence, while all citizens should be equally involved in financing the state's tasks, it should strictly be in accordance with their ability to pay (principle of taxation on the basis of ability to pay).[16]
This principle of equal treatment is decisively overridden in inheritance tax law if two situations exist: either it conflicts with

This principle of equal treatment is decisively overridden in inheritance tax law if two situations exist: either it conflicts with another taxation principle established by the Basic Law; or the legislature wishes to promote or direct the behaviour of taxpayers for reasons of the common good. Here two decisive unequal treatments of the currently valid inheritance tax law can be identified: preferential treatment within the family; and preferential treatment for business assets.

another taxation principle established by the Basic Law; or the legislature wishes to promote or direct the behaviour of taxpayers for reasons of the common good.[17] Here two decisive unequal treatments of the currently valid inheritance tax law can be identified: preferential treatment within the family; and preferential treatment for business assets. The latter are to be favoured for reasons of the common good not only to create value and employment, but also to preserve jobs.[18] The necessity of these two restrictions in the principle of equality will now be assessed separately.

Protecting business assets

As discussed above, an unfair advantage for a category of assets can be justified only if it serves legitimate objectives. This raises two questions: what should the aim of inheritance tax be in this context, and does the objective pursued by current relief measures require such unequal treatment?

In regard to the latter question, it can be taken as established case law in this context that small and medium-sized enterprises are considered worthy of protection as guarantors of German growth and prosperity. Hence, they and the jobs associated with them should not be endangered.[19] In its 1995 judgement, the Federal Constitutional Court stated that the principle of equality already requires that the reduced (financial) capacity of heirs resulting from continuation of the business (as opposed to sale or abandonment) should be taken into account through a preferential treatment of business assets.[20] In its judgement of 7 November 2006, though, the Federal Constitutional Court then stated that any increase in (financial) capacity is measured by the (sales) price achievable under objective conditions[21] and thus preferential treatment is not justified by the principle of equality alone. Accordingly, the reasoning inherent within these three rulings, namely that the assets of small and medium-sized enterprises should be favoured for reasons of public welfare, remains since a transfer to the next generation should not result in any loss of jobs and jeopardise the enterprise's survival.[22] Thus, it seems that more generous solutions for benefiting these companies should be created/maintained. However, in our view protecting the continued existence of transferred enterprises can also be guaranteed in connection with a lower level of preferential treatment for business assets than is currently the case (see ch. *Benefiting business assets*) and thus less discriminatory for the heirs of non-business assets.

In its most recent judgement from 2014, the BVerfG states that the legislature has set limits on benefits that are contrary to Basic Law, so much so that the purpose of this support is contrary to other statutory provisions.[23] In this context, the question arises as to why the principle of the welfare state, laid down in Article 20 (1) of the Basic Law, has to date not been given concrete consideration in inheritance tax law and the BVerfG's relevant case law (outside of a special vote).[24] At best, it could only have an effect as a kind of "moderation norm" of tax law (Hey 2017: 20). This article, although it does not have "fundamental rights status" (Articles 1-19, Basic Law), together with Article 1 of the Basic Law, forms the core of the constitution declared to be unalterable by Article 79.3 of the Basic Law. That is why its provisions can also be described as the constitution's normative core (Grzeszick 2014: Article 20, Basic Law no. 3).[25] Inheritance tax should, above all, also be an instrument for promoting equality of opportunity or some other requirement distributive justice. It should thus also be the objective of inheritance and gift tax as an instrument of the welfare state to prevent wealth in the possession of a few from growing disproportionately on the basis of (social) origin or personal ties alone, which is why an associated equalisation is the responsibility of politics.[26] Beneficial treatments for corporate assets implemented by the legislator for reasons of the common good should therefore have its limits at least where another principle of the Basic Law triggers its scope. Insofar as the continued existence of a company and in particular its jobs can be secured, we believe that inheritance tax should above all be understood as an instrument of redistribution in order to do justice not only to the principle of equal treatment (Article 3 (1), Basic Law) but also the principle of a welfare state (Article 20 (1), Basic Law).

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Beneficiary transfer to family members

From a constitutional perspective stemming from Article 3 (1) of the Basic Law, taxation based exclusively on (financial) capacity is the key premise. The legislature's ability to implement an inheritance tax privilege for family members (lower tax rates; higher allowances) in the ErbStG is due to Article 6 which competes with Article 3 (Piltz 2018: 172). Provision in the former, which has the same rank as the latter, selectively overrides the principle of taxation on the basis of ability to pay and considers the protection of marriage and family as regulating the tax burden level.[27] In this context, the Federal Constitutional Court demanded in its judgement of 1995 that "The access to family members within the meaning of tax class I[28] (§15 (1) ErbStG) for inheritance tax purposes [...] must be moderated in such a way that each of these taxpayers benefits from the estate transferred to him or her – depending on its size – at least to a clearly predominant extent or, in the case of smaller assets, completely tax-free."[29] The BVerfG also requires "that inheritance for the spouse still remains the result of the marital acquisition partnership and that also a co-entitlement for the children to the family property, as laid down in inheritance law, is not lost."[30] Otherwise, the BVerfG's above-mentioned judgements make no reference to the family principle, which is why these unspecific formulations require interpretation by constitutional judges.

The special position of spouses (registered civil partners), children and other family members, whose existence is understood in the literature,[31] based on Article 6 (1) of the Basic Law, has a far-reaching legal tradition in German inheritance (tax) law.[32] Present differentiation of tax rates and allowances depending on the family closeness of a testator/donor is based on the above-mentioned BVerfG ruling of 1995.[33] In this context, the decisive question thus arises as to what constitutes a "clearly predominant" part of the estate. This depends to a large extent on the choice of scale. If a clearly predominant part of each estate (irrespective of its amount) has to be passed on, is this considered from a macroeconomic point of view, so that a clearly predominant part of the sum of (all) estates is affected, or is this to be considered from the point of view of an "average heir"? The latter would mean that the "average" inherited assets within "the family" can be transferred to the next generation largely tax-free (see also ch. *Personal allowances*).

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In addition to the Articles referenced in this section, Article 6 (1) of the Basic Law can also be taken into prior consideration with regard to tax exemptions (currently regulated in §§13 ff. ErbStG). Thus, concerning the transfer of assets within the family, constitutional conformity can be conclusively assessed only as a combination of tax exemptions (e.g. for family homes, transferred household effects and other objects), personal allowances and tax rates.

Constitutional conclusion

In summary, it can be stated that BVerfG case law provides more or less concrete framework conditions for an inheritance tax system. To date, these have comprised: formulating the principle of taxation on the basis of ability to pay (Article 3 (1), Basic Law), together with protecting marriage and family (Article 6, Basic Law) as well as the right to property (Article 14, Basic Law). However, in our view an inheritance tax system should above all take account of the welfare state principle contained in Article 20 (1) of the Basic Law, which places the legislature under an obligation to ensure that social differences are balanced out and thus a fair social order is provided.[34] Inheritance tax should therefore be an instrument of the state, which is used to compensate for unequal opportunities in life, so that an increasingly unequal distribution of resources does not cause the opportunities for social and political participation to drift further apart.[35] Inheritance tax should thus be used to counteract a consolidation of influence and power, irrespective of individual performance, and linked to "social origin".[36]

Approaches to reforming the inheritance and gift tax system

General background

In Germany, norms from the Inheritance and Gift Tax Act (ErbStG) contribute in many ways to the current unequal distribution of wealth not having at least been reduced over time. In particular, tax exemptions have predominantly privileged the "richest" members of society for generations (Beckert 2017: 27) and favour the concentration of wealth. The currently relatively minor social importance of inheritance tax in Germany is also reflected in the low level of inheritance tax revenues (see endnote 2). Inheritance tax is currently not a steering mechanism, a redistributive function or a recognisable justice factor (Eckhoff 2016: 233; Tipke 2003: 875). Indeed, it has been noted that the current inheritance tax leads to "a mere sham taxation" (Hey 2017: 18). In order to achieve a real distribution of property, which would allow all citizens to participate in the wealth and could remedy possible negative consequences of unequal wealth distribution, a higher inheritance tax burden for large properties could be one solution.

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The following reform approaches for the German inheritance tax system demonstrate ways of improving intergenerational and, in particular, intragenerational justice, while fulfilling the constitutional framework set out in the chapter *Constitutional framework of inheritance and gift tax*. They will explain: which regulations in the current inheritance tax system make it possible to transfer assets to the next generation on a low or untaxed basis; to what extent these regulations could be changed; and ways in which additional revenue could be used. It is not our intention here to propose one final reform of the inheritance tax law to solve all known problems. Likewise, our individual proposals are not to be regarded as conclusive. Certain details would still have to be worked out or empirically verified before implementation.

It should be borne in mind that inheritance and gift tax is only one part of an overall construct that has an impact on intergenerational and intragenerational justice. Reform approaches are proposed which may be part of a system change with regard to the unequal distribution of wealth along with the resulting effects on intergenerational and intragenerational justice. Alongside adjustments to the inheritance tax system specifically, this would require further changes to the current tax system as a whole, together with further legal adjustments, which are not part of this study. In particular, it would also be necessary to consider maintaining and possibly even improving performance incentives. If a correspondingly large intervention in the economic and tax system is undesirable or is judged impossible through inheritance tax (Eckhoff 2016: 224; Birk 2005: 348), then the reform approaches could also lead to less invasive interventions. The result is a frame that can be filled out according to political and social will. At the appropriate points, reference is made to different options.

In essence, our proposed reform approaches are based on the elimination or reduction of material and personal tax exemptions, to be replaced or enhanced by the introduction of a progressive tax rate depending on average assets held by an adult in Germany. This will ensure that high assets are taxed more heavily, in line with their value. A personal tax exemption – also dependent on the average assets – satisfies the constitutional protection of family and property and ensures that small and medium-sized assets can be transferred with a low inheritance tax burden or in many cases none at all.

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Benefiting business assets

As the investigations on constitutional assessment in the previous chapter have already shown, one of the most controversial exemptions from inheritance tax concerns business assets. The current Inheritance and Gift Tax Act provides for extensive tax exemption norms (possibly 100% tax exemption) for the transfer of business assets. If business assets are classified as eligible for preferential treatment (§13b (1) and (2) ErbStG) and not as administrative assets[37] (§13b (3) and (4) ErbStG), an 85% exemption from inheritance tax (§13a (1) ErbStG) is possible up to a business asset value of 26 million euros. This exemption is dependent on wage bill development (§13a (3) ErbStG) and a five-year retention

period (§13a (6) ErbStG). If the administrative assets amount to less than 20% of total assets, then a 100% tax exemption is possible upon application (§13a (10) ErbStG). Between 26 million euros and 90 million euros, the tax exemption is reduced (§13c ErbStG). A ten-year period is considered for calculation of the 26 million euro limit. This makes it possible to transfer companies or shares in a company tax-free, even if they are worth a multiple of 26 million euros, as long as there are always more than ten years between the individual transfers.

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There are no other original exemption standards for business assets. Under §28a of the German Inheritance and Gift Tax Act (ErbStG), though, testing for exemption qualification in the case of business asset transfers valued at greater than 26 million euros can be carried out upon application. In this case, inheritance tax is waived on two conditions: the wage bill will be developed (§28a (4) sentence 1 no. 1 ErbStG); and there will be a seven-year retention period (§28a (4) no. 2 ErbStG). This is possible if the inheritance tax is not covered within ten years by half of the heir's assets which are not classified as beneficiary business assets (§13b (1) and (2) ErbStG) (§28a (2) and (4) no. 3 ErbStG). As a result, it is possible to minimise the inheritance tax burden very significantly by appropriate tax or asset transfer planning.
Business assets are predominantly owned by the richest 10% of the population and, for example, achieved the highest increase in value in 2017 compared with other asset components (Dao et al. 2019: 8, 21; Grabka/Halbmeier 2019: 742 f.). From this, it can be concluded that privileges for business assets make a major contribution to the unequal distribution of wealth.
The tax legislator's justification for preferential treatment is based on the avoidance of difficulties, particularly for small and medium-sized enterprises, in being exposed to the risk of liquidity problems due to high inheritance tax claims. Continuation of these businesses and the jobs created by them should not be jeopardised,[38] albeit whilst the fear is understandable there is no empirical evidence that the existence of companies is threatened by inheritance tax (scientific advisory board at the Federal Ministry of Finance 2012: 30). Hannes/Holtz also state that it is not an unobjectionable step to assign a special role to business assets in the inheritance and to give them tax privileges over other assets (2018: §28 ErbStG Rz. 1; also as a result, e.g. Birk 2005: 349 ff.). In our opinion, this line should be followed. A comprehensive preferential treatment of business assets can lead to a distribution of wealth that is not fair from a generational perspective.

> The tax legislator's justification for preferential treatment is based on the avoidance of difficulties, particularly for small and medium-sized enterprises, in being exposed to the risk of liquidity problems due to high inheritance tax claims. Whilst the fear is understandable there is no empirical evidence that the existence of companies is threatened by inheritance tax.

Whilst we are concentrating here on German inheritance and gift tax law, a brief look at the equivalent laws in other European countries shows that business asset exemptions are not just a German phenomenon. For instance, a study by the auditing company PWC from 2015 should be noted, which clearly shows that many West European countries have specific tax facilities for business succession which include substantial allowances (de Lange-Snijders et al. 2015).

Possible approaches for reform
Accordingly, the question arises as to how much preferential treatment of business assets is necessary or which regulations are required to ensure that inheritance tax does not jeopardise the continuation of businesses. After all, an inheritance tax which would tend to make businesses unviable after the death of the owner could be socially negative. This must be prevented and furthermore constitutional law gives this order.[39]
It is questionable whether a business can be (successfully) continued only if its heir is exempted from inheritance tax. It is the business assets that must be protected and not the private wealth of heirs. Private assets can be used to pay the inheritance tax, if they are insufficient for this purpose. Deferral regulations could be used to ensure that the inheritance tax burden is bearable and does not have a negative impact on companies' investments. Hence, under certain conditions the state should grant a deferral of inheritance tax upon application. The payment of inheritance tax per se is possible for heirs of companies that have a positive value according to the income capitalisation approach, as future profits can be expected – albeit with risks. In our opinion, a lump-sum remission such as is currently provided for under §28a ErbStG should therefore be rejected except in cases of hardship, or at least made subject to much stricter and more restrictive conditions.

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A prerequisite for deferral should be a deferral requirement assessment. This means that the acquiring person must prove that the inheritance tax cannot be paid from other available assets. If the inheritance tax exceeds available assets, the excess must be deferred upon application. Moreover, available assets must be clearly defined. For example, it might be possible for owner-occupied residential property or retirement provision contracts to be excluded and only a certain percentage of the other available assets to be taken into account. The deferral could be linked to reasonable conditions in terms of generational justice (e.g. job preservation, environmental protection, etc.).
In addition, an heir is always free to sell the company (or whichever share of it they inherit). As a supplement or alternative aimed at reducing the strong unequal distribution of company assets, there are also pre-acquisition rights for employees.[40] This would enable them to participate in their own company's future increases in value and profits. In addition, employees with a stake in the company should have more of an interest in its long-term success, as their personal financial gain is linked to the company's success. Furthermore, a (partial) change of ownership could also be good

for new entrepreneurial input. In addition, there is no apparent evidence supporting an idea that the best alternative for continuing a business is always to pass it on exclusively to the next generation of the family (Birk 2005: 349; Tipke 2003: 902; Houben/Maiterth 2009: C5; Mill 1852: 373). Companies can also break up due to family disputes and/or the incompetence of family successors (for this also: Tölle 2020: 10). Empirical studies even argue against favouring family-run or heir-run companies.[41] Furthermore, extensive preferential treatment in conjunction with retention periods create economic pressure on an heir not to sell, but continue the business regardless of any prevailing circumstances. However, in the long term this might even work against the goal of preserving jobs.

A (partial) change of ownership could also be good for new entrepreneurial input. There is no apparent evidence supporting an idea that the best alternative for continuing a business is always to pass it on exclusively to the next generation of the family.

In regard to the creation and implementation of a system for the protection of business assets, it is also important to consider that any compulsion to limit and dispose of assets resulting from a restrictive (higher) inheritance or gift tax burden can create niches and opportunities for young entrepreneurs (Hannes/Holtz 2018: §28 ErbStG Rz. 1). If, for example, this were to be accompanied by additional (income) tax relief on company profits, it could serve as motivation and thus a catalyst for such entrepreneurs.
If preferential treatment for business assets is desired or, for example, is deemed necessary in connection with possible high tax rates in order not to jeopardise continuation of the business, inheritance tax should be used for (generationally equitable) steering purposes. Thus, in addition to the current qualifications for tax benefits (preservation of jobs, company size), further conditions could be applied for economic reasons or issues to do with generational equity (e.g. closing the digitalisation gap; minimising CO2 emissions; ecologically sustainable production). However, high planning and monitoring costs for both the state and the company must also be taken into account.
The question of how much protection should be provided for the continuation of businesses depends essentially on the basic levels of tax rates (see ch. *Tax rates*) and must be chosen accordingly. If necessary, different preferential treatment or deferral options must be determined depending on the size of an enterprise in order to honour the greater need for protecting small and medium-sized enterprises as comprising an established constitutional requirement (see ch. *General information, Protecting business assets*). Here, valid studies must also be prepared which show the possible burdens relating to tax rates and their consequences together with the effectiveness and feasibility of protection measures mentioned here. In this context, consideration may also need to be given to any adjustments which could be considered necessary in coordination with income tax positions (currently §35 EStG) in order to avoid unwanted double taxation.

A moral approach to the higher taxation of company assets
One specific point should be taken into consideration when transferring businesses to the next generation. Heirs to businesses inherit not only property but also power in the form of authority (Locke 1691: §91 ff.). Although this issue can also arise with other types of assets, it seems most pressing in the context of business transfers, albeit largely to do with businesses of a certain size.
Here, a certain distinction must be drawn from a moral perspective, in that goods and power need to be differentiated (Locke 1691: §91 ff.). There is no moral right to transfer so-called rule or dominion (Locke 1691: §93 ff). The right to inherit property does not automatically give rise to the right to inherit power (Locke 1691: §97 ff.). There is no reason from which it can be deduced that power should be hereditary (Locke 1691: §93 ff.; §123 f.). In addition, there is no such right derived from the German Basic Law.
Furthermore, the question is prompted from macroeconomic and social points of view as to whether or not it is morally or legally legitimate to pass on companies from generation to generation within a family. For this to happen, the condition would have to be met that an heir possesses not only the entrepreneurial skills but also the ability to deal sensibly with this inherited power (Locke 1691: §123 f.). If these skills are available in the family, it would at least seem reasonable to conclude that the heir has learned what is required from previous generations. However, at the same time it must not necessarily be assumed that an heir is the best candidate or at least one of the best to hold any power associated with the company.
Summarising, there are significant arguments which speak against the inheriting of companies, or at least those businesses which are large enough to give their owners authority over a large body of employees. Moreover, it is questionable whether inheritance tax is the right instrument for resolving such an issue.
Conversely, complete expropriation (even with compensation payments) would be difficult if not impossible to justify under the present terms of the German Basic Law. It would also lead to numerous complex concerns and further questions about implementation and realisation that would need to be settled.
However, the problems presented above could at least be limited by the application of inheritance tax, if it led say to a partial sale of the company and the power of authority were consequently divided. From this moral perspective a certain level of inheritance tax which would trigger at least the partial sale of any company should be evaluated positively. This applies in particular when employees could be given opportunities to acquire company shares.

Conversely, complete expropriation (even with compensation payments) would be difficult if not impossible to justify under the present terms of the German Basic Law. It would also lead to numerous complex concerns and further questions about implementation and realisation that would need to be settled.

Favourable treatment of owner-occupied residential property
A tax-free transfer of owner-occupied residential property from parents to their children (currently 100% under the conditions of §13 No. 4c ErbStG[42]) strengthens inequality of wealth between property owners and persons without residential property. This is particularly true for valuable properties. In addition, the tax exemption of residential property gives a certain preference to certain assets. It seems simpler and fairer therefore to set a general personal tax allowance for children, which *inter alia* can then be used for residential property (see ch. *Personal allowances*).

If homeownership is nevertheless to be comprehensively favoured, as is currently the case, then a right to choose between the general allowance and exemption for residential property should be introduced. Double preferential treatment, as in the case of current inheritance tax law, should be avoided in order to limit the untaxed transfer of large assets. Likewise, in our opinion there is no need for protection in the transfer of residential property which is above average in value. In current inheritance tax law, there is a size limit (200sqm living space according to §13 No. 4c EStG), but no value limit. In addition, there are legal possibilities to transfer non-leased properties in general tax free (Blank 2020: 2179). These should be abolished.

Personal allowances

The level of personal allowances pursuant to §§16 and 17 ErbStG is justified in particular by observing constitutional requirements covering the rights to property and family protection, as discussed above. The current levels for children (400,000 euros) and grandchildren (200,000 euros) correspond approximately (and depending on the concept of wealth used[43]) to double or equivalent to the average wealth (arithmetic mean) of an adult in Germany (Shorrocks et al. 2019: 48), respectively. This means that well over 60% of all adults can probably transfer their assets to a child without having to pay inheritance tax (Shorrocks et al. 2019: 48). Hence, in our view these tax allowances appear beyond doubt to be compatible with the protection of marriage and family as set out in Article 6 of the Basic Law and also as required by the German Constitutional Court in its judgement of 22 June 1995[44] (see ch. *General background*). It is of course debatable as to whether or not the level of existing allowances could be reduced. However, at least the absolute allowance (400,000 euros for children and 200,000 euros for grandchildren) does not contribute to the tax-free transfer of extremely high assets. In principle, a regular and automatic adjustment to the development of average assets is considered sensible. Alternatively, tax allowances could be set in relation to the median at around 32,000 euros (Shorrocks et al. 2019: 48), so that the distribution of wealth is better taken into account.

In our view, the decisive factor in this context is that the personal allowances apply to all purchases by a person and can also be applied only once (in a lifetime). In addition, they must be offset against each other, so that in total it will never be possible to use tax allowances in excess of 400,000 euros. If, for example, a tax allowance of 20,000 euros (§16 (1) no. 5 ErbStG) has already been "used up" by an acquisition from a third party, only a further tax allowance of 380,000 euros can be used in the case of a later acquisition, for instance from parents (and vice versa). This is intended to avoid multiple use of different tax allowances. At present, it is possible to use the respective tax allowances pursuant to §16 (1) ErbStG for acquisitions from different persons, which means that the different allowances can be cumulative. In addition, the tax allowances can be used again after 10 years have elapsed (§14 (1) ErbStG) for the same testator. As a result, it is possible to use tax allowances cumulatively several times using suitable tax planning in order to transfer large assets without a tax burden.

A (non-economic) reason why (higher) inheritance taxes for wealth transfers within families are refused relates to the morality of parental partiality. It is considered a duty or virtue to exercise partiality to one's own children and hence to bequeath them assets. The state should not intervene in this (critical discussion: Brighouse/Swift 2014: 123-148). Brighouse and Swift show that even without asset transfer, important (non-economic) goods can be transferred from parents to their children (Brighouse/Swift 2014: 125). Moreover, they explain that gifts and inheritances are not especially crucial in maintaining a valuable bond between parents and children, or at least that they could still do so if heavily taxed (Halliday 2018: 8). Hence, a high taxation of (high) wealth seems justified.

These thoughts can also be found in constitutional law. As explained above, this calls for a certain untaxed transfer of assets to the children (protection of marriage and family), but also applies high tax burdens on significant assets.

Tax rates

In addition to the overall base – in particular tax-free elements – tax rates comprise the essential element in determining the burden of inheritance tax. Thus, they become decisive in designing an inheritance tax system that is fair. In combination with a tax-free allowance that does justice to the protection of the family, in our view top tax rates beyond 50% are also possible, provided that companies succeed in finding ways of continuing their business despite the high inheritance tax burden (see ch. *Inheritance law and tax rate*). If tax rates far beyond 50% were to be considered desirable, the restrictions imposed by Article 14 of the Basic Law (see ch. *General information, Inheritance law and tax rate*) must be clearly specified.

In addition to the overall base – in particular tax-free elements – tax rates comprise the essential element in determining the burden of inheritance tax.

The current tax rates, in accordance with §19 ErbStG, are in the form of a progressive graduated marginal rate tariff depending on the degree of kinship. Current tax rates range between 7% and 50% depending on the value of taxable acquisition and degree of kinship. However, since tax liability can be severely restricted by tax planning, as explained above, particularly in the relationship between (grand)parents and (grand)children, tax rates in the current inheritance tax system are not of great significance in the context of an overall view that is detached from the individual case. As a matter of principle, the tax rates should also be adjusted to average assets or the distribution of assets (Piketty 2020: 1206). This could, for example, be structured as follows:

Up to the value of the taxpayer's acquisition depending on the multiple of average assets (before personal allowance application)	Value of taxable aquisition in Euros
1	200,000
2	400,000
5	1,000,000
10	2,000,000
100	20,000,000
1,000	200,000,000
10,000	2,000,000,000
> 10,000	> 2,000,000,000

The progressive rate structure in conjunction with tax allowances ensures that low and medium assets (compared with average assets) are not taxed or subject to only light taxation and that high assets are taxed more heavily in line with their higher performance. The choice of tax rates is a political and social issue. It essentially depends on the extent to which redistribution through inheritance and gift tax is to be achieved, how much funding is needed to create equal opportunities and if necessary to what extent other taxes or social security contributions are to be reduced in return. Despite very high tax rates in percentage terms for large assets, such assets could still be transferred to the next generation in nominal terms. Thus, despite high tax rates, there would not be a total equalisation of wealth. However, the massive differences would be reduced or taken more into account in taxation. As with tax allowances, the median of wealth distribution (approximately 32,000 euros) could be chosen as the basis for a rate curve instead of the average wealth.

If a less severe intervention in the unequal distribution of wealth through inheritance tax is desired, this could be achieved by applying lower tax rates. In our view, though, a progressive rate depending on average assets is the best way to ensure that the ability-to-pay principle is properly taken into account and at least partially reduces the wealth inequality instead of establishing the inequality.[45]

Current tax rates range between 7% and 50% depending on the value of taxable acquisition and degree of kinship.

Use of (additional) inheritance tax revenue

In addition to the amount and basis for assessing inheritance and gift tax, as already mentioned it is the use of (additional) tax income that is decisive in the effects of inheritance tax on generational justice. This is particularly improved if the funds are used to reduce inequality of distribution or to combat its negative symptoms. Of course, whilst inheritance tax plays its part, it is merely one instrument and hence cannot alone ensure this comprehensively. Moreover, if the funds are (additionally) made available to the general state budget, equality can be achieved only to a limited extent. There are many concrete possibilities which can be used. In particular, investments in education, health and infrastructure that specifically compensate for the disadvantages of poorer sections of the population appear to be sensible. In the tax field, additional revenue could be used to reduce the income tax on small and medium incomes. This could also be achieved, for example, by lowering VAT or consumption taxes, especially on non-luxury goods. Also conceivable would, for example, be: an exemption from real estate transfer tax for residential property up to a certain amount; a refund of VAT or consumption tax; subsidies/negative taxes for certain investments, homeownership, say; old-age provision; or the reduction of social security contributions for small and medium incomes. In the entrepreneurial sector, especially in small businesses, increased special depreciation or subsidies to the employer's social security contribution are possibilities for the use of funds. For reasons of intergenerational justice, repayment of the national debt, insofar as it is considered restrictive and negative, is also a possibility.

Piketty's proposal dealing with a capital endowment for young people (2020: 1204) also seems worthy of discussion. Here the state would pay out a certain amount of money to everyone, for example at the age of 25. This would make a strong contribution to the diversification of property ownership and enable everyone to participate in the economy and society, at least up to a certain point, thereby significantly improving the current situation.

Conclusion

Inheritances and gifts (transfer of assets to the next generation) that are not taxed, or are taxed at too low a rate, create or promote wealth inequality, respectively. Possible consequences are that this could be classified as unjust or undesirable against the background of intergenerational justice. This would be reduced by a higher inheritance and gift tax burden on capital transfers and a corresponding use of funds. The constitutional framework for achieving this has not yet been exhausted. A broader assessment of basis and tax rates depending on the distribution of wealth could lead to a taxation system that is more closely based on the ability-to-pay principle (derived from Article 3, Basic Law), since an enormous gain in performance at certain points would be taxed more heavily. In addition, a cross-subsidy could provide relief for lower income earners. It should be noted that a reduction in the unequal distribution of wealth would take greater account of the welfare state principle (Article 20 (1), Basic Law) than the current inheritance and gift tax. Despite the higher taxation especially of larger assets, a reformed inheritance tax system could also honour the constitutional right to property and thus inheritance (Article 14, Basic Law) as well as the protection of marriage and family (Article 6, Basic Law).

Notes

1 In Germany, the inheritance and gift tax law is referred to only as the inheritance tax law. Inheritances and gifts usually lead to the same legal consequences.

2 6.99 billion euros in 2019 out of a total revenue of 799.3 billion euros (NWB 2020, p. 1687).

3 The unconstitutionality of the ErbStG was established by the BVerfG in 1995 (BVerfG resolution of 22 June 1995, 2 BvR 552/91, BStBl. II 1995, 671), 2006 (BVerfG resolution of 7 November 2006, 1 BvL 10/02, BVerfGE 117, 1) and 2014 (BVerfG judgement of 17 December 2014, 1 BvL 21/12, BVerfGE 138, 136).

4 BVerfG resolution of 10 February 1976, 1 BvL 8/73, BVerfGE 41, 269; BVerfG resolution of 8 March 1983, 2 BvL 27/81, BVerfGE 63, 312; BVerfG resolution of 9 November 1988, 1 BvR 243/86, BVerfG 79, 106; BVerfG resolution of 22 June 1995, 2 BvR 552/91, BVerfGE 93, 165; BVerfG resolution of 28 October 1997, 1 BvR 1644/94, BVerfG 97, 1; BVerfG judgement of 18 January 2006, 2 BvR 2194/99, BVerfGE 115, 97; BVerfG resolution of 7 November 2006, 1 BvL 10/02, BVerfGE 117, 1; BVerfG resolution of 17 April 2008, 2 BvL 4/05, BVerfGE 121, 108; BVerfG resolution of 21 July 2010, 1 BvR 611/07, 1 BvR 2464/07, BVerfGE 126, 400; BVerfG judgement of 17 December 2014, 1 BvL 21/12, BVerfGE 138, 136.

5 Cf. BVerfG resolution of 22 June 1995, 2 BvR 552/91, BStBl. II 1995, 671, margin note 20.

6 Ibid.

7 Cf. BVerfG judgement of 18 January 2006, 2 BvR 2194/99, BVerfGE 115, 97; BFH judgement of 30 May 2001, II R 4/99, BStBl. II 2001, 606. With regard to this judgement of the BFH,

it must be noted that it applied the (fundamental) prohibition of arbitrariness and the principle of proportionality as yardsticks for the "strangling" effect. These limit an excessive tax burden (irrespective of the type of tax).

8 §35b EStG provides for a pro rata credit against the income tax that would result from a sale for a period of five years after the date of the contract which is subject to inheritance tax.

9 Cf. BFH judgement of 17 February 2010, II R 23/09, BStBl II 2010, 641.

10 A "confiscatory" tax burden is regarded as a tax with expropriating effect.

11 Note: an addition of the tax rates is not really possible here, as these relate to different tax bases.

12 The discussion held in this context as to whether taxation based on the efficiency principle requires a progressive tax rate is not considered further at this point.

13 Cf. BVerfG resolution of 22 June 1995, 2 BvR 552/91, BStBl. II 1995, 671, margin note 33 et seq.

14 Cf. BVerfG resolution of 7 November 2006, 1 BvL 10/02, BStBl. II 2007, 192, margin note 103 with citations.

15 Cf. BVerfG judgement of 17 December 2014, 1 BvL 21/12, BVerfGE 138, 136, margin note 121 with further references.

16 See BVerfG decision of 7 November 2006, 1 BvL 10/02, BStBl. II 2007, 192, marginals 157, 181, 200.

17 See BVerfG judgement of 17 December 2014, 1 BvL 21/12, BVerfGE 138, 136, margin note 121 with reference to BVerfG resolution of 22 June 1995, 2 BvR 552/91, BVerfGE 93, 165; BVerfG decision of 7 November 2006, 1 BvL 10/02, BStBl. II 2007, 192, margin note 98.

18 Cf. BT-Drs. 16/7918, 33.

19 Cf. BVerfG judgement of 17 December 2014, 1 BvL 21/12, BVerfGE 138, 136, margin note 133; BVerfG resolution of 22 June 1995, 2 BvR 552/91, BVerfGE 93, 165, margin note 30.

20 Cf. BVerfG resolution of 22 June 1995, 2 BvR 552/91, BVerfGE 93, 165, margin note 31.

21 Cf. BVerfG resolution of 7 November 2006, 1 BvL 10/02, BStBl. II 2007, 192, margin note 104.

22 Cf. for this: BVerfG resolution of 22 June 1995, 2 BvR 552/91, BVerfG resolution of 7 November 2006, 1 BvL 10/02, BStBl. II 2007, 192, margin note 97 et seq.; BVerfG judgement of 17 December 2014, 1 BvL 21/12, BVerfGE 138, 136, margin note 133.

23 Cf. BVerfG judgement of 17 December 2014, 1 BvL 21/12, BVerfGE 138, 136, margin note 138.

24 Dissenting opinion of Judges Gaier and Masing and of Judge Baer on the judgement of the First Senate of 17 December 2014, 1 BvL 21/12 BVerfGE 138,136.

25 In the context of a competitive relationship between Article 20, Basic Law and one of the fundamental rights provisions, none of the provisions must be given priority in the interpretation. See for this: Grzeszick, in: Maunz/Düring GG commentary, Article 20 GG, margin note 2 (December 2014). Article 20, Basic Law thus also makes it possible to restrict the scope of a fundamental right provision.

26 Cf. the differing opinion of Judge Gaier and Judge Masing and Judge Baer on the judgement of the First Senate of 17 December 2014, 1 BvL 21/12, BVerfGE 138, 136, margin note 5.

27 Cf. BVerfG resolution of 22 June 1995, 2 BvR 552/91, BVerfGE 93, 165, margin note 25; BVerfG resolution of 21 July 2010, 1 BvR 611/07, 1 BvR 2464/07, BVerGE 126, 400, margin note 99.

28 In the state of law in force at the time of the ruling, tax class I included the spouse, children and stepchildren as well as the children of deceased children and stepchildren.

29 BVerfG resolution of 22 June 1995, 2 BvR 552/91, BVerfGE 93, 165, margin note 28.

30 BVerfG resolution of 22 June 1995, 2 BvR 552/91, BVerfGE 93, 165, margin note 29.

31 Cf. BVerfG resolution of 21 July 2010, 1 BvR 611/07, 1 BvR 2464/07, BVerGE 126, 400, margin note 99 with reference to: Leisner, Constitutional Limits of Inheritance Taxation, 1970, 111; Löhle, constitutional leeway and limits in the taxation of inheritances and Donations, 2001, 25, 102 f.; Papier, in: Maunz/Dürig, GG, March 2010, Art. 14 Rz. 301 et seq.; Reinisch, Inheritance tax and constitutional law, 1999, 69 et seq.

32 See BVerfG resolution of 21 July 2010, 1 BvR 611/07, 1 BvR 2464/07, BVerGE 126, 400, margin note 98.

33 However, the absolute level has increased significantly over time.

34 Cf. BVerfG resolution of 18 July 1967, 2 BvF 3, 4, 5, 6, 7, 8/62; 2 BvR 139, 140, 334, 335/62, BVerfGE 22, 180, margin note 62.

35 Cf. the divergent opinion of Judges Gaier and Masing and of Judge Baer on the judgement of the First Senate of 17 December 2014 - 1 BvL 21/12, BVerfGE 138, 136, margin note 4.

36 Ibid.

37 Administrative assets according to §13 Abs. 4 EStG are e.g. real estate leased to third parties, investments in corporations of less than 25%, works of art, securities and surplus funds after deduction of a basic amount.

38 Cf. BT-Drs. 18/5923, 1 and 16.

39 Cf. BVerfG judgement of 17 December 2014, 1 BvL 21/12, BVerfGE 138, 136, margin note 140.

40 This may need to be further simplified by company law regulations.

41 For an overview of the Houben/Maiterth 2009 studies: C 5.

42 The residential property may not be larger than 200sqm and must be used by the purchaser for his own residential purposes for 10 years from the date of purchase. The testator must have used it for his own residential purposes until the testator's death.

43 State pension rights are not taken into account as they constitute insurance benefits.

44 Cf. BVerfG resolution of 22 June 1995, 2 BvR 552/91, BVerfGE 93, 165, margin note 25 et seq.

45 Looking at the absolute rather than the relative burden, it could also be argued that a proportional tariff trend is sufficient to reflect the performance principle.

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Johannes Stößel M.Sc. is a certified tax consultant. He studied Business Administration and was a PhD student and research assistant in corporate taxation at the University of Bamberg. In his research he focuses on tax effects and on the value-added tax in Europe and Germany.

Contact details:
Dr Johannes Stößel
E-Mail: johannes.stoessel@gmx.de

Julian Schneidereit is a PhD student in corporate taxation at the University of Bamberg. In his research he focuses on taxation of partnerships. He studied business administration at the University of Bamberg and the Cooperative State University Mosbach. The topic of his master's thesis was the inheritance and gift tax reform 2016 in Germany.

Contact details:
Julian Schneidereit
Otto-Friedrich-Universität Bamberg
Germany
E-Mail: julian.schneidereit@uni-bamberg.de

Sonja Stockburger is a PhD Student in corporate taxation at the University of Bamberg. Before this, she studied Finance and Accounting at the University of Bamberg and business administration at the University of Applied Science in Kiel. In her research she deals, among other things, with questions of tax justice and fair taxation.

Contact details:
Sonja Stockburger
Otto-Friedrich-Universität Bamberg
Germany
E-Mail: sonja.stockburger@uni-bamberg.de