

October 2011/Private Clients

The Handling of Works of Art in German Inheritance Tax Law

from Dr. Stephan Scherer and Leopold Thon

Works of art and cultural assets forming part of an estate are often handled in a privileged manner in comparison to pure cash assets or other assets under German inheritance tax law. However, in most cases it is fundamental to possess a competent amount of knowledge pertaining to the corresponding inheritance tax law regime in order to take advantage of these privileges.

The following therefore serves to provide an overview of the evaluation procedure for inherited artworks (1) and the requirements for an exemption from inheritance taxes for these works (2).

1) Valuation of Works of Art

The value of the relevant estate, and thereby also that of the art objects contained therein, must first be determined for the assessment of inheritance tax. The actual price/market value is primarily decisive for this determination. Due to the fixed-date principle (*Stichtagsprinzip*), the value which would have been obtained by the heir in case of a sale on the exact day of succession is to be determined.

The value determination focuses, in particular, on the following points:

a) Purchase price

Since market conditions are generally volatile, usually the purchase price is only a minor indication for the current market value.

b) Insurance Value

The insurance value of the works of art in question is often an ineffective indication as well, since it was determined by the owner and communicated to the insurance company.

c) Appraisal Report

In practice, it is recommended to obtain an expertise from a renowned art auction establishment or an authorized expert. Such appraisal report is not required to elaborate in detail on the basis of the evaluation. The evaluation should, however, especially focus on the state of preservation, the merchantability and marketability of the artwork as well as current trends and tastes.

It must be considered that the value of the objects of art would normally only benefit the heir in a depreciated manner in the event of a sale. Therefore, the usual seller costs, especially the commission, as well as, inter alia, costs for catalogue illustrations, transportation and insurances pertaining to the appraisal normally must be deducted from a realistic hammer price in an auction.

Additionally, when in possession of a large collection, it must be taken into account that a sale *en bloc* on the day of succession is feigned due to the fixed-date principle. Should many works of a particular artist exist in the collection, a group reduction (*Paketabschlag*) should be granted. The Federal Fiscal Court (*Bundesfinanzhof*) also fundamentally accepts that the evaluation must take place on the basis of supply and demand so that a supersaturated offer price would thereby have value-reducing impact.

2) Exemption from Inheritance Tax

Pursuant to Sec. 13 Para. 1 No. 2 German Inheritance and Gift Tax Act (*Erbschaftsteuer- und Schenkungsteuergesetz/ErbStG*), art collections, collections of scientific interest and other cultural assets can, under certain conditions, be exempted from 60%, 85% or even 100% of the inheritance tax.

However, the possibility of an exemption in accordance with Sec. 13 Para. 1 No. 2 ErbStG is generally only applicable if the objects are located in Germany. An exception is often made for art objects located within the EU, especially considering that European law prohibits unequal fiscal treatment of art objects in other EU-countries compared to such objects in Germany. However, settled case-law has not yet been established.

a) 60% Tax Exemption

To achieve a **tax exemption of 60%**, the inherited objects must be works of art or cultural assets the preservation of which also lies within public interest due to their significance for art, history or science.

The relevant object must also be “permanently unprofitable”. The costs – amongst which restoration costs, insurance costs and provision expenses may be taken into consideration – must therefore exceed the projected revenue. However, occasional and short-term surpluses, e.g. due to special exhibitions, are not harmful.

Lastly, the work of art or cultural possession collection must be made available to the public to some extent. In order to fulfill this requirement, it is advisable to coordinate with the fiscal authority. Which components of the collection are to be made available to the public and at what times can be agreed upon in a contract. As an alternative, cooperation agreements with museums can be entered into, temporarily surrendering certain collection pieces to them. Although the heir is normally not required to make the collection accessible to the public directly after the succession, noticeable preparatory measures should be taken within a few of months of the acceptance of the inheritance. However, no judicial decisions have been made concerning this time-frame. It is therefore advisable to closely cooperate with the fiscal authority.

b) 85% Tax Exemption

A **tax exemption of 85%** applies to properties and parts thereof whose preservation is considered to be in public interest due to their importance for art, history or science. To prove the public interest in this field, it is advisable – and often also required – to

obtain a certificate from the competent monument protection agency.

c) 100% Tax Exemption

Complete tax exemption requires that the inherited object is registered in the directory of protected objects based on the heir’s request. This requirement is, however, often omitted if the Monuments and Historic Buildings Act (*Denkmalschutzgesetz*) of the state, in which the object is located, does not offer protection for such objects.

It is further required that the object must either have been in the family’s possession for at least the past 20 years, or be registered in the directory of nationally valuable cultural assets in accordance with the German Cultural Asset Protection Law against Migration (*Gesetz zum Schutz Deutschen Kulturgutes gegen Abwanderung/KultSchG*). However, the registration in the directory of nationally valuable cultural assets has a disadvantage: Once artworks have been registered in this directory, artworks cannot be taken abroad without a corresponding authorization from the relevant authorities. The family possession of the object for 20 years is especially problematic if the collection as such has reached this age, but individual objects were only added to the collection at a later date. In this case, close cooperation with the fiscal authority is well advised. A separation into two collections – one in family possession for more, and one for less than 20 years – may also present a further option.

Conclusion

Works of art and cultural assets as part of an estate are often substantially privileged by the German inheritance tax law legislators. In order to take advantage of all tax privileges, a proper value assessment process must take place. If the above-mentioned requirements are met, an inheritance tax exemption amounting to 60% of the value of the relevant object can often be achieved. If other circumstances appear, appropriate consultation can also result in a complete exemption from inheritance tax.

This publication merely serves as a basis for discussion and is no substitute for legal advice. We would be pleased to provide you with additional information or to render advice with regard to a specific situation.

The following contact persons are at your disposal:

Dr. Stephan Scherer*
+49.621.4257.214
stephan.scherer@sza.de

Dr. Martin Feick
+49.621.4257.221
martin.feick@sza.de

Leopold Thon
+49.621.4257.221
leopold.thon@sza.de

* Certified Expert Attorney for Estate Law and Certified Expert Attorney for Tax Law

SZA SCHILLING, ZUTT & ANSCHÜTZ RECHTSANWALTS AG

D-68165 Mannheim, Otto-Beck-Straße 11
D-68027 Mannheim, PO Box 10 27 50
Germany
Telephone: + 49 (0) 621 4257 0
Telefax: + 49 (0) 621 4257 280
info@sza.de
www.sza.de

D-60329 Frankfurt am Main,
Taunusanlage 1
Germany
Telephone: + 49 (0) 69 9769601 0
Telefax: + 49 (0) 69 9769601 102
info@sza.de
www.sza.de