

ECJ Advocate General Opines That 10% Inheritance Tax Exemption for Real Property Rented Out for Residential Purposes Is Compatible With EU Law (*BA*, (Case C-670/21) (Direct Tax)) – Details

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Advocate General (AG) Collins of the Court of Justice of the European Union (ECJ) has opined that national legislation that limits the application of a 10% inheritance tax exemption for real property rented out for residential purposes to real property situated in EU Member States or EEA countries is compatible with the free movement of capital. In the case of *BA v. Finanzamt X* (Case C-670/21), AG Collins considered the issue whether EU Member States can pursue social policy objectives within the territory of the European Union by means of measures that constitute a restriction on the free movement of capital to and from third countries. Details of the opinion are summarized below.

(a) Facts. The taxpayer, a German resident individual, inherited from his father, also a German resident, a share of a property located in Canada leased for residential purposes. The tax authorities assessed the taxpayer to inheritance tax with respect to that property. The taxpayer sought to amend the inheritance tax assessment so that the property located in Canada would be subject to tax at 90% of its market value. The tax authorities denied the request.

(b) Legal background. German inheritance tax law provides that real estate property may be valued only at 90% for inheritance tax purposes when it is used for residential rentals, is located in Germany or in another EU Member State or EEA State and is not a business asset. The 10% inheritance tax exemption does not apply to real estate property situated in third countries.

(c) Issue. The issue of the case was whether or not EU Member States can pursue social policy objectives within the territory of the European Union, such as the promotion of affordable rental housing, by means of measures that constitute a restriction on the free movement of capital to and from third countries.

(d) AG's opinion. At the outset, the AG noted that the case must be examined in the light of the free movement of capital as contained in article 63 of the [Treaty on the Functioning of the EU \(TFEU\)](#). The AG established that the national rule in question has the effect that a higher base is used to calculate inheritance tax due in respect of real estate located in a third country and thus constitutes a restriction on the free movement of capital. Also, real estate property located in third countries, such as Canada, is in a situation comparable to that of such property located in Germany, the European Union or the European Economic Area.

The AG considered that the German legislature had adopted the rule in question in pursuit of an objective of general interest, namely to increase the availability for residential use of individually owned real estate property so as to reduce the concentration of residential leasehold property in the hands of investor groups. The tax advantage is designed to reduce the pressure on individuals who inherit property leased for residential use to sell it in order to pay tax, thus retaining its use for that purpose. Recalling the ECJ's decisions in [Jäger](#) (C-256/06), *Woningstichting Sint Servatius* (C-567/07) and [Busley and Cibrián Fernández](#) (C-35/08), the AG established that a Member State may invoke social policy objectives, such as the promotion of the availability of affordable housing, as overriding reasons in the general interest to justify a restriction on the free movement of capital between the Member States. While article 9 of the TFEU provides that the European Union must guarantee an adequate level of social protection when defining and implementing its own policies and activities, article 153 of the TFEU indicates that it shall support and complement Member States' activities to fight social exclusion. There is nothing in those provisions to oblige Member States to pursue social policy objectives in third countries. The AG therefore opined that EU law does not require Member States to take the availability of affordable housing in third countries into account in order to justify a restriction on the free movement of capital between the EU and third countries. The AG further pointed out that it is principally a matter for the referring court to assess the national legislation's compliance with the principle of proportionality.

The AG noted that the referring court must determine whether a 10% reduction in the base of property leased for residential use, used to calculate the value for inheritance tax purposes, is capable of reducing the pressure on heirs to sell such property and the consequences for the availability of rental property. In this regard, the AG also noted that if the scope of the tax advantage were narrower and it was limited to real estate property valued at below a certain threshold, thereby excluding luxury properties, the impact of the restriction on the free movement of capital to and from third countries might be more limited.

The AG further opined that the national rule in question may not be justified based on the effectiveness of fiscal supervision, as Germany is able to attain necessary information to verify that the conditions to obtain the 10% exemption have been met based on exchange of information under article 26 of the [Canada - Germany Income and Capital Tax Agreement \(2001\)](#), which covers all taxes charged by the Contracting States, including inheritance tax.