

How do Germany, Italy and France deal with tax exemptions (private homes, companies, allowances...)?

Introduction

What is a tax exemption? A person is considered to be tax exempt when they are not imposed on a particular income or transaction, for example the sale of an asset. This exemption can be full, meaning the person will pay no tax at all, or it can be partial, meaning the person will benefit from a tax deduction or allowance.

These tax exemptions or deductions are incentives to attract taxpayers in a certain jurisdiction rather than another to make their investments and transactions. If taxpayers know they will pay less tax in state A than in state B, they will likely favor the state where the tax is lower or where they will benefit from exemptions.

How do Germany, Italy and France deal with tax exemptions? In this presentation, we will study and give you a brief overview of some of the tax exemptions in France, Italy and Germany. We will compare them to show the key differences and determine which are more advantageous.

I. Tax exemptions in France

A. Companies

To start, we will give you examples of tax exemptions applying to companies in France.

First, I will present The Dutreil Pact : it is a mechanism that allows the transmission (as a gift or part of an inheritance) of a family business with a major tax deduction of 75% of the value of the shares of the company.

In France, when you are gifted or inherit an asset, you have to pay a gift or inheritance tax. The rate of this tax depends on what you are being given, and from who you are receiving said asset. By making a Dutreil Pact, the tax will be computed on 25% of the value of the asset, instead of its entire value. Main benefit = this results in the reduction of the inheritance and gift taxes due by the donee.

The Dutreil Pact therefore is a very advantageous tax regime for the recipient of a business. However, there is a very specific procedure that must be followed to be able to benefit from it.

There are different conditions to fulfill to be able to benefit from the Dutreil Pact :

- The company must engage in an industrial, commercial, artisanal or agricultural activity or must be a holding company
- First, the donor must conclude a collective agreement for themselves and their heirs with other partners. They commit to keep at least 17% of the financial rights and 34% of the voting rights for at least 2 years. This agreement must be ongoing at the time of the transmission
- Second, an individual agreement must be concluded at the time of transmission of the shares. Each person receiving shares must commit to keeping the shares they have

received for a minimum of 4 years. The 4 years start being computed at the end of the collective agreement

- One of the partners signing the collective agreement or one of the donee or heir (someone receiving the company) must engage in the company's activity during the collective commitment period and for 3 years following the transmission date. They must work in the company, and this should be their main professional activity, or they must fulfill a managerial role

To summarize = the donor or the donee must commit to holding the shares for a certain amount of time ; they must engage in the company's activity for the duration of the collective commitment period and for 3 years following the transmission date.

If this tax regime is often associated with the donation or inheritance of a business from a parent to their child, there is no condition associated with the relation in between the donor and the donee. The donation can therefore take place between unrelated individuals, and the Dutreil Pact tax reduction will still apply.

On top of the Dutreil Pact, when a parent gifts an item to their child, the child also benefits from a tax allowance of 100 000€, meaning the child won't pay any tax on the first 100 000€ being donated from a parent.

To make this clearer, I will now give you a concrete example of how a Dutreil Pact works.

Example : Mr A wants to give his bakery business worth 1 million euros to his son. According to the inheritance and gift tax rate applicable to a parent gifting an asset to their child (article 777 of Code général des impôts, it is a progressive tax rate), his son would have to pay 212 962€ worth of tax after the exemption of 100 000€ without the Dutreil Pact (the tax is being computed on a tax basis of 900 000€, to which we apply the rate of article 777).

With the benefit of the Dutreil Pact, the tax is being computed on a tax basis of 25% of the value of the bakery, 250 000€. His son will also benefit from the tax allowance (because it is a gift from his dad), meaning the tax basis will be 150 000€. He will therefore only pay 28 194€ in tax.

The effective tax rate therefore went down from 21% to almost 3%.

Later in the presentation, my fellow German and Italian students will tell you about similar tax exonerations in German and Italian Tax Law.

Indeed, all 3 states share the same goal of supporting the continuity of family businesses by lessening the tax burden weighing on the people inheriting from a business.

The specific conditions one must fulfill to benefit from the exemption may differ, but they all share the same goal : to ensure the continuity of the economic activity and the preservation of jobs.

B. Private homes

1. Capital gains on property

a. France

France has a number of tax exemptions for capital gains on property.

One of the best known of these is for principal residences. A capital gain arises when the difference between the sale price of the property and the purchase price is positive.

In France, capital gains are totally exempt if the property is sold as a principal, usual and effective residence, meaning that it is where you spend most of the year, as well as outbuildings that are immediate and necessary, such as a garage, cellar or courtyard.

The same applies to the sale of a property worth less than €15,000, which will be fully exempt.

Beyond the principal residence, it is possible to be exempted depending on the characteristics of the property sold, and the situation of the vendor or the purchaser.

Characteristic of the property sold: when a property is sold if 2 conditions are met. The sale price must be used to buy or build a principal residence within 2 years, and you must not have owned a principal residence in the 4 years preceding the sale. If the re-investment is only the same, then the capital gains exemption will be proportional to the fraction of the price that is re-invested.

Beyond that, there is an exemption from capital gains tax for all properties that have been owned for more than 22 years.

Linked to the seller: these are people who have an old-age pension, who are not resident in France or who live in a home for the elderly or disabled, for example.

This condition applies when you are selling your main residence and you are in a care facility such as a nursing home. The sale must take place within 2 years of entry and the residence must not have been occupied.

Linked to the purchaser: if the property is sold directly or indirectly to an organisation responsible for social housing, or if the property is sold to a private operator who undertakes to build or complete social housing, for example, there will be an exemption.

Not only are there exemptions, but the government has also introduced allowances for length of ownership and exceptional allowances.

Firstly, deductions for length of ownership :

- As can be seen from this table, the allowances start from the 6th year of ownership. The rate of allowance is 6% from the 6th to the 21st year on the basis for income tax and 1.65% on the basis for social security contributions
- In the 22nd year, the allowance is 4% for income tax and 1.6% for social security contributions
- After the 22nd year, there is total exemption from income tax and only a 9% allowance from social security contributions, which will be totally exempt after the 30th year

Lastly, there are exceptional allowances :

- 70% if the purchaser undertakes to demolish the existing building and build a collective dwelling. However, the undertaking to sell must be signed between 1 January 2024 and 31 December 2025, and the property must not be sold to a spouse/partner/ascendant/descendant. In addition, the work must be completed within 4 years

b. Italy

In Italy, the exemption for capital gains on property is not the same.

Firstly, there is a choice of taxation: either the progressive tax scale, thus the ordinary tax system, or the substitute tax at a rate of 26%.

On the other hand, the AF is less favourable as it exempts capital gains on a principal residence completely from tax if it has been held for more than 5 years. This is in contrast to France, where there is no holding period requirement for principal residences.

However, under French law, this condition appears to be more favourable for other assets that are not the principal residence.

One of the main criteria here is the time lapsed since the date of acquisition, since 5 years of acquisition are required to qualify for exemption. There are other circumstances in which capital gains tax can be waived:

- If the owner acquired the property by inheritance
- Or by gift

If the owner has lived in the property for more than half of the time since the date of purchase.

2. Property wealth tax

There are exemptions for property wealth tax.

Property and property rights held directly or indirectly by the tax household on 1 January whose value exceeds €1,300,000 are subject to property wealth tax.

The principal residence is taken into account after an allowance of 30%.

There is a total exemption for business assets, subject to certain conditions, and a partial exemption for woodland and forests, as well as for agricultural landholding groups and shares in forestry groups, subject to certain conditions.

If we focus on the total exemption of business assets. These are units and shares representing property used in an exempt industrial, commercial, craft, agricultural or liberal professional activity. In addition, in order to claim this exemption, the owner of the units or shares, or his or her spouse for example, must carry on his or her main professional activity in the same company. The property or rights must be necessary for the exercise of the profession.

Germany, on the other hand, has not imposed a wealth tax since 1997, nor has Italy.

C. Allowances

We will now present the various tax allowances applicable to gifts between living persons in France. First of all, we'll look at the application of these allowances and the conditions for eligibility.

1. Application of allowance and eligibility conditions

In France, as in a number of other countries, gift tax is linked to inheritance tax. Donations are subject to a tax called free capital transfert tax, which must be paid to the Treasury.

Most gifts benefit from the same tax allowances as inheritance tax. An allowance reduces the basis on which gift tax is calculated. The amount of the allowance depends on the relationship between the donor and the donee. These allowances apply to direct gifts, collateral gifts and gifts to the disabled. There are also other specific allowances, notably for gifts between spouses or PACS partners, and gifts to great-grandchildren.

For donations in the direct line : an allowance of €100,000 is available for donations to ascendants (father/mother) and children.

In collateral lines : an allowance of €15,932 between brothers and sisters and €7,967 for nephews and nieces.

For the disabled : an allowance of €159,325 regardless of relationship, which is added to the personal allowance.

Gifts made by grandparents to their grandchildren (regardless of age) are eligible for a specific allowance of €31,865 per share (art. 790 B CGI). This allowance is personal and global. It applies to each beneficiary grandchild in respect of all gifts made to him or her by each of his or her grandparents.

Donations between spouses or PACS partners are eligible for an allowance of €80,724 (art. 790 CGI). The same applies to gifts between PACS partners, but the allowance is withdrawn if the PACS is dissolved in the year of its conclusion or the following year for a reason other than the marriage of the partners or the death of one of them (art. 790 F CGI).

Lastly, donations made to great-grandchildren are eligible for a special allowance of €5,310 per share (art. 790 A CGI).

These allowances can be applied several times in succession if each gift to the same person is made at least fifteen years after the previous one (instead of ten years previously).

However, in the case of successive donations, it is not possible to waive the benefit of an allowance on the first donation and carry it forward to a subsequent donation made before the expiry of the tax recall period for donations.

It is also possible to make a gift of 31,865 euros every fifteen years, in the form of money and in full ownership, to a child, grandchild, great-grandchild or, if the donor has none, a nephew or niece, or by representation to a grand-nephew or grand-niece (art 790 G CGI). The

beneficiary must be of age or emancipated, and the donor must be under eighty (80). This allowance may be used once every fifteen years between the same donor and the same donee.

2. Payment of gift tax and the different rates applicable

We will now discuss the payment of gift tax and the different rates that apply.

In general, gift tax is payable by the donee. However, current legislation allows the donor to pay them himself instead of the donee, without the amount being added to the value of the donated property. This is an additional advantage.

As for the different rates applicable over and above the allowances provided, they differ, like the allowances, according to the relationship between the donor and the donee.

There are a number of different rates applicable after the corresponding allowances have been applied. Firstly, for direct line transfers, the rates range from 5% to 45%, depending on the bracket in which the taxable amount falls. The same scale applies to married or civil union spouses.

In the case of gifts between brothers and sisters, after applying the tax allowances, a scale is applied according to the taxable amount transferred. Under 24 430 euros, the rate is 35%, and over 45%.

As far as the tax scale is concerned, when you pass on to relatives up to the 4th degree (nephew, niece, uncle, aunt...), the tax rate is 55% after application of the allowance.

And finally, the scale applicable to distant family members, third parties and, above all, cohabiting partners is 60%, with no limit on the amount passed on.

Comparison between the French and Italian systems of tax allowances for donations between living persons :

So, if we look at the three systems of tax relief for gifts between living persons : the 3 countries implement different thresholds for tax relief, the aim is to enable taxpayers to benefit from more advantageous tax treatment when passing on their assets.

As a result, the inheritance tax system varies widely from country to country, as do the tax allowances applicable to donations between living persons. Most countries apply rules favorable to spouses and lineal descendants, in the form of higher exemption thresholds and lower tax rates.

And it's particularly worth noting that, from a tax point of view, gifts are currently particularly attractive in Italy. In fact, tax allowances are much higher for spouses and descendants. Germany is also more attractive than France thanks to the tax allowances granted to spouses, PACS partners, children and grandchildren.

D. Historic monuments

The tax regimes applicable to buildings protected as historic monuments and certified by the heritage foundation :

5 French tax exemption or deduction schemes:

1. Deduction of property expenses relating to historic monuments that do not generate income (income tax)

The aim is to ensure the conservation of the property's heritage.

System: property expenses (e.g. hedge maintenance costs) are deductible from overall income for the year, in full or in part, depending on whether or not the property is open to the public.

This offsets the additional costs incurred by the owners (in return). In addition, this scheme helps to make the region more attractive to tourists.

The tax cost for 2020 is €40m (PLF 2020, Voies et Moyens tome II).

Sources :

- *Article 156-II-1 ter CGI*
- *Annexe III, articles 41 E à 41 J CGI*
- *Annexe IV, articles 17 ter à 17 quinquies A CGI*

2. Unlimited deduction from overall income of property losses incurred by owners of listed historic monuments (income tax)

Property losses arising from listed buildings may be offset against the overall income of the owner of the historic monument up to and including the sixth year.

The following conditions must be met before property expenses can be taken into account:

- Undertaking to retain ownership of the property for at least fifteen years from the date of acquisition
- Direct ownership of the property (with certain exceptions for non-trading companies not subject to corporation tax)
- No joint ownership of the building, unless all or part of the building is classified or listed as a historic monument and at least 75% of its living space is allocated to residential use within two years of the date of division

These tax deductions are the counterpart for the obligations placed on private owners to conserve and enhance their buildings.

State aid is essential to maintain this unique heritage in a good state of conservation and prevent it from being put up for sale.

The tax cost for 2020 is €62m (PLF 2020, Voies et Moyens tome II).

Sources :

- *Article 156-I-3° 1er alinéa CGI*
- *Article 156 bis CGI*

3. Tax relief for expenditure on the restoration of buildings in outstanding heritage sites: new Malraux scheme (income tax)

The 2009 Finance Act reformed the "Malraux" scheme:

- Transforms the system of deducting expenses into a reduction in income tax
- Adjusts the conditions for applying the scheme (capping mechanism)

In outstanding heritage sites, this tax reduction is :

- 22 %
- Increased to 30% where there is an approved conservation and enhancement plan
- 30% for areas covered by the new urban renewal programme

The amount of expenditure giving entitlement to the tax reduction is limited to €400,000.

The Malraux scheme is part of a public policy to develop and redevelop town centres, and has been used to renovate a large number of buildings in protected areas.

This work helps to preserve architectural heritage and contributes to housing policy.

The tax cost in 2020 is €26m (PLF 2020, Voies et Moyens tome II).

Sources : article 199 ter viciés du CGI

4. Registration and stamp duties

Listed buildings, as well as movable and immovable property by destination that constitutes their historical or artistic complement, are exempt from gratuitous transfer duties.

On condition that the heirs, legatees or donees sign an agreement for an indefinite period with the Ministry of Culture, with the approval of the Minister for the Budget, setting out the terms of public access and the conditions for the upkeep of the property concerned.

The aim is to avoid dispersal of the heritage. This system makes it possible to keep in place movable objects and to present to the public movable collections that are related, from a historical and artistic point of view, to the exempted monument.

This scheme encourages private owners to keep protected property in their own hands or those of their families.

Sources :

- *Article 795 A CGI*
- *Annexe III au CGI, article 281 bis CGI*
- *Décret n° 2003-1238 du 17 décembre 2003*

5. VAT

Reduced VAT rate of 10% for improvements, conversions, fittings and maintenance work carried out on residential premises completed more than two years ago.

Application of this rate will depend on whether the premises are used for residential purposes.

Source: article 279-0 bis CGI

II. Tax exemptions in Germany

Companies

The goal of the German legislator excepting companies from inheritance and gift taxation is to protect “family business and companies”. Under certain conditions, business assets of German-based business property are (partially) excluded from inheritance or gift taxation.

If the business is continued for the next 5 years, the majority of the jobs are maintained and not more than half of the relevant business assets are seen as passive assets.

Private Homes

- Residence contents and other movable tangible assets: allowance of up to € 41,000/ € 12,000 (§ 13 Abs. 1 Nr. 1 ErbStG)
- Primary Residence: 100% tax free, if a primary residence is inherited or donated among spouses or inherited by children or grandchildren (sec. 13 para. 1 nr. 4a – 4c)
- Rented residential property: apartments rented out for residential purposes are exempted from inheritance and gift taxation with an allowance of 10 % (10 %, § 13d ErbStG)

Allowances

According to the personal relationship of the deceased/donor and the beneficiary/donee a distinction is made between three tax different categories (sec. 15 ErbStG). The tax rates and the amount of the granted allowances depend on the categories (sec. 19 and sec. 16 ErbStG).

F. ex. spouses and civil partners are in category I and are granted a tax allowance of € 500,000, children of € 400,000 and grandchildren of € 200,000. Other people in category I are granted a tax allowance of € 100,000.

F.ex. siblings, nieces and nephews, grandparents and parents-in-law are in category II and granted a tax allowance of € 20,000. All other people in category II and people in category II are granted tax allowances of € 20,000 as well.

In addition, there are special non-taxable allowances on benefits on inheritance tax for spouses and children.