

ESTATE PLANNING NEWS



The German-American Estate Plan: Special Considerations for German Citizens & Beneficiaries

CONTENTS

Feature Article
Announcements
Tip of the Month
Entertainment

Special considerations are required when planning an estate for German citizens or for the benefit of German beneficiaries.

Different Systems

The legal systems for estate planning in the U.S. and Germany are very different and seemingly incompatible.

1) While German law recognizes the legal representative of an estate, and that representative sees that the decedent's wishes are fulfilled, the representative never holds legal title to estate property. Rather, Germany follows the concept of "universal succession." As of the moment of the decedent's death, title to her property vests immediately in the beneficiary. In the U.S., the representative holds legal title during probate proceedings and files a separate estate income tax return.

(continued on page 3)

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Announcements

Happy Holidays! The Law Office will be closed from December 15 through January 1. If you have any urgent matters, please be sure to contact me at your earliest convenience.

In 2008, publication of this newsletter will switch from monthly to quarterly.



Tip of the Month

When Does a Trust Violate Public Policy?

Settlor created a trust with a no-contest clause. The clause revoked the gift to all 3 of his daughters if any one of them contested the trust. In *Tunstall v. Wells*, a California Appellate Court held that the clause was valid, even though it would punish non-challengers.

Testator's will placed her home in a life estate trust for her husband. Husband could continue to live in the home until he died, but the gift would terminate if he remarried or cohabited with another woman. Husband remarried. However, an Indiana Appellate Court held that the condition was invalid, and husband could continue living in the home until he died.



Entertainment

Stardust (2007)

A young man journeys to a magical world to win the heart of his true love in this charming fantasy based on Neil Gaiman's novel. Tristan (Charlie Cox) has promised Victoria (Sienna Miller) that he'll retrieve a fallen star to secure her love. Along the way, he battles a pirate named Captain Shakespeare (Robert De Niro), an evil witch (Michelle Pfeiffer) and other assorted goblins and ghosts. Peter O'Toole, Claire Danes and Rupert Everett co-star.



Estate Planning News



As we struggle with shopping lists and invitations, compounded by December's bad weather, it is good to be reminded that there are people in our lives who are worth this aggravation, and people to whom we are worth the same.

-- DONALD E. WESTLAKE
American writer & novelist

The German-American Estate Plan

(Continued from page 1)

- 2) Germany's "forced heirship" law requires the distribution of a significant portion of the decedent's properties to certain people, notably his surviving spouse, children, and parents (if he left no children). Under U.S. law, decedents may disinherit natural heirs and choose other beneficiaries.
- 3) Germany has no estate tax. Rather, Germany taxes the beneficiaries. The Federal Constitutional Court recently ruled that Germany's existing inheritance and gift tax law (discussed *infra*) is invalid and must be revised by the end of 2008.
- 4) U.S. estate planning often involves the use of trusts. Trusts are not recognized as legal entities under German law, and German courts have refused to allow the transfer of German real estate into trusts.
- 5) In the U.S., the disposition of a decedent's property is controlled by the state law where the decedent resided. But Germany applies its law based on citizenship. Both countries agree that real estate is governed by its situs (*i.e.*, the law where the land is located).

German Inheritance Taxes

German inheritance taxes generally apply to all assets given by or to a German resident. The applicable tax rate depends on the decedent-beneficiary relationship.

Class I -- the decedent's spouse, (step)children, grandchildren, and parents and ascendants (transfer by death).

Class II -- the decedent's parents and ascendants (transfer by gift), siblings, nephews/nieces, stepparents, sons/daughters/parents-in-law, and exes.

Class III -- all other beneficiaries and transfers to or from trusts.

After exemption amounts ranging from 307,000 Euros for the surviving spouse to 5,200 Euros for Class III beneficiaries, tax rates range from 7% for an inheritance of 52,000 Euros for Class I beneficiaries to 50% for an inheritance of over 25,565,000 Euros for Class III beneficiaries.

Exemptions are reduced to 1,100 Euros if neither the decedent nor the beneficiary reside in Germany.

(continued on page 4)

Estate Planning News

The German-American Estate Plan

(Continued from page 3)

Fortunately, a U.S.-German tax treaty reduces the burden of double taxation. “Domicile” (*i.e.*, where a person lives and intends to stay) determines which system applies. With a few exceptions, property can be taxed only by the domiciliary country. As a key exception, the U.S. also taxes its citizen decedents/donors, and Germany taxes its resident beneficiaries.

Applicable Estate Law

Because it is based on citizenship rather than domicile, German law makes matters more complicated and conflicts may arise.

Conflicts may be avoided when a German citizen who lives in the U.S. and owns only U.S. assets leaves a will distributing his estate to U.S. beneficiaries. However, if the German citizen disinherits his German children, in violation of the forced heirship rules, the disinherited heirs could file a lawsuit. While German courts will not apply forced heirship rules to U.S. real estate, they will split the estate so that U.S. law governs real estate and German law controls other assets. Still, unless the disinherited heirs live in the U.S., it will be challenging to enforce a German judgment in a U.S. court.

Validity of U.S. Wills

Germany recognizes a will if it was valid in the country where the decedent:

- (a) executed the will;
- (b) held citizenship when the will was executed or when she died;
- (c) had his habitual abode when the will was executed or when he died; or
- (d) held real property.

Still, using a U.S. will in a German probate procedure may be complicated. An apostille must authenticate the will, which is then translated into German.

Complications with U.S. Trusts

Although trusts are used to ease the transfer of wealth in the U.S., trusts are not recognized in Germany. The German Supreme Court hinted that it may be possible to reclassify a trust as Treuhand, a fiduciary relationship recognized under German law. Even then, trusts can create higher tax liability. If either the trustee or beneficiary is a German taxpayer, then the trust may also be considered a German taxpayer. German beneficiaries are subject to tax on distributions of trust income and principal, though a small break may be available if the transfer qualifies under Class I or II.

Planning Opportunities

- (1) Give German beneficiaries bequests from the U.S. estate (not the trust).
- (2) U.S. domiciliaries may place their German assets in a U.S. partnership, with the partnership owned by the U.S. trust.

Conclusion

Estate planning for German citizens and beneficiaries can present a challenging task. It is important to have both U.S. and German estate planners who are aware of cross-border issues.

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