

Resubmission: The tax policy discussion in Germany

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Since the federal election campaign in 2013, the revival of the wealth tax/levy and an increase in the top income tax rate have been a fixture in the election programmes of the SPD, Green and Linke parties. During those ten years, CDU/CSU and FDP consistently opposed such tax increase proposals, with the FDP actually in favour of reducing the tax burden. Now the CDU has decided to pursue new tax policy reforms.

Taxes have featured previously in this column - namely after the Sachverständigenrat für Wirtschaft (Expert Panel on the Economy) released its tax policy proposals. At the same time, it is also important to assess this particular foray into tax policy. To start: Tax increases are not required to ensure the financing for the federal government, federal states and municipalities in order to consolidate the new government debt that has accumulated in the most recent crises. Notwithstanding all of the special assets, the national debt ratio remains at 70 percent of GDP and will continue to decline as long as there is no new crisis. This applies both the federal level and (particularly) also to the federal states, which are currently enjoying financing surpluses and which would be entitled to the revenue from a revived wealth tax and inheritance/gift tax. Therefore tax reforms must be assessed with respect to the efficiency of the tax system, the effect on Germany's competitiveness, and the issue of distribution.

The latter is at the centre of the demand for wealth-based taxes, because the distribution of wealth in Germany has become more unequal. Wealth taxes are always a tax on assets and therefore require special justification. Their increased importance in other OECD countries is mainly due to the property tax regimes that exist in those countries. Otherwise, Switzerland and the Netherlands also have wealth taxes. In both countries, they represent a substitute for capital gains taxes. Instead of taxing gains when portions of equity portfolios are sold, both countries impose wealth taxes; instead of taxing actual income from realised gains, they tax the budgeted income, because every wealth tax can be transformed into an income tax with a fixed capital interest. In Germany, capital gains are already subject to a flat tax, so that a wealth tax would create an additional burden. This would lead to significant distortions and would have a negative effect on private investments. Therefore a wealth tax is not a good idea.

The intent is similar when it comes to discussions about inheritance taxes. The exemption rules for business assets, which were introduced in the latest reforms for

this tax, allow for the tax-free or more advantageous transfer of assets to heirs under certain conditions. There are many who think this is unfair. In any case, these requirements increase the administrative requirements for these taxes at the companies themselves. According to the CDU proposal, the exemption rules would be removed and replaced by a 10% flat tax on all inherited asset types, along with generous tax-free amounts and deferral rules. It is an interesting proposal, because it greatly reduces the administrative costs associated with the inheritance tax, and it would probably be acceptable to most of the family-managed companies. At the same time, additional detailed regulations (particularly with regard to deferrals) will be required to prevent liquidity problems from occurring.

The CDU also proposes to integrate the solidarity surcharge into the income tax rate and flatten the so-called Mittelstandsbauch (mid-size sector bulge) in the income tax. The solidarity surcharge was originally designed as a temporary supplementary tax, but it has taken on a quasi-permanent character in the meantime. The proposal takes this into account, without aiming to increase the top burden on incomes (compared to today). However, a much higher top tax rate of over 50% would be required to entirely flatten the mid-size sector bulge. Hence the CDU would have to specify whether it intends to flatten the mid-size sector bulge entirely or only partially, and what the financing would look like on the expense or income side. Finally: While the federal government is entitled to the revenue from the solidarity surcharge, the revenue from income taxes is divided between the federal, state and municipal governments. In view of the current imbalance with regard to the distribution of tax income between the federal government and the state governments, there is no reason to give them an even greater piece of the tax pie. Therefore the states would have to be willing to return turnover tax points to the federal government. Such negotiations promise to be fraught with difficulties.

Sincerely yours



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