Germany: New attempt to impose radical tax reform

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The elevation of Paul Kirchhoff, a flat-tax advocate, into the election team of Christian Democratic Union (CDU) leader Angela Merkel was instrumental in shrinking the 20 percent lead enjoyed by her party and its political partner the Christian Social Union (CSU) in the polls, to a 1 percent advantage over the Social Democratic Party (SPD) in the general election campaign last year. All three parties are currently united in Germany's "grand coalition" government. The introduction of a uniform tax rate for all incomes—irrespective of low or high income—was regarded as so unjust that many conservative voters turned their backs on the union (CDU-CSU) parties. After the election Kirchhof and the flat tax seemed to have disappeared from the scene.

Now big business and the German government are seeking to introduce a radical tax reform which would have similar consequences for incomes and wealth as the flat tax. On February 13 the "Board of Experts for the investigation of overall economic development" submitted a model for a reform of business taxation that had been commissioned by the former SPD-Green party government.

At the heart of the model is a "binary income tax," which envisages substantially less burden for capital incomes than for ordinary incomes. While wages and salaries are to be taxed by a rising sliding tariff of up to 42 percent, a uniform rate of 25 percent will apply to company profits and income from interest and capital returns. At the moment the tax rate for profits and capital returns averages 39 percent.

This substantial cut of around 14 percent would enrich companies and owners of capital by €22 billion annually. It would lead to approximately the same rate of tax relief for big business as the SPD-Green tax reform of 2001. At that time corporation tax (the tax on company income) was lowered from 42 to 25 percent and the highest tax rate for private incomes from 53 to 42 percent. The average total cost to enterprises at that time still lay at over 25 percent, since they also had to pay other taxes such as trade tax. According to this latest proposal this total sum of deductions for companies is not to exceed 25 percent.

A consequence of the SPD-Green tax reform was that many internationally operating major companies in Germany paid no tax at all. The effects of this loss of income for the public purse were devastating. Those paying the price were public service employees and all those dependent on public services and support.

Now the Board of Experts suggests that the additional treasury losses resulting from their new tax plan should be partly compensated by an increase in value added tax of approximately 2 percent. Since the grand coalition has already decided on a VAT rise of 3 percent, this means a total increase of 5 percent. As a result, tax gifts for owners of capital and big business will be financed by consumers, in particular by the poorest layers of society—the unemployed, pensioners and young people—who are currently not taxed because of their low, or total lack of income.

The Board of Experts justifies its proposal as follows: "It has to pay once again for German and domestic investors to earn their income and pay taxes in Germany."

The utter cynicism of this line of argument is evident when one recalls that average incomes have stagnated for the past 10 years in Germany, while income from possessing capital has exploded.

According to a study by the Economics and Sociological Institute (WSI), which has links to the German trade union movement, the net wage ratio (the proportion of wages and salaries as part of gross income) has fallen from 56 percent in 1960 to under 40 percent today. The average tax burden on earned incomes increased during this period from 6 to 18 percent.

In contrast, the proportion of income from company profits and wealth rose over the same period from 24 to 32 percent of gross income, while the tax burden on profits and wealth of private households fell from 20 to 5 percent. Taxes on profits of financial companies fell from 33 percent in 1980 to just 9 percent today.

Now, according to the Board of Experts, this enormous re-division of incomes and wealth is to be continued and deepened.

The "economic wise men," as the Board of Experts is also known, would like to establish conditions similar to those in the low-tax countries of Eastern Europe. They boast that the implementation of their proposals will result in Germany being the fourth-most favorable location for American companies in Europe (after Slovakia, Italy and Poland) and third-most favorable location in Europe for British enterprise.

German Finance Minister Peer Steinbrück (SPD) wants time to assess the proposals of the experts and is preparing his own tax reform for July of this year, which is then to come into force in the year 2008, according to the post-election coalition agreement. One can assume he will adopt many of the proposals made by the Board of Experts.

Steinbrück is a close friend of former economics minister Wolfgang Clement (SPD), who commissioned the latest report and has agitated for a binary income tax system for some time. According to a report in the *Süddeutsche Zeitung*, there is also "considerable sympathy for this approach" within the German Finance Department.