Redistribution from the bottom to the top

German parliament cuts corporate taxes

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Two weeks ago, the German Bundestag (parliament) voted for massive cuts to corporate taxes, with the support of all the government parties: the Christian Democratic Union (CDU)/Christian Social Union (CSU) and the Social Democratic Party (SPD). The cuts, which are due to come into effect next year, will effectively hand over at least €8 billion per year to German corporations.

Significantly, just a few days after the vote, the finance ministry announced that it had collected billions of extra euros in revenue from the increased value-added tax, which rose from 16 to 19 percent at the start of this year. The policy of the German government could not be clearer: tax cuts for companies are being financed by the general population. Take from below and give it to the top.

From 2008, the company tax rate on retained earnings will fall to just under 30 percent, down from the current 38.6 percent. Tax on non-retained earnings will fall to just 15 percent from the current 25 percent. In 1998, when the SPD-Green Party coalition entered federal government, these rates were 40 percent and 30 percent, respectively. In other words, the most important levels of company taxation have been more or less halved within 10 years.

Tax rates for partnership companies will also be slashed. Retained earnings will be taxed at a flat rate of 28 percent. At present, their earnings are taxed according to a progressive tax scale from 15 to 42 percent. This means a huge windfall for those partnerships that record high earnings and profits.

The introduction of a new compensation tax will replace existing taxes on investment income. Interest, dividends and private profits from the sale of shares will also be taxed at a flat rate of 25 percent from 2009. These forms of income are also currently taxed according to a sliding scale, meaning that high profits from the sale of shares attract the highest rate of 42 percent.

These huge tax cuts were not enough, however, to satisfy the appetites of corporations. German industry “insistently” warned the German government of endangering Germany as a research centre. The tax bill (which has yet to be passed by Germany’s upper house of parliament, the Bundesrat) also includes measures to increase taxes for companies that have operations, patents and licences outside of Germany. “If this occurs, no one will invest in German research any more,” threatened a tax expert from Siemens, Werner Stuffer, at a meeting of the Federation of German Industries (BDI) two weeks ago. The tax manager from BASF made similar remarks.

The day before the BDI meeting, German Chancellor Angela Merkel (CDU) had already announced changes to the draft legislation in order to avoid damaging research in Germany.

Economic Minister Michael Glos (CSU) in turn criticised the bill for disadvantaging smaller companies and made a point of having his objection noted in the minutes of the cabinet meeting that approved the legislation. CDU/CSU parliamentary fraction leader Michael Meister told the *Financial Times Deutschland*: “In the course of the bill’s passage through parliament, we want to see what we can do to assist medium-sized companies.”

When the intention to reform company taxation was announced last year, Finance Minister Peer Steinbrück (SPD) calculated that the measures would reduce federal government income by €5 billion per year until 2010. This figure has since proven to be anything but accurate. According to the calculations of the Quantification Group, comprised of tax representatives from federal, state and local governments, the income tax loss in the first year would be €8 billion. The loss for each of the subsequent two years would be just under €7 billion. It would only be in 2011 that the tax gift to companies would reduce federal income tax receipts by €5 billion.

According to other estimates, the revenue loss would be even greater. Tax expert professor Lorenz Jarass computes revenue lost due to the tax cuts to be in the order of at least €10 billion per year.

Whichever figure is correct, one thing is certain: companies are being handed billions of euros by the federal government. Recent announcements by the finance ministry itself on the state of current tax revenues show exactly how this corporate tax gift is to be funded: from the taxes paid by the masses of ordinary working people.

At the beginning of last week, Steinbrück’s ministry announced that in February 2007, €5 billion more (16.7 percent) was received in tax revenue than for the same month in 2006. In January 2007, the government received 13 percent more in tax revenue than in January 2006. According to current estimates, the increase in income for the entire year will be more than €15 billion above what was originally estimated.

The biggest source of tax revenue for the government, the value-added tax, is proving especially fruitful for the government. At the start of 2007, the federal government increased this tax from 16 to 19 percent. In February 2007, the income from value-added tax increased by nearly 23 percent to €16.6 billion compared to February 2006. Income tax from wages and salary earners is the second biggest source of government income. Last month, it contributed almost €10 billion to tax coffers.

According to Steinbrück, value-added tax revenue will increase by €20 billion this year compared to last year. The corporate tax cuts will mean that approximately half of this will then be handed over to businesses.

There was a reason why, after the federal elections in 2005, the SPD wanted to retain the most important ministries of finance, health, employment and social security. This allowed the SPD to continue the policies it had implemented during its previous seven years in government in coalition with the Green Party. In 2001, Steinbrück's predecessor Hans Eichel (SPD) introduced the so-called "century reform," which implemented the largest reduction in taxes for the rich and companies since the founding of the federal republic after World War II.

Then, as now, the SPD justifies the tax cuts on the basis of increasing the international competitiveness of German companies, which would then, as the argument goes, increase investment and create more jobs.

"Our firms will therefore remain internationally competitive," explained Steinbrück shortly before he introduced the current tax cuts. "Apart from that, Germany as a business location will be more interesting for new investors." Steinbrück said that in the United Kingdom, France, and above all the eastern European countries, corporate taxes are far lower than in Germany. In order to allow German companies to remain competitive against those in neighbouring countries (which are often the subsidiaries of the same German companies), Steinbrück argues that taxes must be lowered.

In reality, company and investment tax rates in Germany, while nominally just above some other countries, are actually below the international average. According to a study by the EU Commission in 2006, the rate of taxation actually paid for the 2003 calendar year in Germany was 17.4 percent. In comparison, the rate for the other 15 "old" EU member states was 20.2 percent. The rate for all EU countries, including the new eastern European "low-tax states," was 17.7 percent.

According to the calculations of Lorenz Jarass, only 16 percent of company profits are currently being collected in taxes, not even half the nominal rate.

Ninety percent of all German small businesses are currently paying less than 30 percent tax. Three quarters of them are paying less than 15 percent. German taxation laws can be summed up by the following rule: the bigger the company, the lower the tax it pays.

In 2001, the SPD-Green coalition government introduced generous rules to allow companies to offset profits through previous losses and therefore not pay any tax at all. Instead of a reduction of government tax receipts of €8 billion (the government's estimate), these rules resulted in a total reduction of more than €20 billion. In 2001, the government even had to pay €400 million back to companies.

Large companies have made record profits every year thereafter. Typically, announcements of record profits are followed shortly after by announcements of mass sackings, in an attempt to satisfy the unquenchable thirst of shareholders and dividend recipients.

According to the finance ministry, the various cuts to company taxes since 1998 have resulted in an average yearly decrease in tax receipts of €11 billion. However, this figure does not include the aforementioned catastrophic cut in company income tax from 2001.

Mass unemployment continues to afflict German society, with more than 4 million people unemployed. The so-called turn in the employment market, which has seen a reduction in the official numbers of unemployed, is not as rosy as the picture painted by the Department of Employment and the federal government. Although the number of unemployed is almost a million less than the figure of one year ago, the number of persons employed increased by just 550,000. This means that many jobless persons have simply been struck from the statistics.

If one looks at the half million new jobs, the picture is even more gloomy. Half of these new jobs are temporary positions, where wages are lower and workers can be instantly dismissed without complications.

During its two terms in office, the SPD-Green government concentrated on employment reforms (enacted through the series of Hartz laws), above all to create a cheap labour sector. Last year, approximately 700,000 people had to work for "one-euro jobs"—a creation of the SPD-Green government whereby the long-term unemployed receiving benefits are forced to work at jobs provided by the state paying just one euro per hour.

During the first two months of this year, 128,000 people had to accept these jobs, 22 percent more than in the same period last year.

At the end of 2006, the number of workers in Germany engaged in "mini-jobs"—temporary and part-time positions with a maximum wage of €400 per month—was 6.3 million. Although this number has remained constant in the recent period, the number of workers working in private homes has risen dramatically. In December 2006, they numbered 131,000, 20 percent more than in the previous year—the return of the housemaid!

When Steinbrück justifies the plunging of taxes based on international competition, he is only telling half the story. The federal government is not only a victim of international competition, but also a driving force. Its plans to further reduce company taxes will only lead to a heating up of "tax dumping": other countries will use the same argumentation to lower their company tax rates, and, when its turn comes again, the German government will use this once more to justify yet another round of corporate tax cuts.