

Tax Administration and Federalism: The Case of Germany

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Structure

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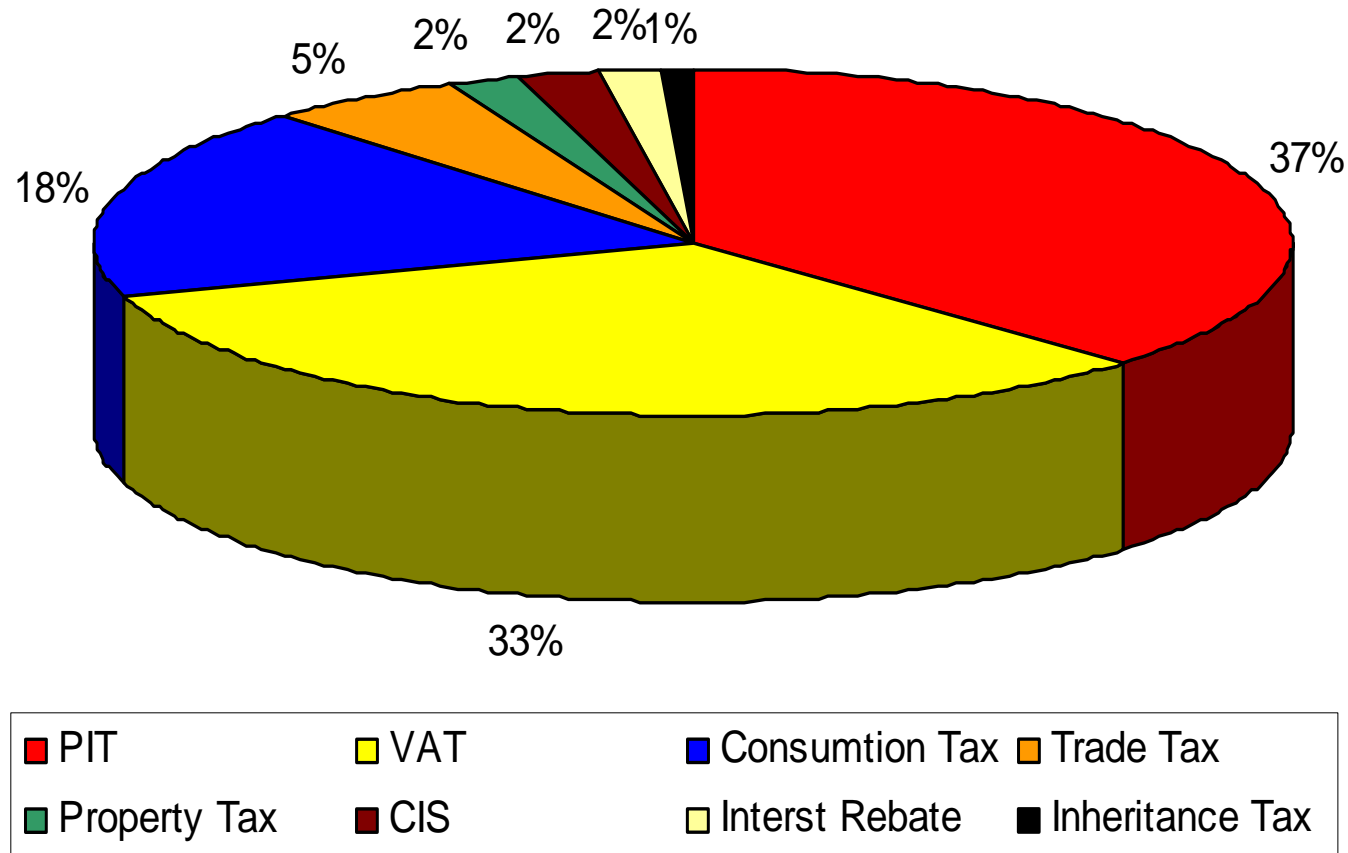
Introduction

Germany:

- is a federal state with a three-level administrative structure:
 - the national government is located in the capital Berlin and the former capital Bonn,
 - 16 Bundesländer (federal states),
 - and 13,897 municipalities.
- tax revenues are distributed among the individual regional administrative bodies.

Introduction

In the fiscal year of 2003 the „Big Eight” generated a tax yield of €420 billion



Introduction

	Central Government	Federal States	Communities
Consumption tax	100 %		
Inheritance tax		100 %	
Property tax			100%
Personal Income tax	42,5 %	42,5 %	15%
Value Added tax	51,4 %	46,5 %	2,1 %
Corporate Income tax	50 %	50 %	
Interest rebate	44 %	44 %	12 %
Trade tax	14,8 %	7,7 %	77,5 %

Introduction

Structure of the tax administration of the central government

Ministry of Finance
(Bundesministerium der Finanzen)

Federal Agency of
Financial Services

(Bundesamt für
Finanzdienst-
Leistungen)

Federal Agency for
the monopoly of spirits

(Bundesmonopol-
verwaltung
für Branntwein)

Federal
Tax Agency

(Bundesamt
für Finanzen)

Federal Debt
Administration
Agency

(Bundes-
schulden-
Verwaltung)

Federal Customs
Office for
Criminal
Investigation

(Zoll-
Kriminalamt)

Regional Tax Office
(Oberfinanzdirektion)

Local Customs Office
(Hauptzollamt)

Introduction

Structure of the tax administration in the federal states

Ministry of Finance in the
respective Federal State
(Länderfinanzministerium)

Regional Tax Office
(Oberfinanzdirektion)

Local Tax Office
(Finanzämter)

Introduction

Companies and freelancers have to pay a tax prepayment, which is based on the tax yield of the preceding year.

- **monthly**
 - Value Added tax
 - Taxes on wages
- **quarterly**
 - Corporate Income tax
 - Trade Tax
 - Personal Income tax

Introduction

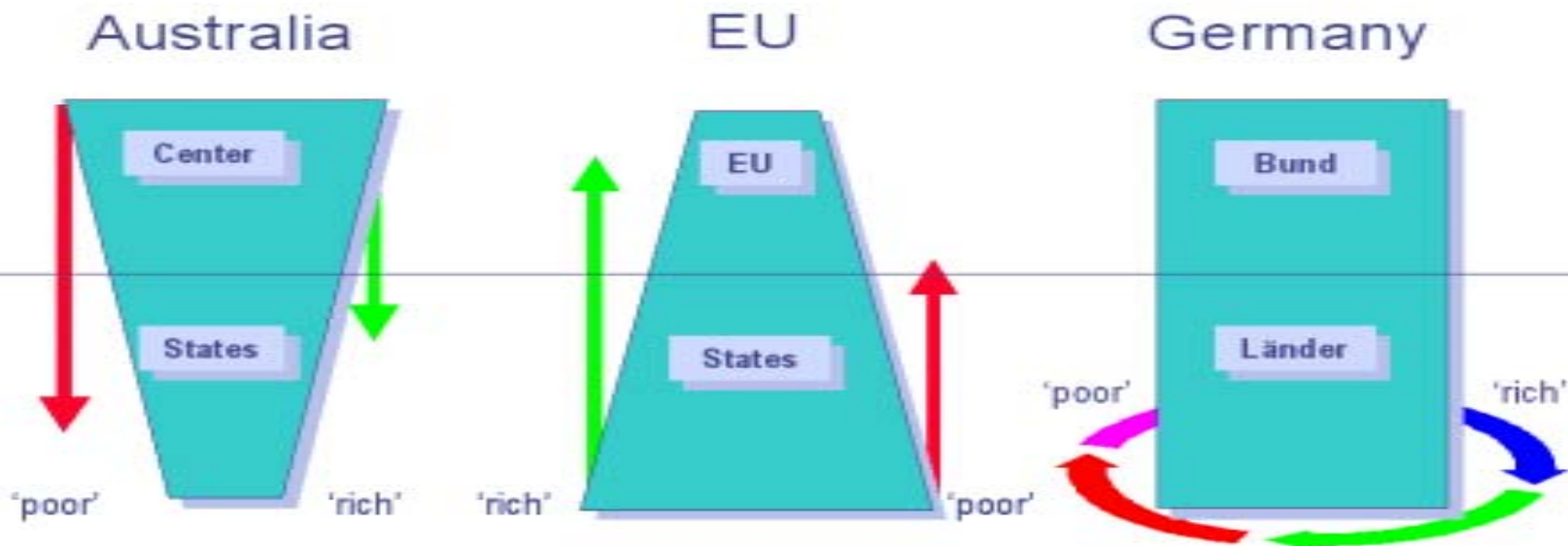
Audit Probability in the German States in 1999

	p_L
North Rhine-Westphalia	4.4731515
Bavaria	3.7885001
Baden-Wuerttemberg	4.1519066
Mecklenburg-Western Pomerania	5.4771242

Note: The audit probability has been defined as the number of tax clerks per 1000 taxpayers.

Models of horizontal equalization:

Approaches to regional equalization



The fiscal equalization among the federal states

- The distribution of corporate income tax and personal income tax
- The distribution of value added tax
- The fiscal distribution among the federal states (narrow definition)
- The distribution of the vertical grants

The distribution of the CIT and the PIT

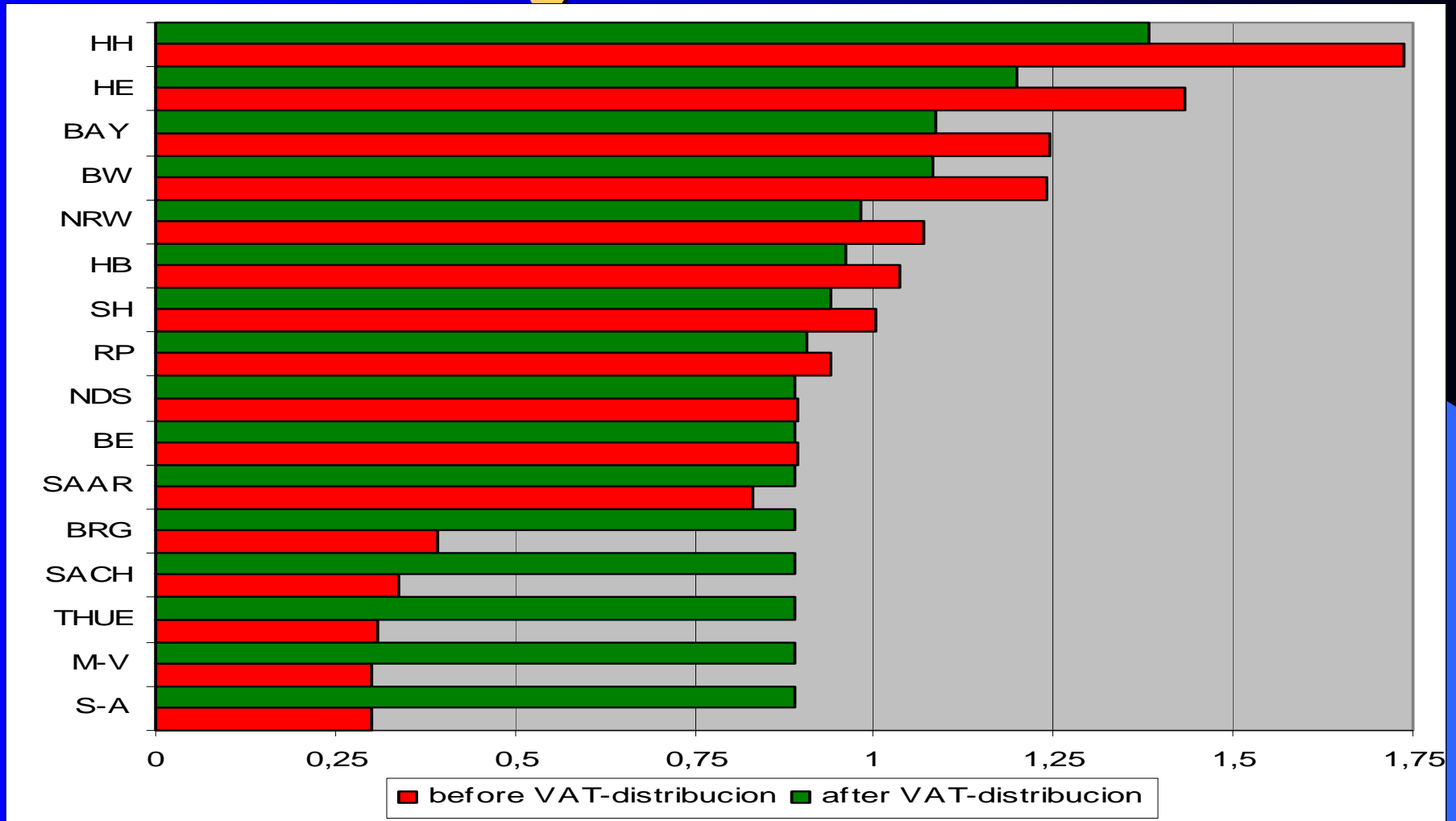
- **Corporate income tax (CIT):**
 - **operational facility principle**

- **Personal income tax (PIT):**
 - **place of residence principle**

The distribution of the VAT

- The horizontal apportionment of the states' VAT share by region follows basically the size of the population (for 75 percent of the share).
- The remaining 25% is distributed as an additional percentage to the financially weak states. This financial redistribution has gained enormous significance.

The equalizing effect of VAT assignment in 2001



Source: own illustration based on data from www.laenderfinanzausgleich.com

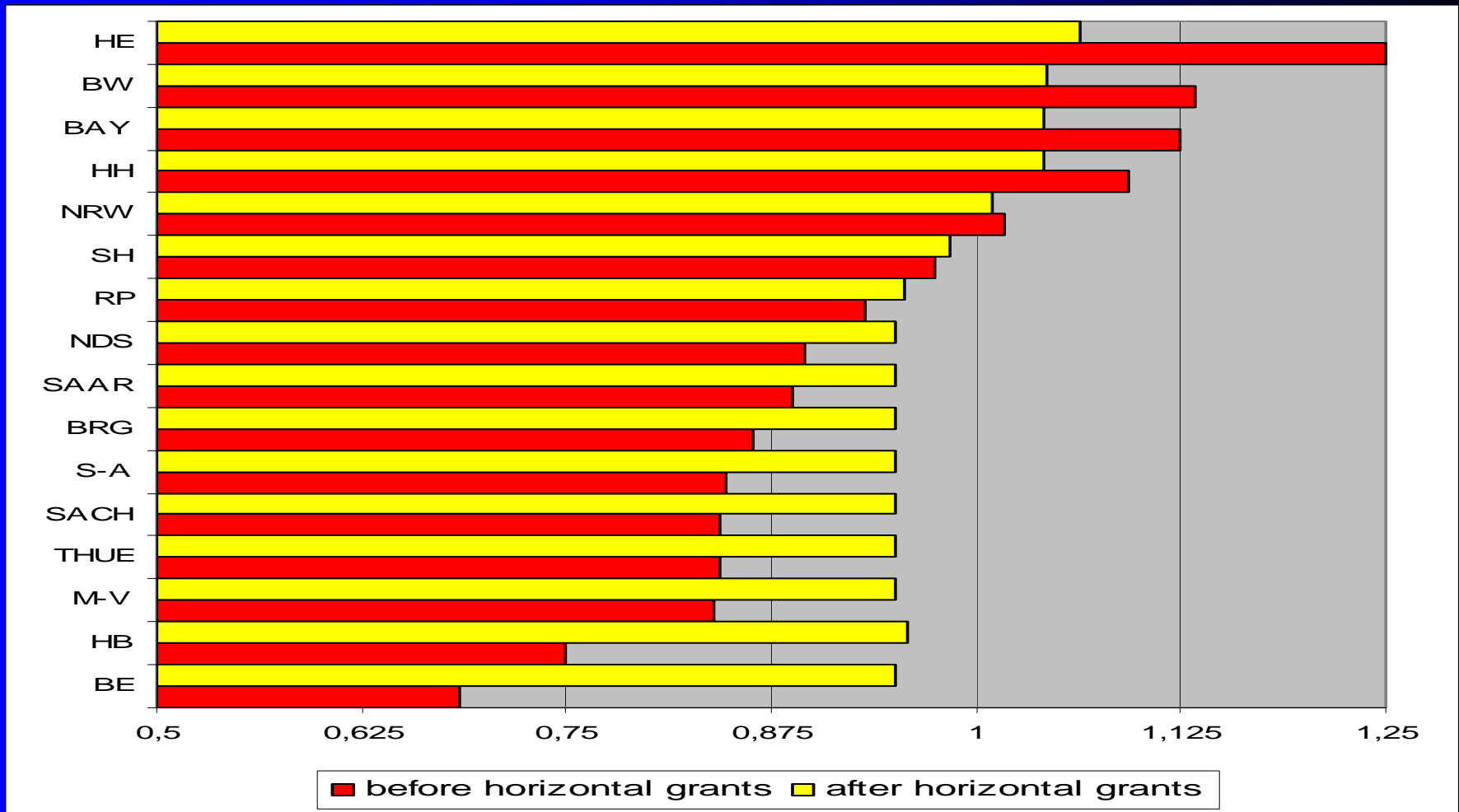
The fiscal distribution among the federal states (narrow definition)

- The scheme equalizes tax capacities, *not* „needs“ or „cost differentials“.
- It is found in a standardized “equalization yardstick” for the state’s fiscal capacity (basically a national average per capita multiplied by the population).
- The procedure comprises a bias in favour of city-states whose populations are weighted by a factor of 1.35.
- Moreover, there are some elements to alleviate supposed „special burdens“ (e.g. for harbours).

The fiscal distribution among the federal states (narrow definition)

- The equalization yardstick is compared with the effective financial situation of each state, and the gap is equalized according to a formula.
- States below the average receive compensation. This compensation is borne, in progressive steps, by the states above the average.
- The tariff of the redistribution scheme reflects the degree of interregional solidarity among states. It is extremely progressive.

The equalizing effect of the horizontal grants in 2001

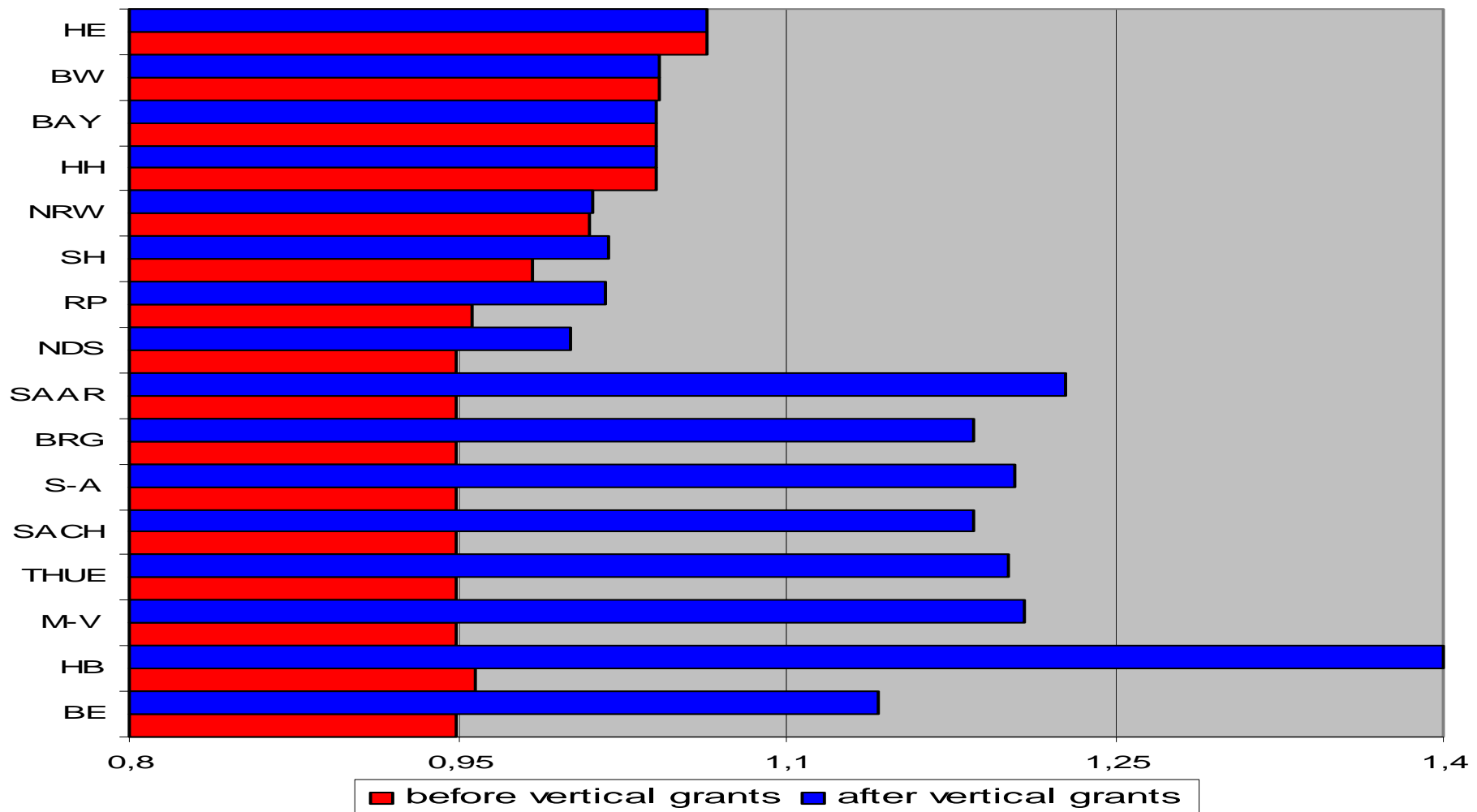


Source: own illustration based on data from www.laenderfinanzausgleich.com

The distribution of the vertical grants

- Moreover, there are asymmetrical vertical grants: so-called „supplementary grants“.
- States receiving such grants are considered “weak in the provision of services”.
- In particular, factual “gap-filling grants” are used to guarantee at least 99.5 percent of the average fiscal ability for all states.
- 9 out of 16 federal states receive grants to relieve their costs of “political management”.
- All Eastern states and some Western peers receive federal grants for “special burdens”.

The equalizing effect of the vertical grants in 2001

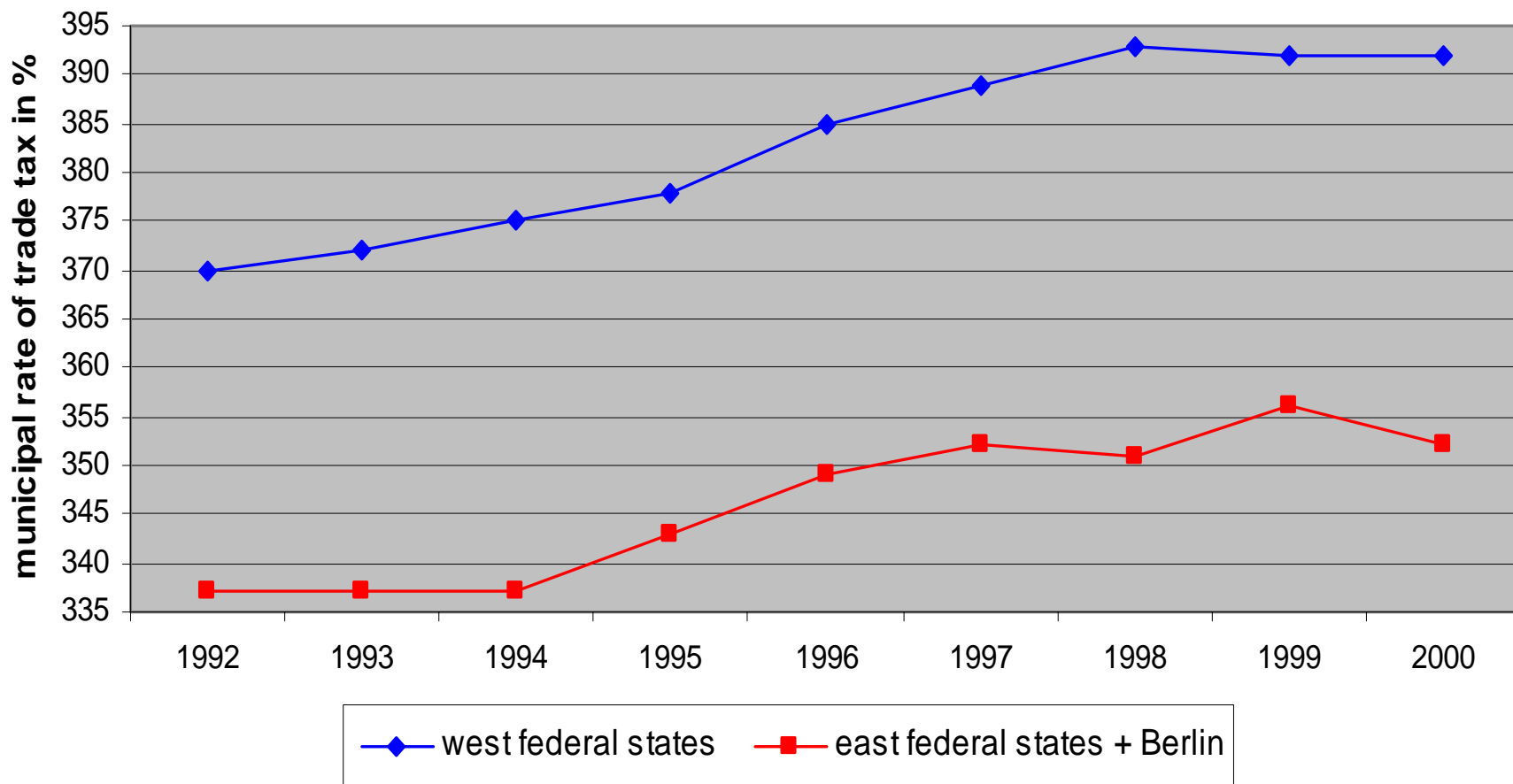


Source: own illustration based on data from www.laenderfinanzausgleich.com

The Trade Tax – Gewerbesteuer

- All German businesses are subject to the trade tax. However, freelance work is exempted from this tax.
- Originally, the German trade tax used to have three tax assessment bases: the payroll tax, the trading capital and the trading profit.
- Today only the trading profit is taxed.
- The trading profit is multiplied by:
 - a central factor (3%-5%) and
 - the local tax rates (0%-490%).

The Trade Tax – Gewerbesteuer



Source: BMF, 2002b, page 14

The Trade Tax – Gewerbesteuer

Local rates in % in 2002	Cities with more than 500,000 inhabitants	in %
410-429	3	25%
430-449	0	0%
450-469	4	33.3%
470-489	3	25%
490-510	2	11.7%

Source: IFST, 2002, page 40, 63-68

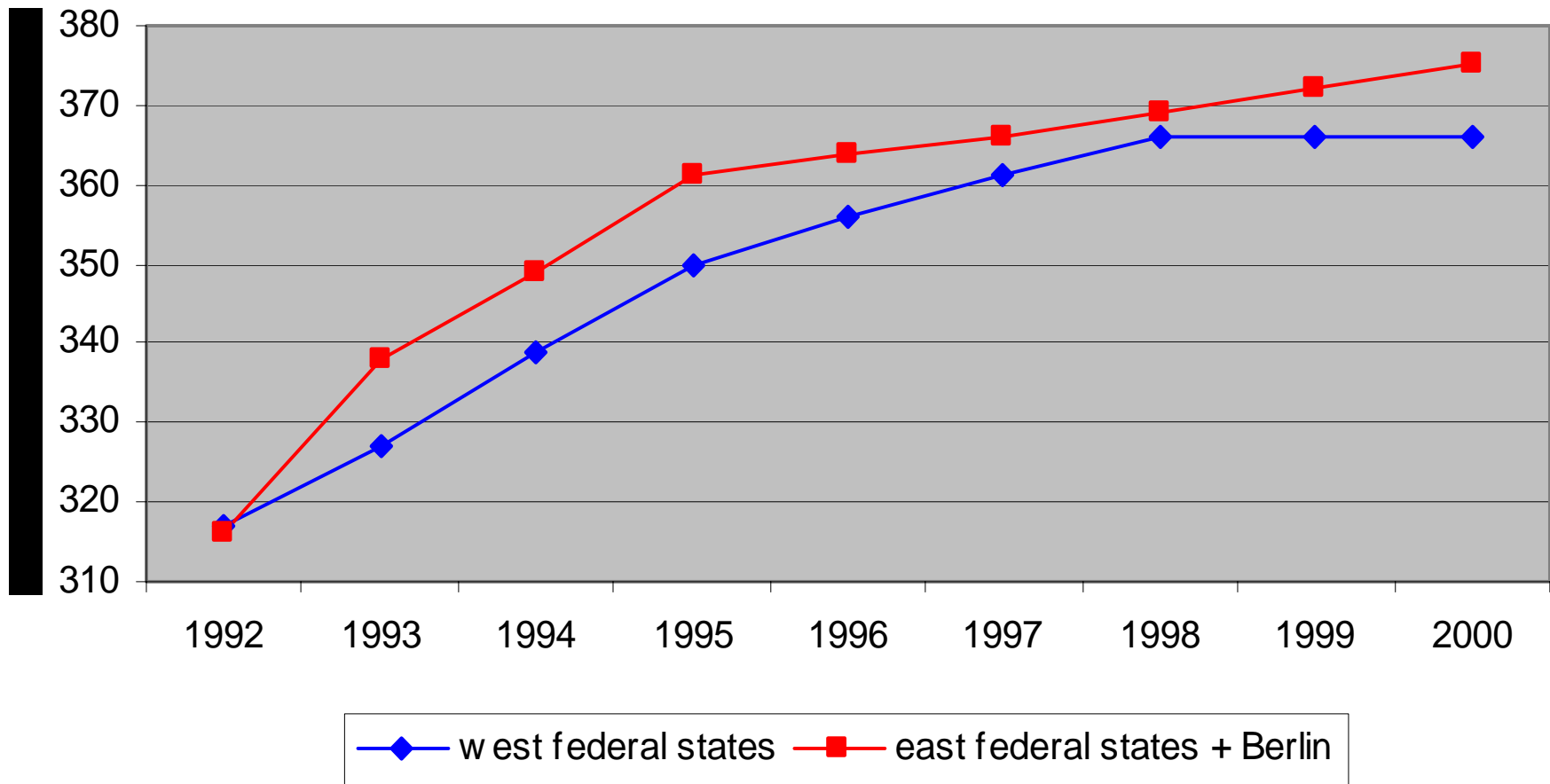
The Trade Tax – Gewerbesteuer

- Based on the operational facility principle.
- A small level of tax competition between local authorities exists only in densely populated areas between the core cities and the surrounding municipalities.
- But only the small Nordic township of Norderfriedrichskoog can afford to levy a zero tax rate on the trade tax as well as on the real property tax. But this small township is truly an exemption.

The Property Tax – Grundsteuer A und B

- Property used for agriculture or forestry is subject to real property tax A, while all other properties are subject to property tax B.
- Publicly-owned real property is not taxed.
- Similar to the trade tax, under the real property tax system the value of the property is multiplied by a tax assessment figure, which is determined by the central government.
- This tax assessment figure is then multiplied by the municipal tax rate.

The Property Tax – Grundsteuer A und B



The Property Tax – Grundsteuer A und B

- The tax assessment – similar to the trade tax - is sent by the local authorities to the taxpayer.
- In the case of disagreements, the taxpayer has to consult the local tax office and not the local authority.
- The local authority does not have to pay the administration costs for the trade tax and the property tax.
 - Same negative impact to reduce the tax clerks as in the relation between the central government and the federal states.

Conclusion

- **The German fiscal equalization among the federal states has to be reformed. The „Solidarpakt II“ is meant to be only the beginning of the reform.**
- **The trade tax also has to be reformed. Otherwise the municipalities are not able to reanimate the economy by local infrastructure investments.**
- **As a result, Germany's Fiscal Federalism will continue to remain in a constant state of flux.**

Thanks for your attention!



Agradecimentos para sua atenção!