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State or private, redistribution or growth

Who will be the winners according to the parties' tax proposals?

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Between 2010 and 2016, the German government's tax revenues went up by one-third to EUR 706 bn. On the face of it, Germany is a low-tax country, with a tax-to-GDP rate of 22.9% (2015) that compares favourably with the UK (26.4%) and France (28.6%), but not with the US (20.2%). The picture is misleading, however, because the German welfare state is largely funded by additional taxes. The overall tax burden on German citizens is higher than the OECD average.

The tax structure in Germany is unfavourable. Over the past six years, the proportion of tax revenue accounted for by direct taxes has gone up 5.5 pps to nearly 54%. This trend is likely to continue. High taxes on salaries, wages and entrepreneurial activity are having a negative impact on economic growth.

It would therefore appear to make sense to flatten the steep trajectory of rising marginal income tax rates for people in the mid-range earnings bracket. Since 2005, the proportion of individuals in Germany who pay tax at the top rate of 42% has more than doubled to reach 6.4%, or 2.69 million people.

Germany's political parties are pledging to reform income tax to appeal to median voters and their core support. All parties are campaigning for a flattening of progressive taxation to lessen the burden on low and middle earners. However, the Social Democrats (SPD), the Greens and, in particular, the Left are looking to fund this by imposing higher tax rates on higher incomes.

Reform proposals motivated by the idea of income redistribution should consider the risk that excessive tax rates for the top bracket could affect growth and employment. This is particularly relevant as amongst the income tax payers there are 2.6 million undertakings in the legal form of sole traders and partnerships.

The solidarity surcharge, which was designed to finance the costs of reunification and is worth some EUR 17.6 bn to the German government in 2017, is obsolete. The major parties would like to see it abolished. The CDU wants to do so in small steps, the SPD envisages initially removing it only for people on low and middle incomes, and the Liberals (FDP) are looking to get rid of it completely by 2019.

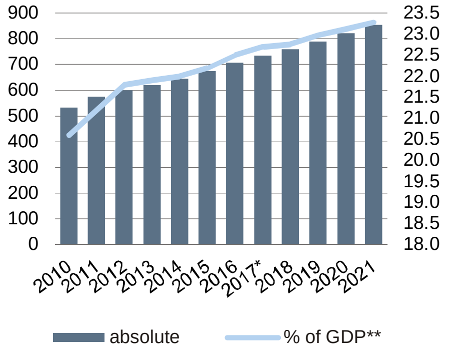
The parties are at least reviewing the flat rate withholding tax of 25% on income from capital gains. But a return to taxation based on individual circumstances, i.e. a re-integration into the income tax scheme, would pose difficult questions regarding the treatment of dividends and create a huge amount of red tape.

When it comes to wealth and inheritance tax, the election manifestos offer few surprises. The CDU/CSU and the FDP reject any change to the status quo; the Greens and the Left see opportunities for greater fiscal intervention.

Overall, the amount by which the burden on taxpayers would be eased varies across the parties. For the SPD, the figure would be in the single-digit billions of euros. The CDU/CSU proposals come in at around EUR 17 billion annually. The FDP wants to go even further and cut taxes by at least EUR 30 billion.

Continued increase in tax revenue* 1

EUR bn (left scale), % of GDP (right scale)

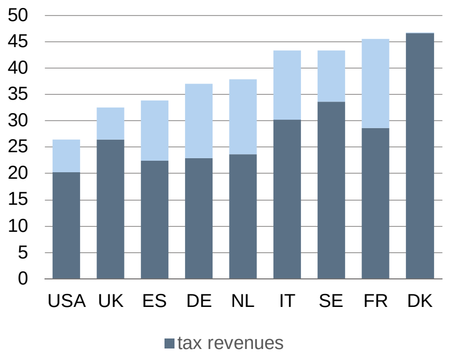


* From 2017 onwards data from the latest official tax estimates,
** according to the definition in the finance statistics

Source: BMF

Total tax-to-GDP-ratios in selected OECD countries 2

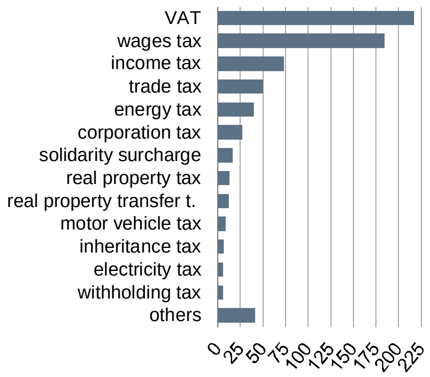
2015, % of GDP



Sources: OECD, Deutsche Bank Research

Government receips from selected taxes 3

2016, EUR bn



Source: BMF

More and more of people's income is going to the state

Tax revenue in Germany keeps rising. Over the past six years, it has gone up an average of 4.9% annually and 33% overall. In 2016, the federal government, the federal states (Bundesländer) and local authorities and the EU collected a total of EUR 705.8 billion in taxes in Germany. And this trend will only continue if the government fails to intervene. According to official estimates, annual tax receipts will increase by an average of 3.8% a year to reach EUR 852 bn by 2021, and growth in economic output is not expected to keep pace. In 2010, the tax ratio (according to government finance statistics) was 20.6% of GDP; last year it was 22.2%, and by 2021 it could have risen by another 1.1 percentage points. But that's only half the story. Social security contributions are also rising sharply. Based on the tax-to-GDP ratio of 23.3% in 2016 (according to the national accounts), the tax and contribution ratio for that year stood at 38.9% compared with 36.6% in 2010.

Tax rate relatively low but overall tax burden high

Individuals in Germany pay more tax overall than the average in the OECD countries (2015: 34.3%; effective tax rate in Germany as defined by the OECD: 36.9%). In particular, the US (26.4%) and Switzerland (27.9%) had much lower effective tax rates in 2015. By contrast, the tax burden is far higher in Germany's northern neighbours in Europe (Denmark: 46.6%; Sweden: 43.3%). However, if only the income tax rate is taken into account, Germany actually has a below-average tax-to-GDP ratio, despite the recent increase. This is because of the differences in how the welfare state is funded. In Germany, unlike in Scandinavia, it is funded mainly by social security contributions.

Tax structure unfavourable

The main factor in the increase in overall tax receipts is rising income tax revenue, i.e. from the tax on wages and salaries and the tax on other income, which have gone up 44.5% and two-thirds, respectively, since 2010. This reflects the encouraging upward trend in employment, rising wages and salaries, and the effect of progressive taxation. Revenue from the solidarity surcharge, which is levied on individual income tax payments and on corporate taxes, has increased just as sharply (up 44%). The amount of the corporate tax has more than doubled (128%) over the same period, albeit from a relatively low level due to the economy and the financial crisis.

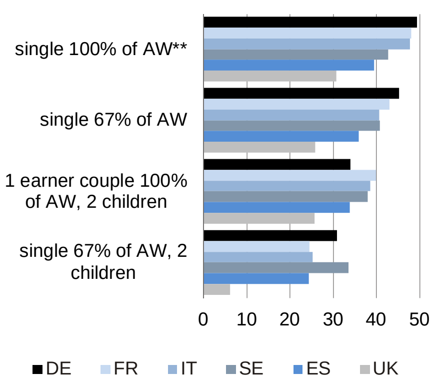
Since 2010, the proportion of all tax revenue attributable to direct taxes has gone up 5.5 percentage points to nearly 54%. If conditions are unchanged, this trend will continue. This is problematic because these taxes tend to have a negative impact on economic growth.[1] Although the tax ratio is below the EU28 average (2015: 26.6% of GDP), the overall level of direct taxation does appear excessive in comparison with other EU countries (2015: EU28 49.6%; EU19: 50%). This is partly because social security contributions in Germany have the same effect as direct taxes and are comparatively high.

Broad tax wedge for average earners

Microeconomic indicators offer a much clearer picture of the shortcomings of the tax system with respect to its impact on economic growth. Germany has one of

[1] Zipfel, Frank and Caroline Heinrichs (2012). The impact of tax systems on economic growth in Europe. An overview. Deutsche Bank Research. EU Monitor European integration. Oct.12, 2012.

Huge tax wedge in Germany* 4



* Net amount of taxes paid as percentage of labour cost,
** average wage

Source: OECD

the highest tax wedges between gross and net earnings. The German government takes a bigger cut of the earnings of childless singles than all other developed countries except Belgium. This applies both to average earners, who receive barely over half the money paid by their employer (tax wedge of 49.43%) and to people on low incomes. Despite the relatively generous children's allowance (*Kindergeld*), single parents, particularly those on below-average incomes, are relatively highly taxed. This reflects the relatively high tax burden that social security contributions place on low earners. However, because of the benefits of Germany's spousal tax splitting model, the tax wedge for a couple with a sole earner and a children is lower than in many comparable countries. In only a handful of countries would the proportional tax burden be so low for this scenario (0.7% of labour costs in Germany), while the overall burden is near average (33%).

From the employer's perspective, the broad wedge between gross and net pay drives up labour costs. This theoretically holds back employment – particularly in sectors where direct taxes are a relatively major factor. It also demotivates the workforce. And the income splitting method for married couples removes the incentive for married women to find employment, particularly in full-time roles.

Adjustments to income tax needed

Particular problems result from Germany's progressive income tax scale.[2] Above the basic personal tax allowance (2017: EUR 8,820 p.a.), there are two sharp increases in the marginal tax rate – the first is from 14% to 24%, the second from 24% to 42%. This top rate currently applies to incomes above EUR 54,058, which is equivalent to only 1.6 times the average annual earnings of an employee in Germany. A large number of people therefore fall into this top tax bracket. In 2017, according to the Federal Ministry of Finance, this would be 2.69 million people, or 6.4% of Germany's 42 million taxpayers.[3] Back in 2005, less than half as many people (1.23 million) came under this tax band. Around 101,000 taxpayers are liable for the so-called wealth tax, i.e. the very highest rate of 45%. In addition, the reunification surcharge of 5.5% is imposed on the tax payable in all the aforementioned tax bands, meaning the top rates are effectively 44.31% and 47.48%, respectively.

Wage development in Germany 5

%, yoy

Source: Federal Statistical Office

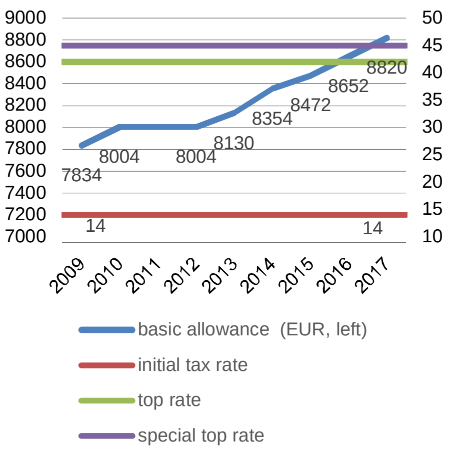
The fact that more and more people are moving into the higher tax bands because of pay rises is particularly problematic if these rises are only at the level of inflation. Hourly standard wages have gone up 25% since 2005 (15% since 2010). However, consumer prices have risen 16% since 2005 (7.4% since 2010). This means that inflation has taken up almost two-thirds of negotiated pay increases. However, it has only been in recent years that adjustments to the tax allowance and tax scale have been made to offset bracket creep, or what the Germans call 'cold progression', which occurs when pay rises only reflect inflation but push their recipients into a higher tax band. The ifo Institute of Economic Research estimates that since 2010 bracket creep has resulted in around EUR 70 billion in additional tax receipts, almost half of which is

2 This can be broken down as follows. No tax is paid on the first EUR 8,820 of annual income. For families, this tax allowance increases by EUR 7,356 for each child. (Alternatively, the German government will pay monthly child benefit of EUR 192 for each of the first and second children, EUR 198 for the third child, and EUR 223 for any further children.) The initial marginal rate for the lower tax bracket, which begins at EUR 8,821, is 14%. Marginal tax rates then increase relatively sharply, up to a taxable income of EUR 13,769. This is where the higher progressive tax bracket begins, which ends at EUR 54,057. In this bracket, marginal tax rates increase at a slightly less pronounced rate from 24% to 42%. High incomes of EUR 256,304 and above are taxable at the special top rate of 45%.

3 The 2.69 million people who have to pay tax at this rate include 1.65 million single people and around 1.04 million jointly assessed spouses.

Modifications of the income tax scale in the past eight years 6

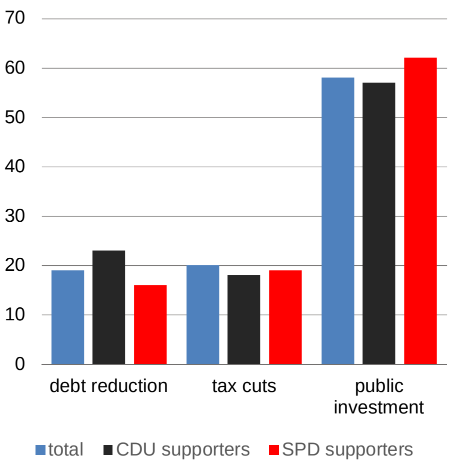
EUR (left scale), % (right scale)



Source: BMF

How the government should use additional tax revenues 7

Percentage of those asked, %



Sources: Infratest dimap: ARD Deutschland Trend, July '17

attributable to bracket creep in the narrower sense of the term.[4] However, we would think that the state should not benefit from inflation by collecting an unwarranted amount of tax revenue. Subjecting increasingly more people at average incomes to relatively high marginal tax rates is also questionable because it removes the incentive to earn more, thus hindering growth, and seems unfair.

This is all an argument for substantial income tax reforms. Flattening the steep progression of tax rates in the middle-income range would strengthen the factors that drive economic growth.

The solidarity surcharge, which is levied on income tax and corporate tax, should also be changed. It was introduced in 1991 as a temporary measure to finance the costs of reunifying Germany. Despite these intentions, however, it kept being extended and is still being imposed today. In 2016, it brought in nearly EUR 16.9 billion for the German government. The Federal Ministry of Finance expects this to rise to EUR 20 billion by 2020.

Substantial changes to the solidarity surcharge and, even more so, to the tax scale would result in substantial losses in tax revenue. Nevertheless, the fact that income tax receipts are rising so steeply and will likely continue to do so without intervention suggests that there is room for manoeuvre. However, the potentially short-term conflict between the objectives of a more growth-oriented, liberal tax policy and higher tax revenues must ultimately be resolved politically. A recent survey into how the government uses additional tax receipts revealed that tax cuts were not generally considered to be a high priority (only 20% of respondents were in favour of tax cuts, whereas 58% wanted to see more state investment and 19% wanted debts to be reduced; Infratest dimap: ARD Deutschland Trend, July). Interestingly, these preferences largely concur with the views of business. When the biggest family companies in Germany were asked which issues the next German government should focus on, they called for greater investment in education and infrastructure but not for tax cuts.[5]

Germany is not a low-tax country when it comes to investment income

The taxation of companies and of investment income also needs to be looked at. It is an important parameter in the international market for capital and investment. Countries that take a smaller cut of businesses' profits tend to have a competitive advantage in this respect, even if private investment decisions depend on many other factors (supply of public goods, including in particular a clear and consistent legal framework). Making comparisons is admittedly difficult here, particularly as dividend earnings can be taxed at different points (before being distributed by a company, after being received by shareholders or both). Corporate structures also vary from country to country in terms of factors affecting the way they are taxed.

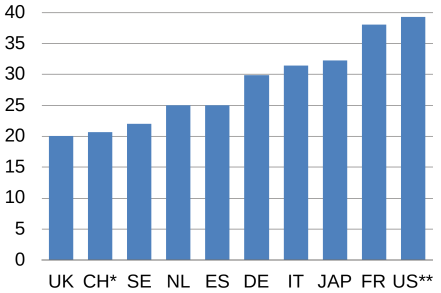
OECD data (as at 2015) suggests that Germany is a low-tax country when it comes to taxation of corporate earnings (4.7% of tax revenue or 1.7% of GDP, compared with 8.3% and 2.2% in the US and 10.9% and 3% in Switzerland).

[4] Dorn, Florian et al (2016). Heimliche Steuererhöhungen – Belastungswirkungen der Kalten Progression und Entlastungswirkungen eines Einkommensteuertarifs auf Rädern. [Hidden tax increases - the extra tax burden of the bracket creep and the expected impact of income tax rates "on wheels" on tax reliefs.] Ifo research report no. 76. According to this, bracket creep is currently bringing in just over EUR 20 bn in additional tax receipts every year, of which EUR 6.7 bn is attributable to bracket creep in the narrower sense of the term.

[5] Deutsche Bank and Federation of German Industries (ed.) (2017). Die größten Familienunternehmen in Deutschland. Unternehmensbefragung 2017. Digitalisierung. [Survey on the biggest family companies in Germany. Focus on digitalisation.] Conducted by the Institute for SME Research, Bonn.

Business taxes 2016: Germany near the average 8

Burden on corporation earnings according to the tax scale, %

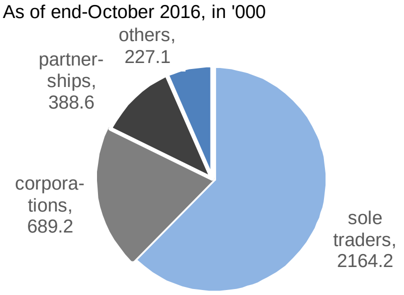


* Zurich, ** New York

Source: BMF

German businesses by legal structure 9

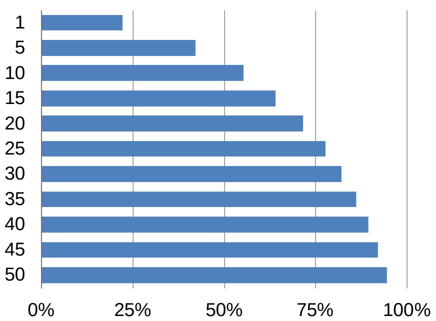
As of end-October 2016, in '000



Source: Federal statistical office

How much different taxpayer brackets contribute to the income tax revenue 10

Upper .. % of the taxpayers (left scale) paid ... % (vertical scale) of the revenue in 2016, %



Source: BMF

However, the data is somewhat skewed because it does not include Germany's sole traders and partnerships, which make up a significant part of the economy, that are subject to income tax rather than corporation tax. It also excludes personal income tax on dividend income. Factoring in these taxes, business-related taxes make up 23% of total tax revenues or 5.2% of GDP. If real estate transfer tax and inheritance tax are added, the ratios rise to nearly 28% and 6.2%, respectively. Based on (gross) tax receipts from corporate and investment income of around EUR 741 billion in 2016, the average tax burden is 26.4%. (In the US, following the same method of calculation, the average amount of tax paid on investment income stood at 23% in 2015.) Using a similar method to work out the tax paid on wages and salaries as a proportion of total wage costs yields a ratio of 12.3%, although this does not include social security contributions. Given these figures, it would be a mistake to classify Germany as a low-tax country for capital and investment income.

Germany is also more in the middle internationally when it comes to corporate tax rates. Key competitors, particularly the US, impose higher rates on profits. However, it is no secret that the Republican Party and the US government are striving to change this.

Redistribution of income & wealth via taxation should not go too far

Tax policy also touches on questions of income and wealth distribution. It is therefore one of the core issues in this and previous German elections – the SPD, in particular, has a slogan that explicitly calls for "more social justice".

In terms of taxation, the concept of fairness – at least according to the traditional German understanding – is enshrined in the ability-to-pay principle, in which those with the broadest shoulders carry the greatest burden. Although this principle is implicitly recognised in a progressive income tax scale, it cannot provide any precise specifications for how such a tax scale should be structured. Politicians must decide on the tax rates.

When setting tax rates, the government should consider the trade-off between the broader desire for greater redistribution of income and wealth[6] and the aforementioned negative impact of excessive taxation on economic growth and employment. This is particularly the case when income tax essentially functions as corporate tax, which is the situation for 2.55 million sole traders and partnerships (as of October 2016).

It should also be borne in mind that income tax in Germany is already being used to a large extent to redistribute wealth. The top quartile of taxpayers pay more than three-quarters (77.5%) of all tax. The top 10% account for over half of total tax revenue (55.3%). The lower half, meanwhile, contribute only 5.5% of this tax.

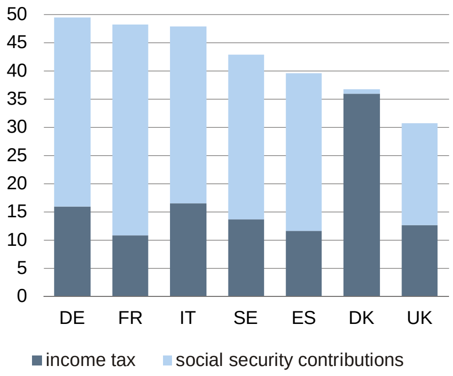
The counterargument is that households with medium and low incomes are relatively highly burdened by social security contributions and VAT. Analysis by the RWI - Leibniz Institute for Economic Research reveals that the tax system taken as a whole is not progressive. According to its research, the effective tax rate on gross earnings for people earning EUR 40,000 and above remains virtually constant at 45%. This is partly because there are income thresholds above which no further social security contributions are levied and partly because the amount of VAT paid by higher-income households is relatively low compared with their overall budget.

However, one could argue that it would make little sense to have a progressive scale for social security contributions or to remove the upper income thresholds. For the state pension, in particular, social security contributions are used to

[6] Support for this falls, however, when the reality of it leading to higher taxes is made clear.

Various mixes of income taxes levied & social security contributions in the EU 11

Income tax paid and social security contributions as percentage of total labour costs*, 2016, %



* Childless single with an average wage

Source: OECD

establish future entitlements that then also have to be funded. What is needed instead is a forward-looking social policy that would provide more sustainability with respect to the funding of the public pension scheme and the health care system without making the contributions too onerous.[7]

Greater differentiation in VAT, which is regularly proposed by various parties, could also be problematic. It might entail, for example, a reduction in the discounted rate for food from its current level of 7% to 5%.[8] Experience has shown that further differentiation of tax rates causes difficulties with regards to definitions and increases the administrative burden. Such a system would likely have only limited effectiveness. Although the regressive impact of VAT would be lessened, the recipients of higher incomes would also benefit from the lower rate.

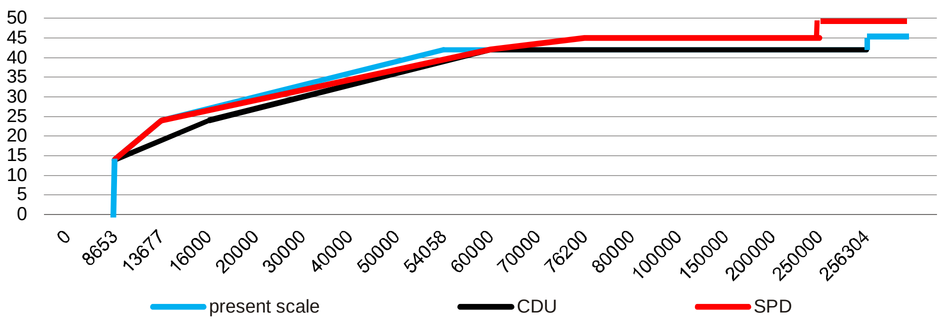
In terms of income redistribution, a key task of fiscal policy is to ease the burden on medium and low earners. But simply imposing additional taxes on higher earners is not the best answer from either a relative or international comparison.

As the election battle heats up, the parties are looking to tax policies to appeal to both median voters and their core support

Tax policy usually plays an important role in German election campaigns, and this year is no different. The parties are focusing mainly on income tax, which affects the vast majority, to win over their target voters. In this respect, the political contest offers few surprises. In line with the median voter theorem, the mainstream parties in particular are promising to ease the burden on the middle class and middle-income earners. Both the CDU and SPD are proposing that the 42% higher rate income tax will kick in at EUR 60,000 of taxable income instead of today's EUR 54,058. The CDU/CSU also intend to flatten the steep rate of progression in the lower bracket.[9] According to figures from the Bavarian Ministry of Finance, this measure (along with others, see below) would mean that in 2021 a single person earning within this bracket would be better off by roughly EUR 873, or 6.5%, compared with 2018.

Major parties' proposals for a reform of the income tax scale* (marginal tax rates only**) 12

As percentage of taxable income, 2017



* Without proposed modifications of the basic allowance (CDU) ** the initial tax rate (14%) is applied to a taxable income of EUR 8,821, the 24% marginal rate to EUR 13,769 and the two top rates (42% and 45%) from EUR 54,058 and 256,304 onwards

Sources: BMF, Lohn-info.de

7 S. Bräuninger, Dieter (2017). Parties not focusing enough on sustainability. Deutsche Bank Research Germany Monitor – German Federal Election 2017.

8 Zipfel, Frank (2009). Mehrwertsteuer, ermäßigter Satz und Befreiungen. Darf es ein bisschen mehr sein. [VAT, reduced rate and exemptions. Can it be a little more.] Deutsche Bank Research. Aktuelle Themen 462.

9 According to press reports, the tax rate of 24% will kick in at EUR 16,625 instead of today's EUR 13,769 (2018: EUR 13,996).

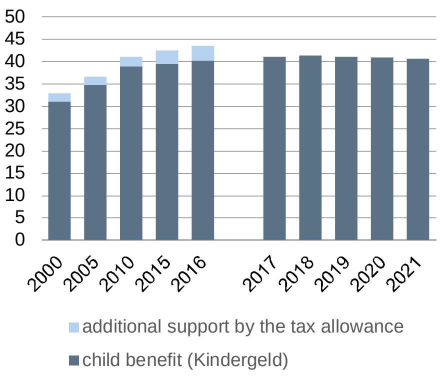
The liberal FDP party is targeting substantial tax relief measures to compensate for bracket creep and incentivise people to earn more. It wants to shift the scale to the right so that each of the marginal tax rates kicks in at a higher income. It also wants to flatten the steep increase in marginal tax rates in the lower and medium brackets. However, the party has so far made no mention of what these new tax rates or income thresholds might be.

All the parties on the left of the political spectrum want low earners to pay as little tax as possible. The liberals, in particular, but also the conservatives have also set their sights on taxpayers with higher incomes, especially those who are sole traders or in partnerships. The SPD, the Greens and, to a much greater degree, the Left are looking to compensate for the reduction in the tax rate for lower and medium incomes, proposed by each party, by imposing higher tax rates in some of the upper ranges. The SPD is calling for both of the top tax rates to increase by 3 percentage points and, linked to this, for a third progression zone.[10] Figures from the Frankfurter Allgemeine Zeitung newspaper (June 25, 2017) reveal that this would benefit single people and childless married people earning between EUR 102,000 and 187,000. The Left even wants to ramp up the top tax rate from 45% to 60% and take 75% of income above EUR 1 million. The Greens are calling for a higher basic tax allowance to relieve the burden on low and medium earners, financing this by raising the tax rate for single people earning above EUR 100,000.

Family taxation: departure from the traditional income splitting model?

Amount of family support by means of the income tax scheme 13

EUR bn



* From 2017 onwards according to official estimates, data on the fiscal impact of the child allowance are not available

Source: BMF

As well as low and medium earners, the parties' proposals are also focused on families. There is an overlap in target audience here, with all the mainstream parties looking to support children from families with low and medium incomes. For the Left, the Greens and, to an extent, the SPD, such families would be the only ones to benefit from the changes, whereas families on higher incomes would be left in a worse position when it comes to child support.

The CDU/CSU intend to raise the tax-free child allowance in two stages to the level of the adult tax-free allowance, i.e. by around 20% from its current level, and to raise the child benefit accordingly. However, for the next legislative period, the party is promising to take only the first step, namely a EUR 25, or 13%, increase in child benefit and a higher tax-free allowance to match.[11] The FDP wants to merge child-benefit measures into a single package (*Kindergeld 2.0*). This would comprise a basic payment (not related to income), an income-contingent payment, and credits, for example to fund memberships of sports clubs or music academies.

The Greens are presenting similar ideas (for future marriages/civil partnerships). However, the party intends to taper all child benefits for higher-earning parents. In contrast to a widespread traditional interpretation of the current tax regime's guiding principle, namely that having children reduces parents' earning power and thus the ability to pay taxes, the amount of support given to people bringing up children would in theory no longer depend on income. Granting a 'child bonus' is one of the ways in which the SPD wants to particularly support families and single parents on low incomes. This would take the form of a tax-deductible amount of EUR 150 per child and parent.[12] Higher-income families would

[10] Linear increase from 42% to 45% in the earnings bracket between EUR 60,000 and EUR 76,200. The wealth tax would then kick in at EUR 250,000 (currently EUR 256,304) with a steep increase in the marginal tax rate to 48% (currently 45%)

[11] The CDU/CSU are looking to take the second step when the economic situation allows it, but no later than the subsequent legislative period.

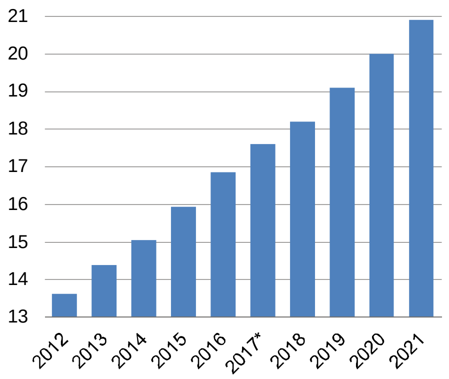
[12] People who pay no or only minimal income tax will be paid the bonus directly by the tax office together with their child benefit (max. EUR 170 per month).

therefore see no benefit from the bonus, compared to the current situation. Also, existing married people would be entitled to the bonus only if they switch to the new family taxation system, in which the benefits of the spousal tax splitting model are limited. The idea is for the new model to apply for any couples that marry in future and be optional for existing married couples.

The Greens and the Left in particular, but also the SPD, want to either change the traditional spousal tax splitting model or eventually abolish it completely. They believe it is important to eliminate the (as they see it) unwarranted tax advantages enjoyed by people in childless marriages/civil partnerships with one higher earner, and to provide greater incentives for married women to work full time. Because the SPD foresees constitutional problems in abolishing the model completely, it is proposing that the amount of income that an individual can transfer to their partner under the tax splitting model be limited to EUR 20,000.

Revenue from the solidarity surcharge 14

EUR bn



* From 2017 onwards according to official estimates

Source: BMF

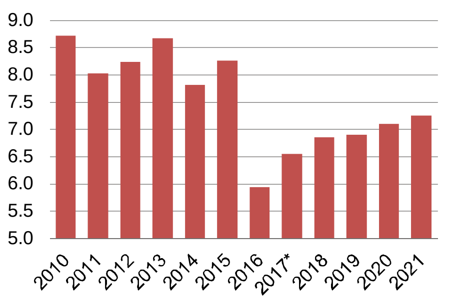
Varying timescales for phasing out the solidarity surcharge

All the mainstream parties, with the exception of the Left, the Greens and the right-wing populist AfD, are in favour of abolishing the solidarity surcharge. The FDP is the most resolute on this and intends to scrap the tax by the end of 2019. The CDU/CSU have said that they want to phase out the tax as quickly as possible from 2020. However, the plans reduce the overall receipts from the solidarity surcharge by only EUR 4 bn in total in the two years 2020 and 2021 (from a total of EUR 41 bn), which would be just a small step in this direction. The first stage of the SPD's proposal would result in a higher reduction, by EUR 10 bn, also beginning in 2020, but under their plans the solidarity surcharge would initially be scrapped only for people earning below EUR 52,000.

Flat-rate withholding tax under review at least

Revenue from the withholding tax 15

EUR bn



* From 2017 onwards according to official estimates

Source: BMF

Equity and fairness are high on the agenda in this election campaign. The Left, the Greens and the SPD are calling for the flat-rate withholding tax of 25% to be abolished and for a return to the system in which people were taxed individually on their investment income (interest, dividends and capital gains). The CDU/CSU are also essentially in favour of this. They point out that the tax environment in the EU has changed to such an extent due to the increased speed of data transfer that a preferential treatment of investment income is no longer really necessary. According to the CDU/CSU, however, replacing the flat-rate withholding tax on after-tax investment income by the income tax must not put investors at a disadvantage.

The proposals are problematic because of the latter risk. Three-quarters of investment income derives from dividends, i.e. earnings on which a company has already paid tax. Tax rates above 25% are likely to come up against constitutional limits. In addition, experience has shown that there is a significant administrative cost to shifting the responsibility for tax assessment back to the tax authorities, both for the authorities themselves and for the financial service providers.

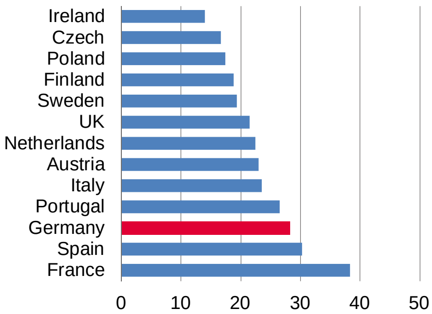
The CDU/CSU and the SPD have included the introduction of a financial transaction tax in their manifestos (based on an EU policy decision within a group of member states), whereas the FDP explicitly rejects such a tax.

Corporate taxation as a means of bolstering research and combating tax avoidance

For the mainstream parties, with the exception of the FDP, corporate taxation is not a major issue. Their manifestos contain only a few aspects related to this area. The parties are largely advocating an increase in support of R&D, although such promises are of course more difficult to keep in practice. For example, the issue of how research spending is defined for accounting purposes would need to be clarified. This is not a trivial matter, particularly as the proportion of R&D spending attributable to staff costs varies greatly between industries. Various parties also want to relax depreciation rules for small businesses and start-ups.

Average of effective corporate tax rate 16

in %, selected countries, 2016



Sources: ZEW, Deutsche Bank Research

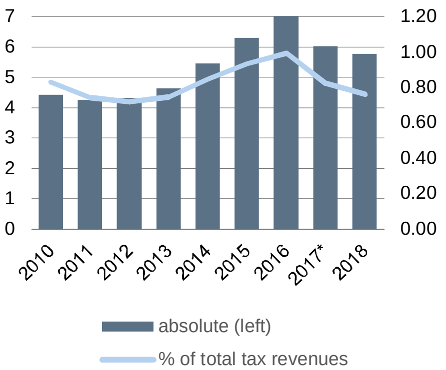
There are proposals to stop companies avoiding tax by transferring profits abroad. In this respect, the CDU/CSU can point to the OECD/G20 Base Erosion and Profit Shifting (BEPS) project, which was co-founded by Germany's Finance Minister Wolfgang Schäuble. As part of their close alliance, Germany and France recently announced that by the end of 2017 they will publish a joint position on how they will be driving forward the harmonisation of their tax regimes based on a European Commission proposal.[13] The effective tax burden, which factors in the different tax-related parameters, is currently nearly 10 percentage points higher in France than in Germany (ZEW, Centre for European Economic Research 2016).

The FDP, in particular, is calling for an improved tax framework for companies. For example, it wants depreciation allowances to be increased, especially for digital capital assets. Improvements for start-ups and venture capital financing are other areas of focus.

Conflicting positions with regard to wealth and inheritance tax

Revenue from the inheritance tax 17

EUR bn (left scale), % of total tax revenues (right scale)



* From 2017 onwards according to official estimates

Source: BMF

The manifestos are simply repeating familiar positions when it comes to inheritance tax and the (re-)introduction of a wealth tax. The CDU/CSU and FDP reject the latter. For the Left, however, this is a key demand, and the Greens are campaigning for an additional tax on "the super-rich" that is constitutional, profitable and actionable. The parties have taken similar positions with regard to inheritance tax. The CDU/CSU and FDP are against any increases to this. Meanwhile, the SPD, the Greens and, in particular, the Left are calling for changes that would impose a higher level of taxation on large estates, but without defining more narrowly what 'large' means.

Substantial differences in the overall tax burden

Overall, the amount by which the burden on taxpayers would be eased varies greatly across the proposals. For the SPD, the figure would be in the single-digit billions of euros. Although the party wants to cut taxes for low and middle earners by a total of EUR 15 billion, a significant slice of this results from the proposed return to parity in the amount of employee and employer contribution to Germany's public healthcare scheme. Although working households would be better off by a total of over EUR 6 bn initially, the companies that employ the workers would have to pay correspondingly higher contributions. Also, phasing out the solidarity surcharge for certain groups would result in much higher revenue shortfalls (beginning at EUR 5 billion p.a.). The income tax reform itself reduced the total by only a few billion euros. This is in line with the SPD's fiscal policy priorities, namely to primarily increase investment in public infrastructure.

According to its own estimates, the CDU/CSU's proposed tax cuts come in at around EUR 17 billion plus EUR 2 billion in research support for business. The Union parties are probably not going any further because they are also targeting higher infrastructure spending as well as a reduction in public-sector debt.

[13] Franco-German Ministerial Council, July 13, 2017.

The liberal FDP party is championing much more substantial tax cuts but also tighter restrictions on state activities. It believes its tax cut of at least EUR 30 billion to be "an appropriate target". This would be equivalent to 3.7% of anticipated tax revenue in 2020 (3.5% in 2021).

Given Germany's strong economy and its relatively favourable public finances, we believe it is likely that the governing coalition parties will largely be willing and able to implement their planned tax reforms in the new legislative period. This would be in contrast to previous election campaigns, for example in 2005.

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