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INCOME TAXES IN GERMAN TAX LAW: A SYSTEMATIC ANALYSIS

Introduction

Income taxes constitute a central component of German tax law and at the same time represent a significant source of revenue for the state. They are linked to the generation of income or profit and thus differ from other types of taxes (e.g. transaction and wealth taxes). Income taxes are designed to tax the natural and legal persons' economic ability to pay and have a substantial impact on the economic decisions of taxpayers.

The aim of this paper is to present the income taxes in German tax law in terms of their fundamental structures and to classify them systematically. To this end, the general principles of income taxation are first explained. This is followed черешнюкby an outline of income tax, corporate income tax and trade tax, each focusing on their essential features. Finally, the interaction between the individual income taxes is examined to illustrate their interdependencies and their significance for the overall tax burden.

Fundamentals of German Income Taxes

The German system of income taxation is fundamentally composed of individual income tax, corporate income tax and trade tax, which are closely interrelated both substantively and systematically. Despite their common objective, these taxes differ with regard to their legal design, tax base and burden effects. At the same time, they interact closely in tax practice, frequently resulting in an overall tax burden for taxpayers that can only be properly assessed by taking all relevant income taxes into account. A systematic understanding of income taxes therefore requires both an isolated examination of the types of income taxes and an analysis of their interaction [1].

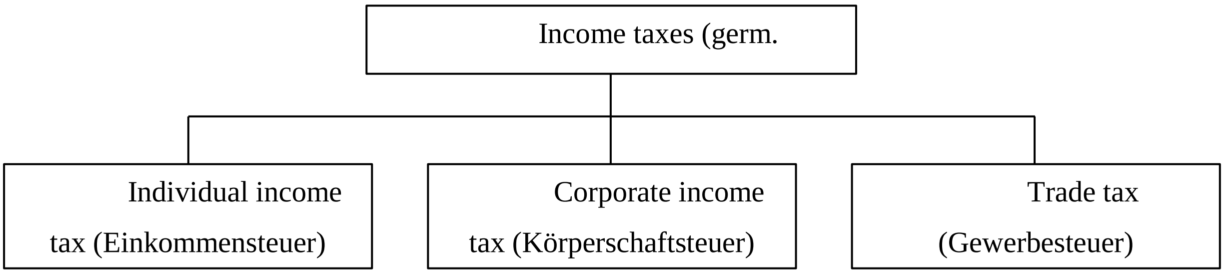

Figure 1. Types of income taxes

A defining characteristic of income taxes is that they are generally based on the periodically generated economic result of a taxpayer. What is decisive in this context is the income earned or the profit generated during the relevant assessment period. Income tax applies to the income of natural persons, while corporate income tax applies to the income of legal persons. Trade tax, by contrast, is an object-based tax that is levied on the operation of a business as such.

Income taxes are firmly embedded in the German tax system and are levied on the basis of federal statutory provisions. From a constitutional perspective, they are primarily shaped by the ability-to-pay principle, derived from the principle of equality under Article 3(1) of the German Basic Law, according to which tax burdens should reflect individual economic capacity [3].

Individual Income Tax

Individual income tax is the central income tax applicable to natural persons under German tax law. It taxes the income earned during the assessment period and is based on the taxpayer’s ability to pay. The legal basis for individual income tax is the Income Tax Act (Einkommensteuergesetz, EStG).

Natural persons who have their residence or habitual abode in Germany are subject to unlimited income tax liability. In this case, taxation generally extends to all income earned by the taxpayer during the assessment period in accordance with the worldwide income principle (i.e. “Welteinkommensprinzip”) [1]. By contrast, persons without a residence or habitual abode in Germany are subject only to limited income tax liability, which applies exclusively to certain types of domestic income.

German income tax law distinguishes seven types of income, which are exhaustively listed in Section 2(1) EStG. These are divided into income from profit sources and income from surplus sources. In the case of profit income, taxable profit is determined either by comparing business assets or by applying the cash basis method, whereas for surplus income, income is calculated as the excess of receipts over deductible expenses [4].

Starting from the total amount of income, taxable income is determined after taking into account statutory deductions (so-called “Nettoprinzip”). Of particular importance is the basic tax-free allowance, which ensures that the subsistence minimum remains tax-free. Only the portion of income exceeding the basic allowance is subject to income tax.

The income tax payable is calculated using a progressive tax tariff. This tariff provides for increasing marginal tax rates as income rises and reaches a proportional top tax rate of 42% or 45% above certain income thresholds [4]. The progressive structure of the tariff serves to implement the ability-to-pay principle and results in a higher relative tax burden on higher incomes.

Corporate Income Tax

Corporate income tax is the income tax levied on legal persons and certain associations of persons. The legal basis for corporate income tax is the Corporate Income Tax Act (Körperschaftsteuergesetz, KStG).

Corporate income tax subjects primarily include capital companies such as stock corporations and limited liability companies. Corporations with their registered office or place of management in Germany are subject to unlimited corporate income tax liability and are taxed on their worldwide income. Corporations without a registered office or place of management in Germany are subject to limited tax liability on their domestic income [5].

The determination of taxable corporate income is generally based on the provisions of the Income Tax Act. The starting point is the taxable profit determined in the course of profit calculation. This profit is adjusted by specific corporate tax provisions, in particular by off-balance-sheet additions and deductions. Unlike income tax, personal circumstances of the shareholders are disregarded for corporate income tax purposes, as it is a tax independent of personal factors.

Corporate income tax is levied at a uniform proportional tax rate. The current corporate income tax rate is 15%. In addition, a solidarity surcharge is imposed on the assessed corporate income tax, increasing the effective tax burden at the corporate level.

Trade Tax

Trade tax is a real tax that is levied on the operation of a business and is independent of the taxpayer’s personal ability to pay. It constitutes an autonomous income tax and primarily serves to finance municipalities. The legal basis is the Trade Tax Act (Gewerbesteuergesetz, GewStG).

Every domestic business operation is subject to trade tax. Taxable persons include natural persons, partnerships and corporations, provided they carry on a business within the meaning of Section 15(2) EStG, which requires an independent, sustainable activity carried out with the intention of generating profit and participation in general economic transactions. Freelance activities as well as income from agriculture and forestry are therefore not subject to trade tax [6].

The basis for determining trade tax is the trade income, which is derived from the profit calculated under income tax or corporate income tax rules. This profit is modified by statutory additions and deductions in order to create an objectified tax base. The purpose of these modifications is to determine trade income as independently as possible from the individual financing structure of the enterprise.

Trade tax is calculated by applying a uniform federal tax assessment rate to the trade income. The actual tax burden is then determined by multiplying the tax assessment amount by the municipal multiplier set by the respective municipality. As a result, the amount of trade tax can vary significantly depending on the location.

Interaction of Income Taxes

Individual income tax, corporate income tax and trade tax are designed as independent types of tax, but they are closely interconnected in substantive and economic terms. The interaction of these income taxes largely determines the actual tax burden of taxpayers and shapes the structure of income taxation in German tax law.

For natural persons operating a business, the profits earned are subject to both income tax and trade tax. In order to avoid excessive multiple taxation, income tax law provides for a partial crediting of trade tax against the assessed income tax. Nevertheless, an additional tax burden usually remains, particularly in municipalities with high multipliers.

For corporations, a cumulative tax burden arises from corporate income tax and trade tax. Trade tax cannot be credited against corporate income tax, meaning that it constitutes a definitive additional burden for corporations. In addition, distributed profits are taxed at the shareholder level under income tax law, resulting in multi-tier income taxation.

The differing interaction of income taxes leads to legal-form-dependent tax burdens. In particular, the choice of legal form has a significant impact on the overall tax burden and can create tax planning incentives. The interaction of income taxes is highly important for entrepreneurial decision-making.

Overall, it can be observed that although German income taxes follow a common underlying concept, they are not designed as a fully harmonized unified system. Rather, the parallel application of several types of tax results in complex tax burden structures.

Conclusions

This paper has presented the income taxes in German tax law regarding their fundamental structures and systematic interrelations. It has shown that individual income tax, corporate income tax and trade tax are independent types of tax which together shape income taxation in Germany. Each of these taxes is based on different taxable persons and tax bases and exhibits specific burden effects.

Income tax, as a personal tax, forms the foundation of income taxation for natural persons and is guided by the ability-to-pay principle. Corporate income tax, by contrast, represents an objectified income tax for legal persons and is characterized by the separation between the corporate level and the shareholder level. Trade tax complements the system as an object-based tax and leads to an additional tax burden, particularly for corporations.

The interaction of income taxes results in differentiated tax burdens that depend largely on the legal form and the nature of the income. These system-related differences demonstrate that German income taxes do not constitute a fully harmonized unified system but are instead characterized by parallel and partially cumulative tax burdens.

Looking ahead, income taxes will continue to be the subject of tax policy debates. In particular, the role of trade tax, as well as issues relating to the overall tax burden and legal-form neutrality, are regularly discussed in the context of reform considerations. A sound understanding of the systematics and interactions of income taxes therefore remains of central importance for both tax practice and academic analysis.

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