Case studies on member states national tax policies - Germany: implemented national tax reforms and the combat against aggressive tax schemes

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As in many other countries, Germany‘s tax policy in recent years has been guided by the objectives of making the tax system resistant against aggressive tax avoidance of multinational firms, of assisting firms in recovering from recent economic crises, and of ensuring a fair distribution of tax burdens in times of constrained budgets. I will focus this statement on the implications of recent German tax reforms targeted at preventing aggressive tax avoidance.

In contrast to most other EU and OECD countries, Germany has not reduced the tax rate on corporate profits over the past 15 years. With an average tax rate of roughly 30 percent, Germany taxes corporate profits by seven percentage points higher than the EU average and even nine percentage points higher than the OECD average (see Figure 1 in the Appendix). It is therefore not surprising that Germany has a tradition of restrictive anti-tax avoidance regulations. To give you some examples: Germany has implemented the interest deduction limitation rule, that has been made EU standard via the ATAD I directive, already in 2008. In the same year, Germany was one of the first countries to introduce a regulation for taxing the outward-transfer of business functions as part of the transfer pricing rules. More recently, in 2018, Germany introduced a so-called royalty deduction limitation rule that restricts the deductibility of intra-group royalty payments made by German corporations if these payments are taxed under a harmful preferential tax regime[1] in a foreign country.

Germany has also applied a restrictive approach in implementing recent European requirements on anti-tax avoidance into national law. Again, two examples:

- First, the ATAD I directive requires EU countries to tax foreign passive income under a national CFC regulation if that income is taxed at a rate below 50 percent of the domestic tax rate in the foreign country. The directive would thus require Germany to cover all such income from countries with a tax rate of 15 percent or lower. Germany, however, has implemented the regulation in 2021 and retained a low-tax threshold of 25 percent.

[1] Harmful preferntial tax regimes are IP box regimes that are not in accordance with the OECD nexus approach.

This rate is two percentage points above the EU corporation tax rate average and even four percentage points above the OECD average (see again Figure 1 in the Appendix), which extends the territorial scope of the CFC regulation substantially beyond what is required by the EU directive.

- Second, the EU required Member States to implement one out of four suggested anti-tax avoidance rules in relation to countries being included on the EU list of non-cooperative tax jurisdictions. Again, Germany has decided in 2021 to go beyond this minimum standard and has implemented all four of the suggested anti-tax avoidance measures.

How effective are these anti-tax avoidance measures in preventing base erosion and profit shifting of multinational firms? The effectiveness of each of these specific measures has been documented empirically on a number of occasions.[2] I will present some results from a recent analysis of income tax statements of large European listed firms to evaluate the effectiveness of Germany's anti-tax avoidance legislation in total. European listed firms have to provide a so-called tax reconciliation in their IFRS financial statements, where they explain the different drivers of their effective tax rate (which may be related to BEPS activities or not). We have compared the tax reconciliations of 57 German and 59 French firms listed on the STOXX 600 over the time period 2011 to 2020. Here are some key findings (see Figure 2 in the Appendix).

- French firms were able to reduce their effective tax rate by 5.7 percentage points on average from using international tax rate differentials. German firms achieved an average effective tax rate reduction of only 2.9 percentage points through this channel. This clearly indicates that German CFC rules and other anti-tax avoidance rules prevent German firms more effectively from shifting income to low-tax countries than similar regulations in France.
- At the same time, German multinational firms benefitted to a smaller extent from tax credits and were affected more negatively from non-deductible expenses and tax-free income.
- Altogether, these three effects account for an effective tax rate disadvantage of German MNEs of more than four percentage points compared to their French counterparts.

While these findings indicate that the restrictive anti-tax avoidance framework in Germany succesfully prevents Base Erosion and Profit Shifting to some extent, it comes at the cost of higher tax complexity and higher compliance costs. Again, an example: The German CFC

[2] See, e.g., Ruf/Schindler (2015) on the effectiveness of the German thin-cap rule, Ruf/Weichenrieder (2012) with regard to the CFC rule and Heckemeyer/Hemmerich (2021) for the royalty deduction limitation rule.

regulation with a low-tax threshold of 25 percent requires all German multinationals to document the activity of affiliates in countries with a tax rate below that threshold. This obligation is irrespective from whether this firm engages in tax avoidance or not. A recent global survey of tax practicioners on the complexity of tax rules and tax systems[3] reveals that the German tax code is not in general perceived as being complicated (overall rank 13 of all EU countries), but that the anti-tax avoidance rules are particularly complex (CFC-rules: rank 4 of all EU countries; Transfer pricing rules: rank 2 of all EU countries). Similarly, a study on tax compliance costs in Europe prepared 2018 by EASME/KPMG for the European Commission reveals that the average tax compliance cost for corporation tax of large German enterprises is more than 50 percent higher than that of all other analyzed countries.[4] Recent reforms that further increased the restrictiveness of German anti-tax avoidance legislation are not even reflected in these statistics.

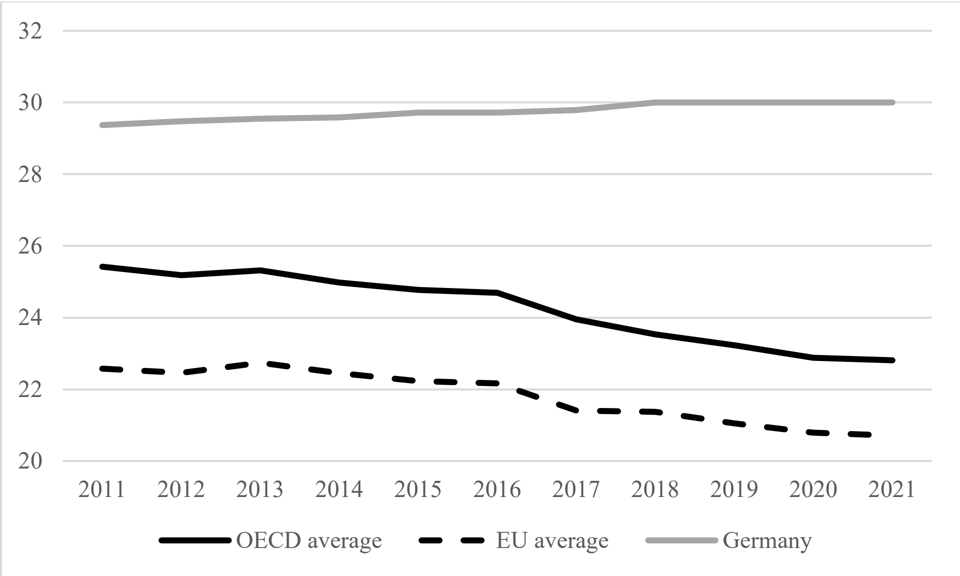
Overall, the German experience suggests that application of restrictive anti-tax avoidance rules may prevent base erosion and profit shifting to some extent. Policy makers should, however, also have the complexity and compliance burden in mind. This holds, in particular, since recent reforms and proposals (e.g., CFC legislation, anti-tax haven rules, Global Minimum Tax) seem to have an overlapping area of application, which may increase complexity even further.

Thank you for your attention!

[3] Survey results can be found at www.taxcomplexity.org. For further information on the survey and index construction see Hoppe/Schanz/Sturm/Sureth-Sloane (2021).
[4] See Buske et al. (2018).

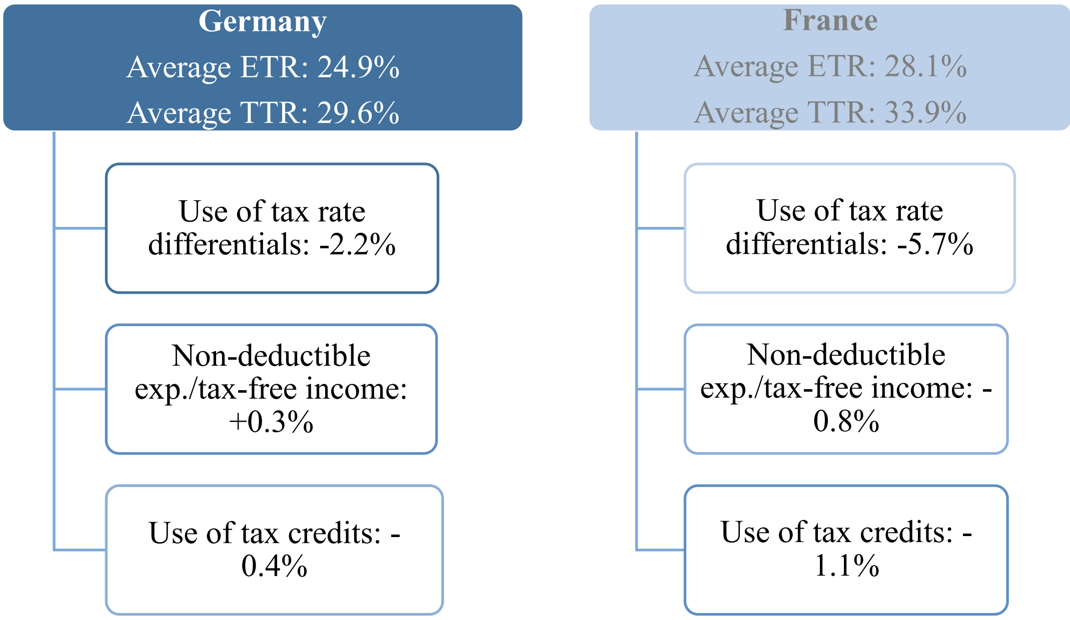
Appendix

Figure 1. Development of statutory corporation tax rates



Source: KPMG, Corporate Tax Rate Tables, https://home.kpmg/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online/corporate-tax-rates-table.html.

Figure 2. Composition of Effective Tax Rates of German and French Firms



Source: Own calculations. Data from Koch/Scheider (2022).

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