

A Local Income and Corporation Tax as an Alternative to the German Local Business Tax

An Empirical Analysis for Selected Municipalities

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Summary

The paper empirically analyses the impact on individual municipalities of replacing the German local business tax by a local surcharge on income and corporation tax. The microsimulation models used for this and refined for the present paper originate in calculations carried out for the Federal Ministry of Finance in cooperation between the Federal Statistical Office and the Humboldt University in Berlin. The data basis is formed by the roughly 30 million individual data sets of the most up-to-date income and local business tax statistics provided by the Federal Statistical Office. A local surcharge tax which, like the BDI/VCI model analysed, assigns tax revenue incurred on profits to the municipality of permanent establishment and that on other income to the domicile municipality, affects the revenue situation of the municipalities in highly differing ways. The losers in such a local tax reform include those municipalities in which an above-average number of industrial and commercial enterprises are resident. These are the “core towns” of the Old Federal Laender in particular. By contrast, the revenue situation of the surrounding municipalities and of the municipalities with a rural character would considerably improve on average. However, the core towns in the New Federal Laender which are currently tax-weak because they have little industry would also improve their revenue situation in most cases by applying a surcharge tax. In order to maintain the financial status quo, the core towns in the Old Federal Laender in particular would have to levy relatively high local tax rates, whilst the surrounding municipalities would be able to become more attractive by applying tax rates which as a rule would be much lower. The consequence of this would be that high-income earners in the core towns would have a not inconsiderable incentive to change their place of residence for tax purposes, which would further worsen the financial situation of the core towns.

Introduction

The reform of the German local business tax (*Gewerbesteuer*) was very high on the agenda of the legislature in 2003. The cause of this was the particularly critical financial situation of the municipalities in Germany, owing to a large degree to a fall in local business

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