

Tax Equalization and Fiscal Controls in Germany's Federation

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Historical Overview

1. German Empire

→ federal government became financially dependent on the states

2. Weimar Republic

→ relationship was reversed; states became financially dependent on the federal government

3. Federal Republic of Germany

→ Parliamentary Council: dependency was to be avoided; federation and Länder should have equal rights and be financially independent of one another

Legal Basis

- **Article 106 GG** [Apportionment of tax revenue and yield of fiscal monopolies]:
 - (1) The yield of fiscal monopolies and the revenue from the following taxes shall accrue to the **Federation**:
 1. ... - 7. ...
 - (2) Revenue from the following taxes shall accrue to the **Länder**:
 1. ... - 6. ...
 - (3) Revenue from **income taxes, corporation taxes** and **turnover taxes** shall accrue **jointly** to the Federation and the Länder (**joint taxes**) to the extent that the revenue from the income tax and the turnover tax is not allocated to municipalities pursuant to paragraphs (5) and (5a) of this Article. The Federation and the Länder shall share equally the revenues from income taxes and corporation taxes. The respective shares of the Federation and the Länder in the revenue from the turnover tax shall be determined by a federal law requiring the consent of the Bundesrat. Such determination shall be based on the following principles:
 1. The Federation and the Länder shall have an equal claim against current revenues to cover their necessary expenditures. The extent of such expenditures shall be determined with due regard to multi-year financial planning.
 2. The financial requirements of the Federation and of the Länder shall be coordinated in such a way as to establish a fair balance, avoid excessive burdens on taxpayers and ensure uniformity of living standards throughout the federal territory.

In determining the respective shares of the Federation and the Länder in the revenue from the turnover tax, reductions in revenue incurred by the Länder from 1 January 1996 because of the provisions made with respect to children in the income tax law shall also be taken into account. Details shall be regulated by the federal law enacted pursuant to the third sentence of this paragraph.

...

Legal Basis

- **Article 107 GG** [Distribution of tax revenue – Financial equalisation among the Länder – Supplementary grants]

(1) Revenue from Land taxes and the Land share of revenue from income and corporation taxes shall accrue to the individual Länder to the extent that such taxes are collected by finance authorities within their respective territories (local revenue). Details regarding the delimitation as well as the manner and scope of allotment of local revenue from corporation and wage taxes shall be regulated by a federal law requiring the consent of the Bundesrat. This law may also provide for the delimitation and allotment of local revenue from other taxes. The Land share of revenue from the turnover tax shall accrue to the individual Länder on a per capita basis, unless otherwise provided in paragraph (2) of this Article.

(2) A federal law requiring the consent of the Bundesrat shall ensure a reasonable equalisation of the disparate financial capacities of the Länder, with due regard for the financial capacities and needs of municipalities (associations of municipalities). To this end, additions to and deductions from the financial capacity of the respective Länder shall be regulated in the allotment of their shares of revenue from the turnover tax. The conditions for granting additions and imposing reductions as well as the criteria governing the amount of these additions and deductions shall be specified in the law. For the purpose of measuring financial capacity, it shall be permissible to consider only part of the revenue from mining royalties. The law may also provide for grants to be made by the Federation to financially weak Länder from its own funds to assist them in meeting their general financial needs (supplementary grants). Irrespective of the criteria specified in the first to the third sentence of this paragraph, grants may also be made to such financially weak Länder whose municipalities (associations of municipalities) have a particularly low capacity to generate tax revenue (municipal tax-base grants) and, in addition, to such financially weak Länder whose shares of the support funds under Article 91b are lower than their per capita shares.

Legal Basis

- Article 106 and 107 GG stipulate **general principles**.
- The **details are regulated by ordinary law** such as:
 - Financial Equalization Act (*Finanzausgleichsgesetz*)
 - Standards Law (*Maßstäbengesetz*)
 - Disassembly Law (*Zerlegungsgesetz*)

Impact of the Constitutional Jurisprudence

1. Financial Equalization Act Case (1952)

„duty of the financially stronger Länder is to assist, within limits, the financially weaker Länder“

→ revenue sharing mechanism was laid down in the Constitution in 1955

2. The Finance Equalization I Case (1986)

The Court instructed the German Parliament (*Bundestag*) to change the basis for allocating tax revenues among the Länder by fiscal year 1988

3. The Finance Equalization II Case (1992)

The Court ruled that the federation's vertical payments to Bremen and Saarland had been too low in view of the serious budgetary problems of both Länder

→ the federal laws implementing the financial equalization regime were formed, in part to incorporate the new, financially weaker Länder of the former East Germany in the financial equalization scheme beginning in 1996

4. The Finance Equalization III Case (1999)

The Court found a number of provisions of the Financial Equalization Act to be incompatible with the standards given by the constitution, particularly the provisions concerning the third stage of horizontal, state-to-state revenue redistribution. The Court found that these provisions did too much to equalize the financial capacity of the Länder. The Court identified a cap on financial redistributions, which it concluded would promote solidarity while preserving state autonomy.

→ revision of the Financial Equalization Act before 1 January 2005

The present Federal Financial Equalization System in Germany

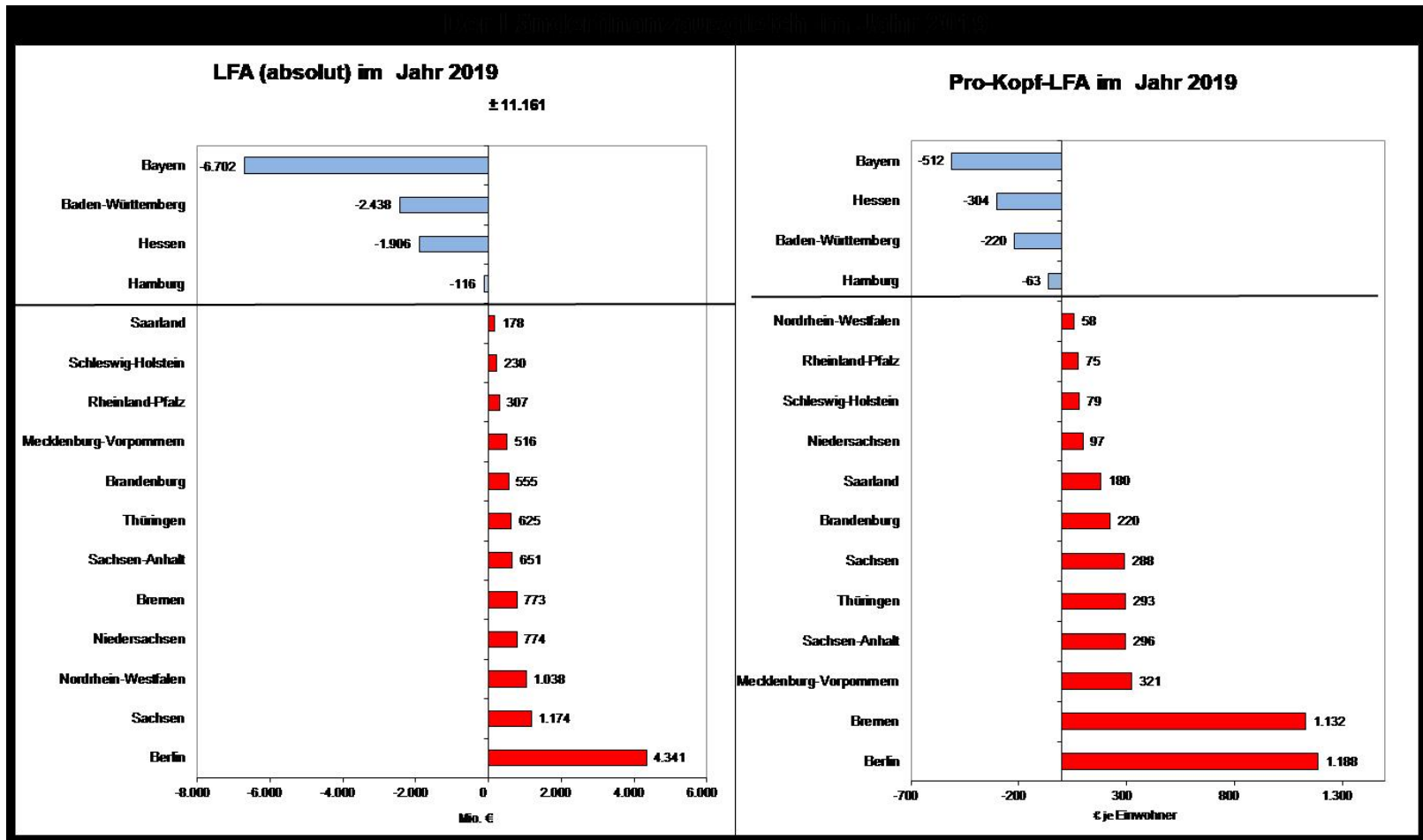
The procedural regulations can be divided in four phases:

- 1. Vertical distribution**
- 2. Horizontal distribution**
- 3. Financial equalization among the Länder**
- 4. Supplementary federal grants**

See. brochure at:

https://www.bundesfinanzministerium.de/Web/DE/Themen/Oeffentliche_Finanzen/Foederale_Finanzbeziehungen/Laenderfinanzausgleich/laenderfinanzausgleich.html

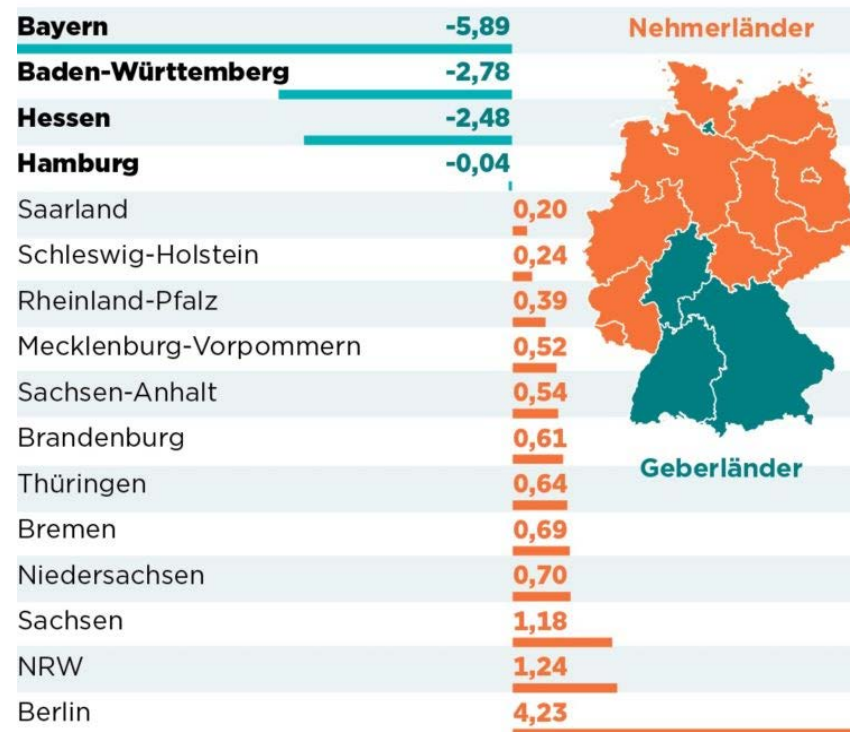
The present Federal Financial Equalization System in Germany



The present Federal Financial Equalization System in Germany

Reiche Bayern, armes Berlin

Länderfinanzausgleich 2017:
Umverteilung von 11,2 Milliarden Euro



Outlook and critical review

- New regulations are meant to apply for the period from 2020 to 2030
 - Critics:
 - Breakthrough of fundamental principles of the federal structure of the Federal Republic of Germany
 - Federal government **gains control** of the co-financed properties
 - **Information claims** and **control rights**
- The federal government is expanding its competencies and governing into the Länder

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Thank you for your attention!

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