

WHAT ARE TAXES AND WHAT ARE THEY USED FOR?



Federal Ministry
of Finance

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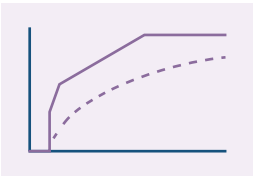
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INTRODUCTION

Taxes are the state's most important source of revenue. The state uses the money to pay for things that are in the public interest, such as the education system, the health care system and public infrastructure.

Everyone has to pay taxes. And everyone benefits from the services that taxes pay for. But who decides how much we have to pay in taxes? And why are there so many different kinds of taxes?

This brochure provides answers to these and other important questions relating to taxes. It shows who pays what kinds of taxes and explains key terms using easy-to-understand examples. It also provides links to websites that offer more detailed information.





1.

IN BRIEF:

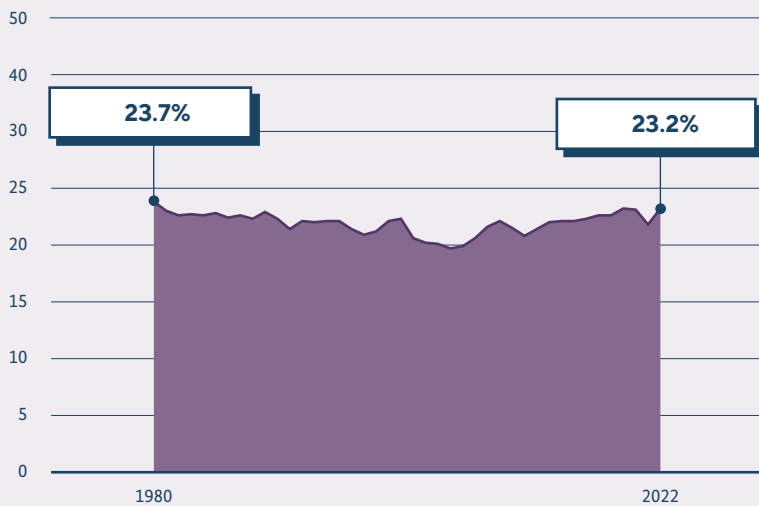
TAX BASICS

When is a tax charged and how is it paid? Precise rules for this are set out in tax laws. The most important piece of legislation relating to taxes in Germany is the Fiscal Code (*Abgabenordnung*). The overall amount of tax revenue that gets collected depends on a variety of factors: not just on high or low tax rates, but also – and especially – on the performance of the economy. An economy's performance is generally measured in terms of gross domestic product, or GDP.

GDP measures the total value of all goods and services produced or provided within a country during a certain period of time, usually one year. In general, GDP growth also leads to higher earnings for businesses, higher gross wages and salaries, and higher tax revenue. Put another way: when more goods and services are produced or provided within a country and profits and wages rise, the amount of taxes paid is also higher, even if the government does not raise tax rates. The ratio between tax revenue and GDP is called the “tax ratio” for short. For decades, Germany's tax ratio has ranged between 20% and 24%.

TAX RATIO IN GERMANY

1980 - 2022



WHAT ARE TAXES?

Taxes have existed for about 5,000 years – ever since people started living together in organised communities. So the idea that every individual must contribute something to the functions performed by a community is a very old one. Early taxes were paid in kind (e.g. fruit, meat or grain) or in the form of community services.

A more modern tax system gradually started to develop after money was introduced as a means of payment. Since taxes were initially imposed in an arbitrary manner, early tax systems were not very equitable. Taxes often served merely to finance the extravagant lifestyles of the people who

Devices for calculating, weighing and counting: some of these devices, which are part of the Finance Ministry's financial history collection, were originally used in German tax offices. The shift to cashless payments made these devices obsolete.



Gift bearer (late 6th/early 5th century B.C.): the relief depicts a Median horseman who is presenting a gift to the Persian king. The king, Darius the Great (about 550–486 B.C.), carried out a comprehensive reorganisation of the tax system.

More items from the financial history collection can be viewed at www.bundesfinanzministerium.de/finanzgeschichtliche-sammlung



held power. Protests against the unjust imposition of taxes sparked upheavals such as the American War of Independence and the French Revolution.

Germany's tax system was fundamentally restructured in 1919–1920 under the so-called “Reich financial reform”, which was headed up by Matthias Erzberger, the Finance Minister at the time. Many of the principles and policies introduced as part of this reform remain central features of the German tax system. These include uniform taxation at the federal level, income tax reform, and a restructuring of fiscal relations between federal and *Länder* (state) governments.



THE TITHE

The tithe was an early form of tax that was charged from the Middle Ages until well into the 19th century. Under the tithe system, landowners paid one tenth of their earnings to a clerical or secular institution such as a church or king.



Four “tithe farmers” (1534): the figures depict farmers paying various tithes in the form of money, grain, geese and vegetables.

WHO PAYS TAXES?

Almost everyone in Germany has to pay taxes. This includes employees, self-employed people, jobseekers and pensioners. Without tax revenue, the state would be unable to perform its functions for the public good.

Nearly 40 different taxes are charged in Germany. These can be classified according to various characteristics. One common way of distinguishing between different types of taxes is to look at the manner in which they are remitted to tax offices: either directly or indirectly.

When you pay an indirect tax, you barely notice it – for example when you buy pet-

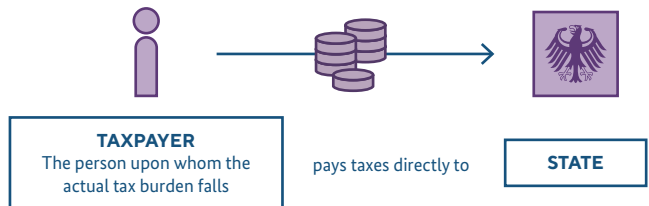
rol, see a film at the cinema, or go shopping. Taxes like this include value-added tax (VAT) and excise duties. VAT is a general consumption tax that falls due when goods and services are exchanged.

Other consumption taxes are charged only when particular products are actually consumed. Such taxes include electricity duty, tobacco duty and energy duty. Take the example of electricity: the final price of electricity – which includes electricity duty – is paid by the people who consume electricity. However, the duty is remitted to the tax authorities by the utility companies that “indirectly” levy the tax as part of the electricity price.

DIRECT AND INDIRECT TAXES: WHAT'S THE DIFFERENCE?

DIRECT TAXES

(income tax, trade tax, motor vehicle tax and more)



Public debates about taxes and taxpayers tend to focus on one particular direct tax: income tax. In Germany, income tax is charged on all income earned by individuals.

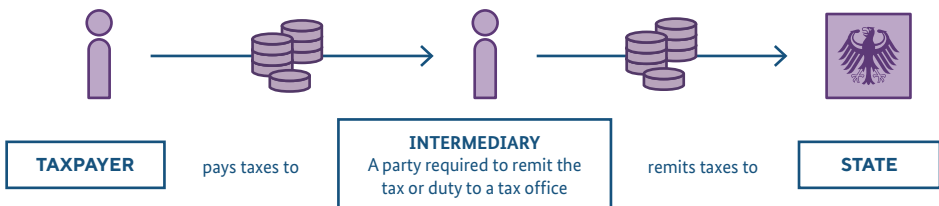
This includes income earned in other countries, such as rental income from holiday homes. Direct taxes are paid directly to the state by the person liable for the tax. For example, people who owe income tax pay it directly to the tax office.

With other types of taxes, the channels of payment to the state can be somewhat more complicated. For example, when someone registers a car, motor vehicle

tax is levied. Motor vehicle tax belongs to the category of “transaction taxes,” which are charged on legal and business transactions. It is a direct tax, which means that the person who owns the car also pays the tax. In this case, the tax is paid directly to a main customs office. Cars have to be insured, too, which requires payment of insurance tax, another type of transaction tax. Insurance tax is charged on top of the insurance premium and collected by the insurer, who remits the tax to the Federal Central Tax Office.

INDIRECT TAXES

(VAT, energy duty, coffee duty and more)



WHAT DO PEOPLE PAY TAXES ON?

PHIL, AGE 35



Phil pays motor vehicle tax on his motorcycle. He has to pay the tax once a year to the main customs office. The amount is based on the motorcycle's engine capacity.

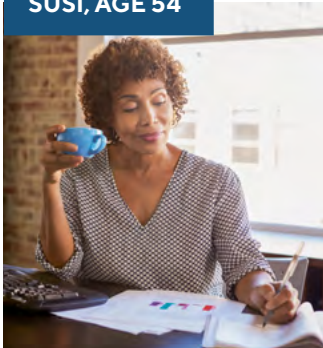
Different people pay taxes on different things. Income tax, for example, is charged on a person's entire earnings. Employees who earn salaries, wages or other types of remuneration pay wages tax (*Lohnsteuer*). Wages tax is withheld directly from taxable income and remitted to the tax authorities.

MARIE, AGE 19



When she goes to her favourite ice cream shop, Marie pays VAT on the ice cream she buys there. Currently, sales in the catering sector are subject to a reduced VAT rate of 7%.

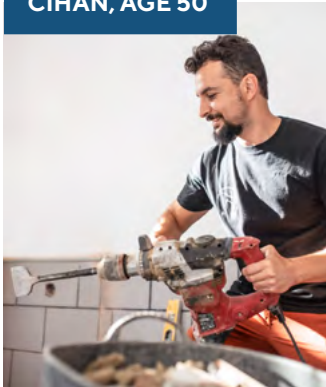
SUSI, AGE 54



As a business owner, Susi pays VAT as well as income tax and trade tax.

Wages tax is not a tax in its own right or an additional tax but rather a specific method of collecting income tax. Self-employed people pay income tax on the profits they make from their business activity. They receive tax assessment notices stating the exact amount they owe.

CIHAN, AGE 50



Cihan works for a construction company. He pays wages tax on his wages. This tax is withheld from his gross wages, and the amount of tax is based on the amount of wages he earns.

**PAUL, AGE 67 &
LOUISE, AGE 65**



Louise and Paul are pensioners. Retirement income is also subject to tax. The share of their pension income that is subject to tax depends on the year when their pension payments started.

HOW MUCH MONEY DOES THE GOVERNMENT COLLECT IN TAXES?

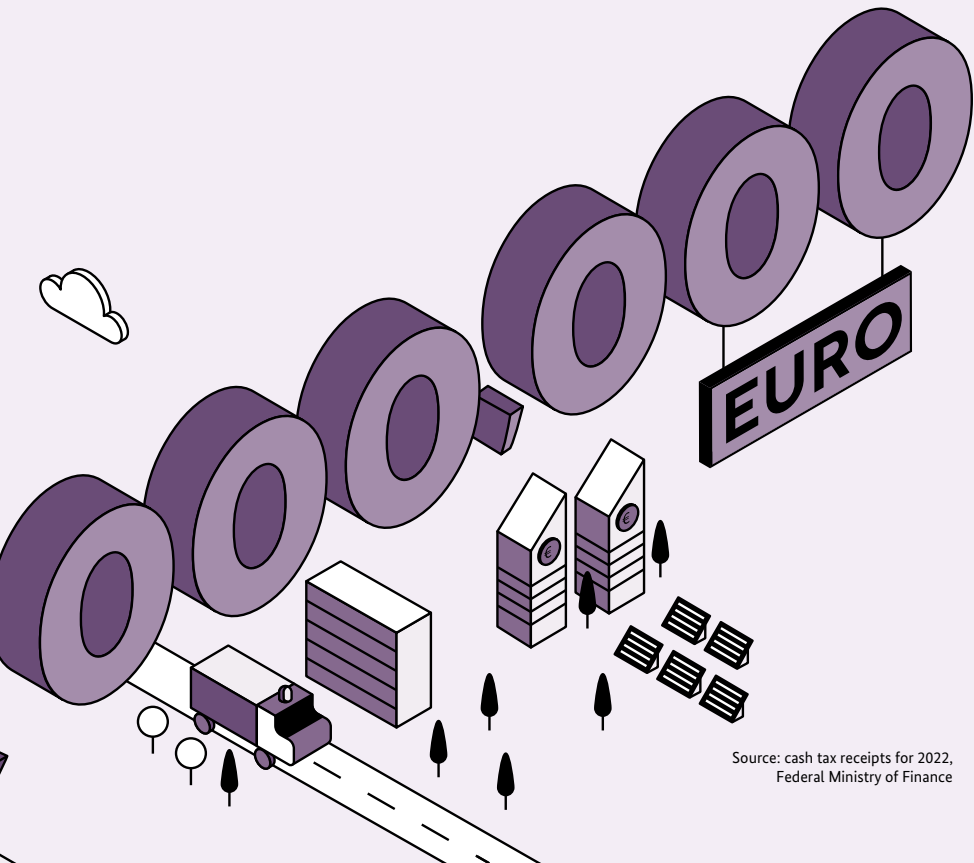
Nowadays, taxes are collected in a fair and uniform way. The money goes to the treasury and is not tied to any specific purpose. This means, for example, that motor vehicle tax revenue is not necessarily used for road construction. This distinguishes taxes from fees: fees are payments for specific state services that are used by the general public, such as drinking water fees. Drinking water fees are based on the amount of water consumed.

The state uses tax revenue to pay for functions and services such as education, public infrastructure, the health care system and internal and external security. A large share of the revenue is returned to individuals in the form of social benefits, such as child benefit and housing benefit.



Tax revenue has increased significantly in recent decades in line with GDP growth, rising business income and higher gross wages and salaries. Put another way: when the amount of profits, wages and supplied goods and services in Germany goes up, the corresponding amount of tax revenue generally goes up as well. In 2019, tax revenue totalled roughly €799 billion.

In 2020, this amount fell by nearly €60 billion as a result of the coronavirus pandemic. Then in 2022, tax revenue rebounded, reaching a total of €896 billion.



Source: cash tax receipts for 2022,
Federal Ministry of Finance

2.

TYPES OF TAX

There are many different kinds of taxes in Germany. A few of them account for a particularly large share of total tax revenue. These are VAT, income tax and wages tax. Taxes can be distinguished according to various criteria – for example, how the revenue is distributed. The receipts from some taxes go exclusively to the Federation, to the *Länder* (states), or to local authorities. However, in the case of what are called “joint taxes”, the receipts are distributed amongst all three government levels.

VAT

There are three different VAT rates in Germany

STANDARD RATE

19%

REDUCED RATE

7%

(for example, on books and fruit and vegetables)

ZERO VAT RATE

0%

(applies only to solar power systems)

WHAT ARE THE VARIOUS KINDS OF TAXES?

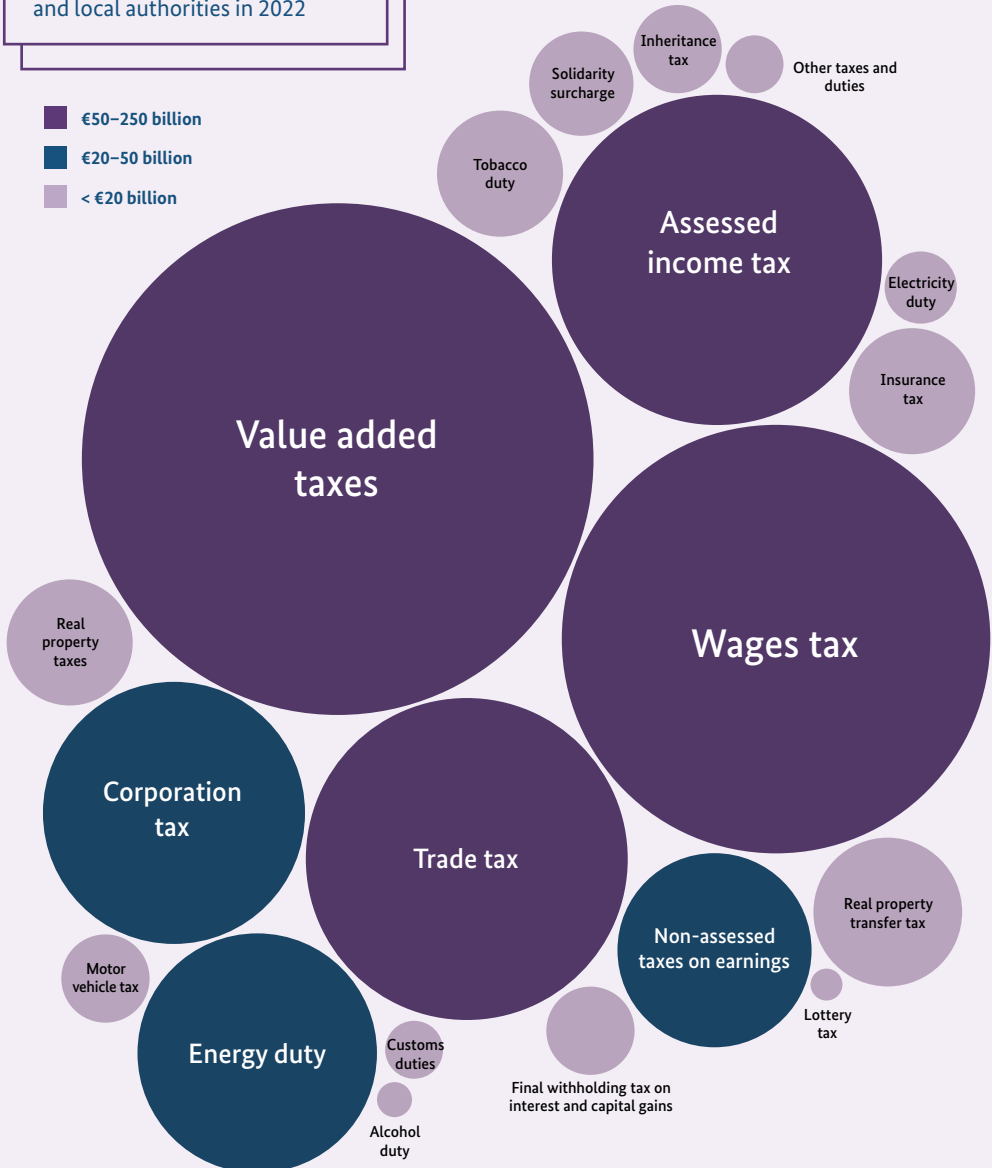
VAT, wages tax and income tax account for nearly two thirds of the total tax revenue taken in by the Federation, *Länder* and local authorities. They form the primary basis of the tax revenue available to the state. What are these taxes charged on?

VAT is charged on all private and public consumption. End consumers pay VAT on the goods and services they buy. On behalf of the tax authorities, businesses add the proper amount of VAT to the (net) price of the goods and/or services they sell. After the sale takes place, they then remit this amount to the tax authorities. Thus businesses collect VAT for the treasury, but the ultimate taxpayer is the consumer.

In Germany, the standard rate of VAT on most goods such as clothing, furniture and electrical appliances is 19%. The same rate is applied to services provided by hairdressers and tradespeople, for example. An exception is made for daily essentials such as bread, fruit, vegetables and meat, which are subject to a reduced VAT rate of 7%. The aim here is to reduce the burden on consumers when they buy indispensable goods. The standard VAT rate of 19% is levied on beverages, while sales in the catering sector are currently subject to the reduced rate of 7%.

TAX REVENUE

received by the Federation, *Länder*
and local authorities in 2022



Source: cash tax receipts for 2022,
Federal Ministry of Finance

INCOME TAX AND WAGES TAX

Every person who lives in Germany or has their habitual place of residence here must pay income tax. Germany has concluded “double taxation agreements” with many countries to make sure that people who earn income both in Germany and abroad do not have to pay tax twice for the same income. Most tax revenue is generated by tax on income from employment: this is called wages tax (*Lohnsteuer*), which is a special form of income tax. When employees get paid, their employers withhold wages tax and remit it to the tax authorities.

Wages tax payments are essentially the same thing as monthly prepayments of annual income tax. The amount of wages tax that is withheld is based on (a) a taxpayer’s salary, (b) their tax class and



TAXES DESIGNED TO INFLUENCE BEHAVIOUR

Taxes not only generate revenue for the state but can also serve as an instrument to influence behaviour. A key example here is tobacco duty, which aims to reduce the appeal of smoking.

(c) the various allowances they receive (for example, allowances for work-related expenses, special expenses and extraordinary financial burdens). The actual amount of income tax a taxpayer owes for a full year is determined at the end of the calendar year, when the total amount of taxable income is known. Taxpayers who pay too much wages tax over the course of a year receive a refund.

Income tax is charged on other types of income, such as income from self-employment, investment income and rental income. For these other types of income, taxpayers file tax returns stating the specific types and amounts of their income. The higher a taxpayer’s taxable income is, the higher the income tax rate they have to pay. The tax office lets taxpayers know how much income tax they owe by sending them a tax assessment notice.



TAXES THAT HAVE BEEN DISCONTINUED

Many taxes that were introduced in the past have been discontinued in the meantime. This can happen for a variety of reasons – for example, if the costs of administering a tax are higher than the amount of revenue it generates. Some of the taxes that have been discontinued may appear rather odd today: these include playing card duty, ice cream duty and acetic acid duty.

IN BRIEF: THE SIX MOST IMPORTANT TYPES OF TAX IN GERMANY

(based on revenue)



VAT

- > **What is it paid on?** Nearly every product and service
- > **What is the rate?** 19% (standard), 7% (reduced), 0% on solar power systems
- > **When was it introduced?** 1968



WAGES TAX

- > **What is it paid on?** Income from employment
- > **What is the rate?** Between 0% and 45%
- > **When was it introduced?** 1920



INCOME TAX

- > **What is it paid on?** Income earned by natural persons
- > **What is the rate?** Between 0% and 45%
- > **When was it introduced?** 1811



TRADE TAX

- > **What is it paid on?** Business profits
- > **What is the rate?** Set by individual local authorities
- > **When was it introduced?** 1891



ENERGY DUTY

- > **What is it paid on?** The consumption of energy products
- > **What is the rate?** Varies according to energy product
- > **When was it introduced?** 1939



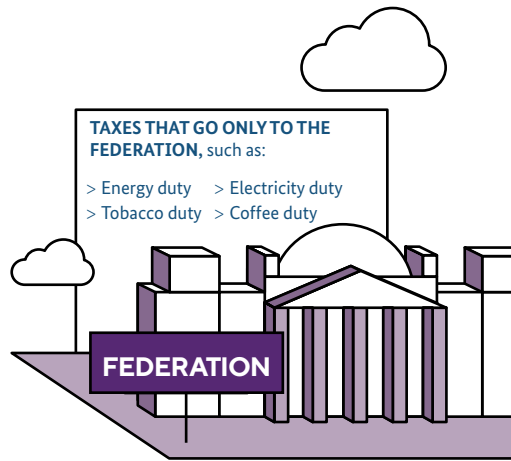
CORPORATION TAX

- > **What is it paid on?** Income earned by legal persons such as incorporated companies
- > **What is the rate?** 15%
- > **When was it introduced?** 1920

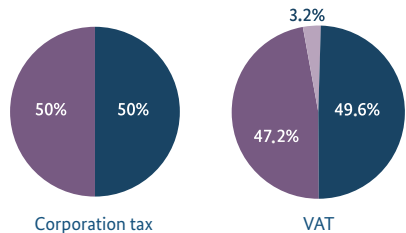
WHO RECEIVES WHICH TAXES?

Article 106 of Germany's constitution stipulates the government level that is entitled to receive the revenue from each type of tax. Most tax revenue goes to the Federation, but the German *Länder* and local authorities are also entitled to significant amounts of financial resources derived from the collection of taxes. The German state is a federal system, and the constitution assigns specific tasks and functions to the federal, *Länder* and local level. Each government level receives revenue from various taxes to cover the costs of performing these tasks and functions.

Germany's taxes can be divided into four categories based on the government levels that are entitled to receive the revenue. There are (1) federal, (2) *Länder* and (3) local authority taxes whose revenue goes exclusively to the designated government level. Then there are (4) "joint" taxes whose revenue is divided up amongst all three government levels based on agreed formulas.

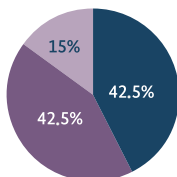
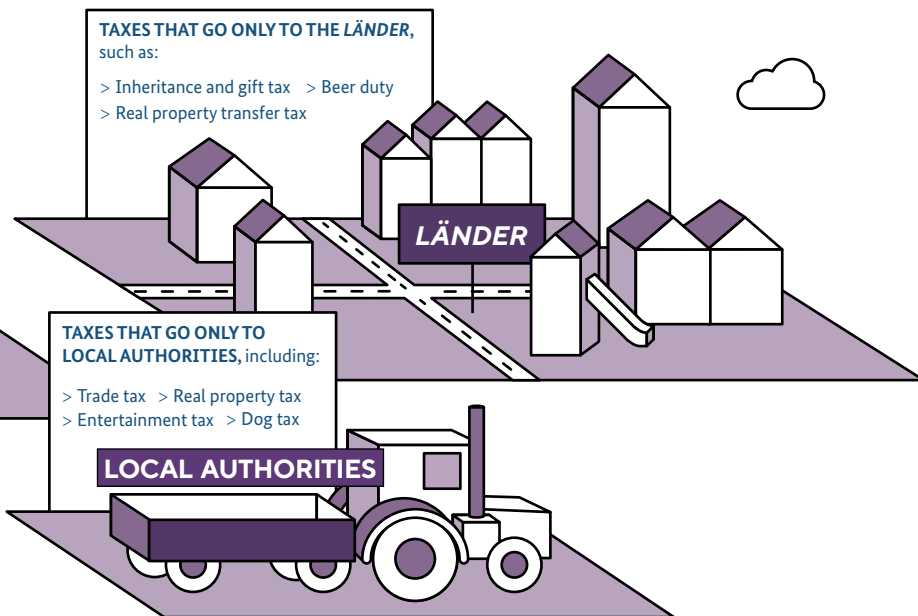


JOINT TAXES

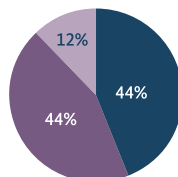


TAX REVENUE FOR THREE GOVERNMENT LEVELS: FEDERAL, LÄNDER AND LOCAL

In Germany's federal system, the Federation, *Länder* and local authorities are assigned different tasks and functions. The constitution sets out rules on public finances, and these stipulate how tax revenue is to be allocated in order to ensure that each government level has the financial resources it needs to fulfil its responsibilities.



Wages and
income tax



Final withholding tax on
interest and capital gains

■ Federation
■ Länder
■ Local authorities

3.

FAIR TAXES

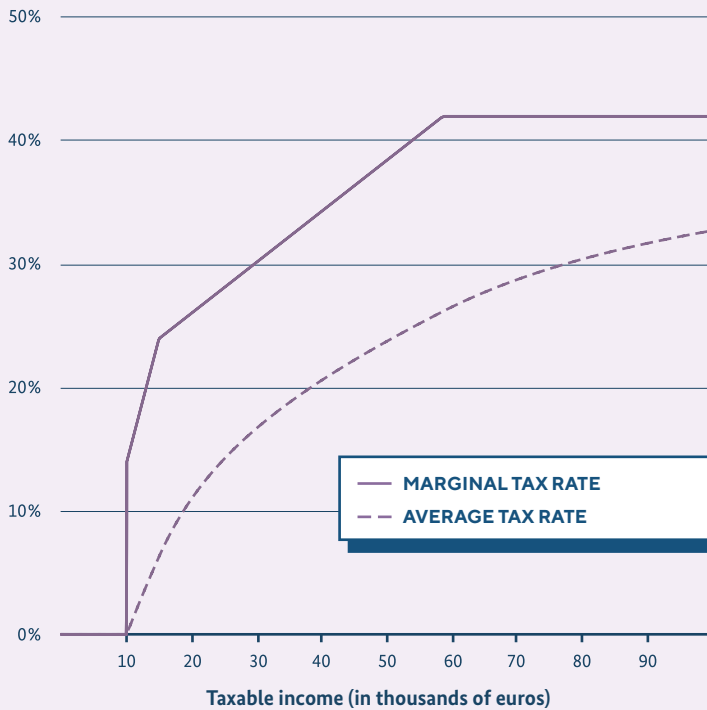
In order to ensure that the tax burden is distributed fairly throughout society, Germany's tax system is based on the "ability-to-pay" principle. Essentially, this means that the more income a person earns, the more they pay in income tax. In order for a tax system to be fair, it is also crucial to take effective measures to fight money laundering and tax evasion. This requires not just national measures but also internationally agreed tax policies and fair rules for the taxation of large multinational corporations.

A general principle for income tax in Germany is: people who earn higher incomes also pay higher taxes. This is achieved with the help of the progressive tax model which is based on rising marginal tax rates that are used to calculate the amount of tax due.

THE PROGRESSIVE TAX MODEL

Tax progressivity forms the basis for a fair income tax system in Germany. This means that taxpayers help finance public goods in line with their ability to pay.

Tax rate



WHAT FACTORS DETERMINE THE AMOUNT OF TAXES PEOPLE PAY?

It is important not only to distribute tax revenue fairly, but also to ensure that the burden of paying taxes is spread fairly as well. But what does a fair tax system look like? Economists have been debating this question for a long time.

One option would be to charge tax in return for a particular service or benefit. In

this type of system – which follows the principle that contributions and benefits should be equivalent – the amount of tax is based on individual use, similar to the cost-benefit principle common in market economies. The amount that people pay in taxes would then be equal to the amount of state services and benefits they claim.

The following sample calculations are based on 2022 tax rates (as of 5 May 2023).

SAMIRA SÜZEN



Age 19, student trainee

- > Annual income: **€7,200**
- > Income tax: **€0**
- > Average tax rate: **0%**
- > Marginal tax rate: **0%**



This may sound like a fair model, but it is not so easy to implement in practice. It is often impossible to determine the exact amount of services or benefits an individual uses. For example, how is the state supposed to measure the amount of police services an individual taxpayer uses? Or an individual taxpayer's use of public roads and pavements?

It is practically impossible to determine fair tax amounts on this basis. For this reason, Germany's tax system is based on a different principle: ➡ **the ability to pay.**



ABILITY TOPAY

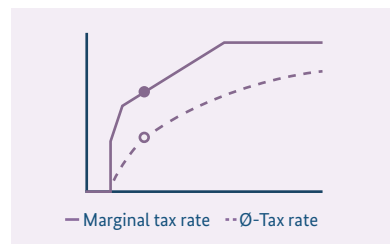
The ability-to-pay principle is geared towards the individual taxpayer's ability to pay taxes. This means that people who earn more income or consume more goods and services should also pay more in taxes, and in this way contribute to the common good.

ROLF HANSEN



Age 34, part-time office clerk

- > Annual income: **€28,500**
- > Income tax: **€4,263**
- > Average tax rate: **14.96%**
- > Marginal tax rate: **28.78%**

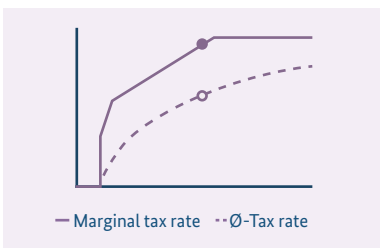


ARTHUR KOTECKI



Age 55, self-employed roofer

- > Annual income: **€54,000**
- > Income tax: **€12,856**
- > Average tax rate: **23.81%**
- > Marginal tax rate: **38.60%**



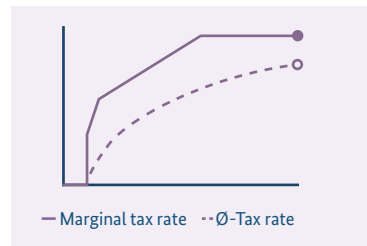
The ability-to-pay principle is most apparent in the case of income tax. The first rule here is: people who earn the same amount of taxable income should bear the same tax burden. People who earn more pay a higher percentage of their income as income tax. The exact rate is derived from the income tax schedule. The income tax schedule in Germany is “progressive”, which means that marginal tax rates are higher for higher levels of taxable income. The income tax schedule in Germany is divided into five brackets. Each bracket has a different tax rate. The first bracket goes up to the maximum amount of the basic personal allowance. This guarantees that subsistence income – in other words, the minimum amount of income that a person in Germany needs to cover the basic costs of living – remains tax-free. The portions of income that exceed the basic personal allowance are subject to increasing marginal tax rates, from the basic tax rate of 14% to the maximum tax rate of 45%.

JASMIN TUPAT



Age 62, patent attorney

- > Annual income: **€105,600**
- > Income tax: **€34,379**
- > Average tax rate: **32.56%**
- > Marginal tax rate: **42%**



In addition, Germany's income tax system tries to cover the widest possible range of living conditions. Only in this way can the tax system take into account an individual's ability to pay. Doing this properly requires a wide range of rules and exceptions. A less complex tax system would not be able to give adequate consideration to the wide variety of individual cases that exist.



BRACKET CREEP

"Bracket creep" occurs when a taxpayer becomes subject to a higher income tax rate after receiving an increase in income that merely offsets the rate of inflation.


HOW DOES THE GERMAN GOVERNMENT FIGHT ILLEGAL TAX ARRANGEMENTS?

Every year in Germany, tax evasion and tax tricks cause billions of euros in revenue losses. This is money that is needed to pay for things like transport infrastructure, schools, childcare centres and hospitals. For this reason, it is essential to take resolute and consistent action against illegal tax avoidance. The Federal Ministry of Finance has taken a wide range of measures to this end.

One effective tool that has been set up to detect and prevent large-scale tax evasion is the “task force to combat tax schemes on the capital market”, which is based at the Federal Central Tax Office. The task force provides federal and *Länder* authorities with assistance in processing ongoing cases and serves as an interface between national and international investigative authorities. This improves the quality of information analysis and aids the coordination of measures that need to be taken. In addition, the German government has introduced reporting requirements for cross-border tax arrangements. Such tax planning arrangements must be reported in particular by tax advisors, law firms, accounting/auditing firms and banks. The measures taken by the German govern-

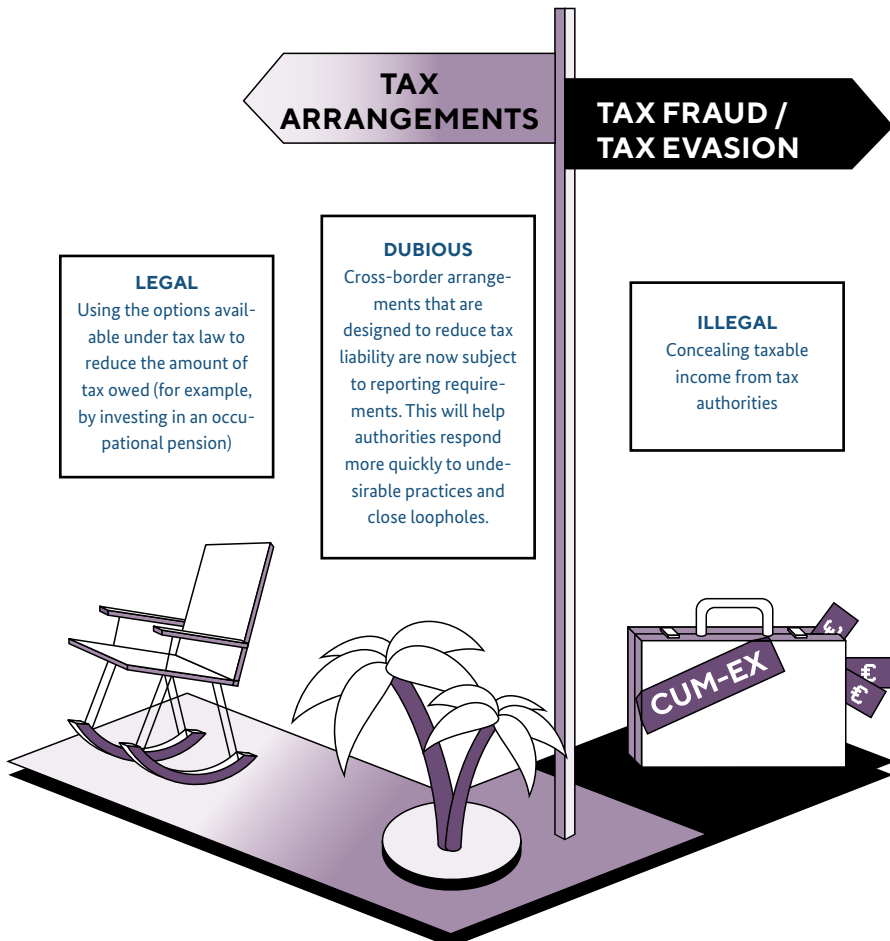
ment enhance transparency, expand obligations for relevant parties to cooperate with the authorities, and give competent authorities new investigative powers. All of this in turn means that illegal tax arrangements can be detected more effectively, and legislators can respond more swiftly by making necessary adjustments to the law.

Steps have also been taken to prevent VAT evasion in online transactions: as of 2019, operators of online marketplaces are now held liable if VAT is not paid on transactions that take place on their platforms. In addition, restrictions on “share deals” ensure greater fairness in the collection of real property transfer tax. Undeclared work is another major problem: the state loses a lot of revenue when taxes and social security contributions are not paid on wages. For this reason, the special monitoring unit for undeclared work has been granted expanded powers in order to improve the state’s ability to fight unlawful employment and benefit fraud.

	SHARE DEALS
<p>Share deals are tax arrangements set up by real estate groups with the aim of avoiding real property transfer tax, particularly in real estate transactions that involve large sums of money.</p>	

TAX ARRANGEMENT OR TAX EVASION? A FINE DISTINCTION

There is often a thin line between a tax arrangement and tax evasion. If a taxpayer stretches the law too far, a court may have to decide whether their actions are legal or not. For example, it is legal to place income in tax havens as long as the income is properly taxed. But concealing such income is a crime.



WHAT IS THE GERMAN GOVERNMENT DOING TO ENSURE FAIR TAXATION AROUND THE WORLD?

The intensified spread of digital technology is not only changing our everyday lives but also transforming the entire economy. This poses major challenges to the international tax system. Digital business models make it possible for multinational corporations to make profits in countries without having an actual physical presence there. Furthermore, digital technology makes it easier for companies to shift their profits to countries that offer low tax rates. This has made it possible for corporations that have subsidiaries located in tax havens to pay very little corporate income tax. This is unfair in at least two senses: first, the government loses out on money that it needs in order to pay for public goods such as schools, childcare facilities and hospitals. Second, it violates our sense of justice when huge multinational corporations can save millions in taxes by exploiting the variations between tax systems in different countries, while individual taxpayers and small local businesses have to follow stricter tax rules at home.

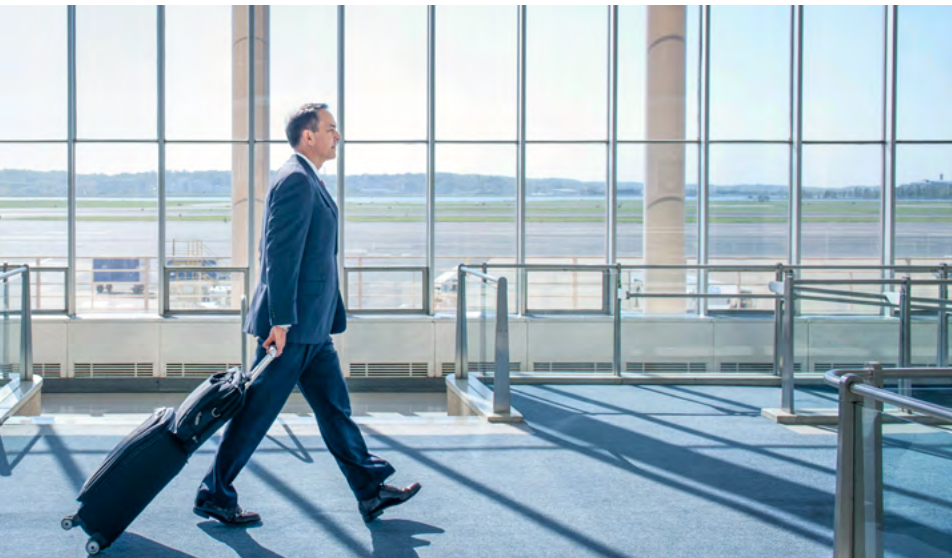
To achieve greater tax fairness around the world, 137 countries and jurisdictions have reached an international agreement to reform the global corporate tax system. The reform encompasses two “pillars”. Under the first pillar, these countries and jurisdictions agreed on a mechanism to ensure a more equitable allocation of tax revenue among states. In the future, new taxing rights will guarantee that the largest and



most profitable multinational corporations pay taxes in countries where their customers live and where their profits are actually made.

The second pillar provides for the introduction of a global minimum effective tax that aims to put an end to harmful tax competition – often referred to as a “race to the bottom”, with lower and lower

corporate tax rates – between countries around the world. In the future, multinational corporations will pay a global minimum effective tax rate of 15% on their profits. No company will pay less than that. A global minimum tax will generate more tax revenue for all states, curb aggressive tax planning, and thereby eliminate tax havens.



TAX OFFICE OR FINANCE MINISTRY?

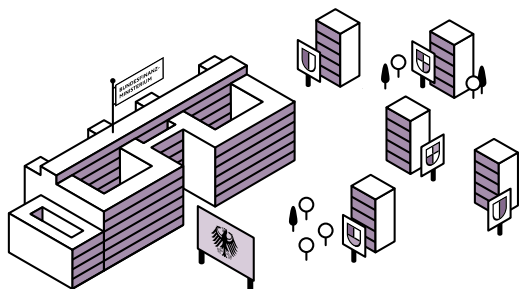
Who writes tax laws? Who is my contact if I have questions about my tax return? Why are there a lot of tax offices and main customs offices but only one Federal Ministry of Finance? Here is an overview of the various functions performed by the Federal Ministry of Finance, tax offices and main customs offices.

THE FEDERAL MINISTRY OF FINANCE:

- > Makes sure that the Federation has the financial resources it needs in order to perform its functions
- > Lays the groundwork for healthy public finances
- > Develops plans and strategies to address key issues of economic, fiscal, monetary and European policy
- > Places a particular focus on budgetary, tax and financial market policy
- > Helps to formulate national and international tax law
- > Takes measures to fight tax evasion, aggressive tax planning, money laundering and terrorist financing
- > Works together with the customs administration to combat undeclared work, unlawful employment and benefit fraud

TAX OFFICES:

- > Are local tax authorities
- > Are located throughout all 16 German *Länder*; as of 2022, there were over 500 tax offices nationwide
- > Carry out the taxation process and investigate tax crimes
- > Process and review tax returns, assess the amount of taxes due and collect them
- > Are the main point of contact for the general public and answer questions on tax matters



GLOSSARY

The taxes mentioned in this brochure are listed below in German and English.

Many working translations of German laws are available online at:

https://www.gesetze-im-internet.de/Teilliste_translations.html

The Federal Ministry of Finance also offers translations of finance-related laws at:

<https://www.bundesfinanzministerium.de/Web/EN/Resources/Laws/laws.html>

Please note that only the German texts of the respective laws are authentic.

ENGLISH	GERMAN
Beer duty	Biersteuer
Coffee duty	Kaffeesteuer
Corporation tax	Körperschaftsteuer
Customs duties	Zölle
Dog tax	Hundesteuer
Energy duty	Energiesteuer/Stromsteuer
Entertainment tax	Vergnügungsteuer
Final withholding tax on interest and capital gains	Abgeltungsteuer auf Zins- und Veräußerungserträge
Income tax	Einkommensteuer
Insurance tax	Versicherungsteuer
Lottery tax	Lotteriesteuer
Motor vehicle tax	Kraftfahrzeugsteuer
Non-assessed taxes on earnings	nicht-veranlagte Steuern vom Ertrag
Real property tax	Grundsteuer
Real property transfer tax	Grunderwerbsteuer
Solidarity surcharge	Solidaritätssteuer
Tobacco duty	Tabaksteuer
Trade tax	Gewerbesteuer
Value added tax (VAT)	Umsatzsteuer/Mehrwertsteuer Please note: These terms are used interchangeably in German.
Wages tax	Lohnsteuer

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