

New Government Announces Proposed Tax Amendments

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The parties of Germany's new government — the Social Democratic Party (SPD), the Christian Democratic Union (CDU), and the Christian Social Union (CSU) — on November 11 reached a coalition agreement that provides for various amendments to German tax and Social Security rules. (For prior coverage, see *Tax Notes Int'l*, Nov. 14, 2005, p. 609.) All the parties have accepted the agreement by votes in their general covenants. Following is a brief discussion of some of the most important proposals.

Proposed Changes Effective January 1, 2006

In the past, it was possible to invest in funds, usually organized in the form of a partnership, that produced significant losses at the beginning of the investment, resulting in substantial tax benefits for the investing partners. Investors were thus able to delay future tax payments, particularly in connection with revolving investments.

Under the amendment proposed by the new government, losses incurred from so-called tax-driven investments no longer could be offset against positive income from other sources. Although the new rule is intended to take effect on January 1, 2006, it could affect investments signed as of November 22, or even November 11, 2005.

The coalition agreement also indicates the government's intention to establish internationally competitive incentives and circumstances comparable to the conditions in other EU member states to attract private investment in German companies. For example, depreciation rates would be increased

for 2006 and 2007, and subsidies available for investments in eastern Germany would be retained, with a focus on investments that support economic growth and the creation of jobs.

Various tax benefits for individuals would be abolished, including public subsidies granted in connection with the acquisition of private homes. Special remuneration paid to employees for working at night or during public holidays would continue, although special remuneration over a basic amount would be partially subject to Social Security contributions.

To reduce the cost of dismissal protection, employers could increase the probation period for new employees up to 24 months.

Proposed Changes Effective January 1, 2007

The general VAT rate would be increased from 16 percent to 19 percent, while the reduced VAT rate of 7 percent would remain unchanged.

The income tax rate would be increased to 45 percent for high-income taxpayers (income exceeding €250,000 for unmarried taxpayers and €500,000 for married taxpayers). As proposed, the increased tax rate would not apply to business income starting January 1, 2008, at which time the government intends to bring into effect a general tax reform for corporations and partnerships.

In anticipation of a German Supreme Court judgment that is expected in 2006, the government also plans to reform the Inheritance and Gift Tax Act, effective January 1, 2007. For example, it intends to

exempt the inheritance of businesses if the recipient continues the business for at least 10 years after the inheritance.

Contributions to the public unemployment plan would be reduced from the current 6.5 percent to 4.5 percent, while contributions to the public pension plan would be increased from 19.5 percent to 19.9 percent.

Other Proposed Changes

Germany's existing VAT system, which allows for the deduction and receipt of input VAT, would be replaced by a so-called reverse charge model for sales between entities or entrepreneurs in an effort to reduce or even eliminate nationally and internationally organized tax fraud. The new government has indicated that it will initiate corresponding activities at the EU level.

State governments would be authorized to set their own rates for the land transfer tax. The federal government also plans to introduce real estate investment trusts, and will seek to expand the existing options for investment in public-private partnerships. A law governing private equity also is being proposed.

The regular age to start pension payments from the public pension plan would be gradually increased from the current 65 to 67, beginning in 2012. ◆

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