IPTI Xtracts

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Competitiveness Index, Germany Retains Top G7 Rank

On the heels of Halloween, leaders of the world's 20 biggest economies endorsed a global minimum tax of 15 percent on large multinational corporations. The minimum tax, signed in Rome and announced by the Organisation for Economic Co-operation and Development (OECD), is intended to curb profit shifting and limit tax rate competition between governments.

In the shadows of this deal lies a scary truth, however. There is much more to a country's tax code than the rate at which the government taxes a corporation.

For example, Germany has the fifth highest combined corporate income tax rate among OECD countries, at 29.9 percent. Italy has a much lower rate, at 24 percent. Given the lower rate and the fact that Rome just hosted such a historic tax deal, Italy must have a more competitive tax code than Germany, *sì*?

The short answer is *nein*.

How, then, should we measure the competitiveness of a country's tax code? More useful, how should we compare the tax codes of the most impactful economies in the world like those in the G7? In what ways should governments strive to be competitive without hurting economic growth or using narrow preferences to attract investment?

The Tax Foundation's recently released 2021 International Tax Competitiveness Index (ITCI) provides many of these answers. The Index aims to evaluate the competitiveness and neutrality of a country's tax code by measuring over 40 tax policy variables. Competition and neutrality are essential to a strong tax code as they promote economic growth and investment while raising sufficient revenue for government priorities.

So, how do Germany and Italy rank this year compared to their G7 partners?

Germany retains the most competitive tax code in the G7 despite slipping from 15th to 16th overall among OECD countries from the 2020 Index. Canada ranks second in the G7 at 20th overall in the OECD, followed by the United States at 21st, the United Kingdom at 22nd, Japan at 24th, and France at 35th. Italy comes in as the least competitive tax code in the G7 and OECD at 37th overall.

How can Germany be the top-ranked G7 tax code with such a high corporate tax rate? Doesn't this rate make Berlin less competitive? Do the experts at Tax Foundation use a broken formula?

Germany scores well on multiple important tax policies relative to its G7 partners beyond its corporate tax rate. Impressively, Germany's property tax score ranks best in the G7 and 11th overall in the OECD. This is primarily due to a lower tax burden on businesses that are looking to improve their property through renovations or expanding a factory and the absence of a wealth tax, taxes on corporate assets, or financial transactions.

Secondly, Germany's cross-border scores rank second best in the G7 and sixth best among OECD countries. This is due to the combination of Germany's expansive tax treaty network with 96 countries and competitive rules that facilitate cross-border investment.

Some G7 countries outperform Germany in specific cross-border policies, such as the United Kingdom, with the most expansive tax treaty network (132 countries), and Canada, with more flexible anti-tax avoidance rules. However, only the United Kingdom has a better combined average score across all four cross-border policies in the G7.

Finally, Germany's consumption tax scores rank 11th best among OECD countries. While this is only the fourth best score in the G7, Germany's value-added tax (VAT), or tax on consumption, is 19 percent, virtually the same as the OECD average (19.2 percent). Furthermore, the German VAT compliance burden is relatively low and has an above average base rank. These above average scores keep the overall German tax code relatively competitive in the G7.

If Germany ranks best in the G7, what can other G7 countries learn from its tax code?

Other G7 countries should reflect on the types of tax policies they rely on for revenues compared to those policy impacts on economic growth. Countries such as France and Italy rank worse than Germany on every major metric in the Index despite France lowering its corporate tax rate over the last few years and Italy lowing its corporate tax rate from 31.4 to 24 percent in 2017. Multiple countries, including Canada, the United States, and the United Kingdom, rank better than Germany on both corporate and individual tax rates. Japan's ranking on corporate tax rates falls short of Germany but ranks better on individual tax rates.

These countries have not been able to overtake Germany's top G7 ranking in the Index because they fail to compete in the other important tax areas—such as cross-border tax rules, consumption taxes, and property taxes—that all contribute to a well-designed tax system.

Germany's relatively competitive and neutral tax policies achieve an efficient balance. The government raises enough revenue to support Germany's social system while promoting investment and economic growth. This balance has allowed Germany's economy to withstand the economic fallout from the COVID-19 pandemic and ensuing supply chain issues.

However, there is still room for Germany to improve relative to the other countries in the OECD. Germany's personal income tax, for example, is complex with an associated compliance burden of 134 hours. That is the third highest among OECD countries. Furthermore, as previously mentioned, Germany has the fifth highest corporate income tax in the OECD. While Germany's tax code does many things well, reforming these policies to increase economic growth would make investment in Germany that much more competitive.

In a world dominated by corporate tax rate headlines and fears of a global race to the bottom, governments and citizens alike should focus on what truly makes a tax code neutral and competitive. More often than not, by looking at Germany's tax code as an example, G7 countries can improve the stability of their revenues and the lives of those they represent.