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By PwC Deutschland | 14 January 2022

Tax privilege granted for income from business profits over income from surpluses in 2007 unconstitutional

In a most recent decision, the Federal Constitutional Court held that the favorable tax treatment of income from trade or business, self-employment, agriculture, and forestry (so called ‘profit income’) versus taxable income computed on a cash-basis (“surplus income”) to be unconstitutional. This privileged tax treatment of income from profits, which only applied for 2007, is considered by the court as unequal and thus not justified.

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In an order published on 12 January 2022, the Second Senate of the Federal Constitutional Court decided that freezing the maximum income tax rate exclusively for income from trade or business, self-employment, agriculture and forestry (referred to as 'profit income' – *Gewinneinkünfte*) in accordance with provisions in the 2007 Tax Amendment Act (Steueränderungsgesetz) and the 2007 Annual Tax Act (Jahressteuergesetz) is incompatible with the general guarantee of the right to equality. The provisions result in an unjustifiable favoring of 'profit income' over income from employment, capital investments and rent (referred to in German income tax law as 'surplus income' (i. e. which is computed on a cash basis by deducting expenses and other allowances or personal deductions from the income / revenues - *Überschusseinkünfte*). The legislator is obliged to revise the provisions by 31 December 2022 at the latest and with retroactive effect for the 2007 assessment year.

The case in dispute: The plaintiffs (spouses) were jointly assessed for income tax for the 2007 assessment period. As managing director of a large accounting firm, the plaintiff earned income from employment of more than €1.5 million. In this respect, the tax office applied the top tax rate of 45% when assessing the joint income tax, which is in contrast to the maximum tax rate of 42% applied on income from profits.

Source:

Federal Constitutional Court, **Press Release No. 2/2022** of 12 January 2022 (Decision of 8 January 2022, case ref. 2 BvL 1/13).

Keywords

profit income, surplus income, tax privilege income