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By PwC Deutschland | 14 September 2022

Federal Cabinet approves Inflation Compensation Bill: cushioning additional tax burdens, supporting families

On 14 September 2022, the German Federal Cabinet approved a bill for an Inflation Compensation Act to compensate for inflation-related additional burdens by means of a fair income tax rate and an adjustment to other tax regulations.

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The Inflation Compensation Act will, inter alia, compensate for the consequences of the so-called cold progression between income tax rates. Additional tax burdens resulting from the clearly noticeable increases in prices will be comprehensively cushioned by the proposed compensation for cold progression. The Cabinet considers this to be an effective and fair instrument which will benefit around 48 million citizens, employees, pensioners, and entrepreneurs. In addition, families will receive targeted tax support. For example, a family of four with an annual income of around EUR 56,000 will benefit by EUR 680 euros per annum.

The bill is intended to implement the adjustments expected to arise from the 14th Subsistence Minimum Report and the 5th Progressions Report in a timely manner, initially taking into account the data from the Federal Government's Spring Projection. When the two reports are submitted in the autumn of 2022, the values will be adjusted accordingly.

Specifically, the following measures are planned:

Updating the income tax rate table.

The basic tax allowance will be increased, and the tariff benchmarks will be shifted. The rise in the basic tax allowance will ensure that taxpayers on or below the subsistence minimum will be tax exempt for the years 2023 and 2024. The shift of the other tariff bands will offset the effect of cold progression at the tariff level. This means that, despite rising inflation, wage increases and reductions in the tax burden will actually reach citizens and will not be reduced by higher income tax rates due to the progression from one income tax band to the next. The shift will not affect the tax bands applicable to very high earners (referred to as the "tax on the rich").

Tax support for families

According to the case law of the Federal Constitutional Court, when taxing families, an income amount equivalent to the material subsistence minimum of a child plus the needs for care and education or training may not be taxed. The tax allowance for parents will be adjusted accordingly for the years 2022, 2023 and 2024, and child benefit will be increased to a uniform EUR 237 per month for the first, second and third child as of 1 January 2023.

Adjustment of tax deduction for maintenance payments

The maximum amount for the tax deduction of maintenance payments, the level of which is based on the basic tax allowance, will be increased, and adjusted retroactively from 2022 through the introduction of a dynamic reference to the level of the basic tax allowance.

Source

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