



German Income Tax Policy Between Equity and Efficiency

LUDWIG VAN DEN HAUWE

Avenue Maréchal Joffre 82 bte 3 B-1190 Bruxelles Belgium

Abstract

Equity and efficiency are usually regarded as the main objectives of tax policy. Commenting on Dr. Reginald Hansen's doctoral dissertation, the author analyses the meaning of the equity-efficiency trade-off framework in the context of the ongoing debate regarding the reform of the German income-tax system. Schmoller's and Wagner's contrasting conceptions of income taxation are discussed. The role of the tax law as an instrument of interventionism within the framework of the "social market economy", especially through the use of tax incentives, is highlighted. Contrary to Dr. Hansen, the author adopts an "Austrian" viewpoint and argues that both the (catalactic) efficiency and equity of tax incentives are disputable, especially but not uniquely through their (ab)use in tax shelter constructions.

Keywords: income tax policy, income tax reform (German), social market economy, tax incentives (equity and efficiency of)

JEL Classification: K34

1. Introduction: the German income-tax system: reform and historical background

A reform of the West German taxation system has been on the policy agenda for quite some time. The two most striking features of the German personal income-tax system are its progressivity and its complexity. Marginal income-tax rates are high, in part because of a desire to achieve numerous policy objectives via tax expenditures. The fact that there are a wide variety of tax exemptions reflecting a multitude of policy goals also adds to the complexity of the system. The reform debate has been taking place within the framework of a continuing public commitment to the "social market economy", but is hindered by the lack of transparency of the tax and transfer systems. The major purpose of the successive tax reforms that have been changing the system for several years was to mitigate the distortive effects of high marginal tax rates. Another purpose of the reforms was to achieve distributive goals. The income tax schedule now comprises different zones. In the first zone income remains untaxed ("basic tax allowance"), while in the "progressive zone", marginal tax rates increase continuously to a maximum value after which they remain constant. In fact the discussion in the Federal Republic of Germany concentrated largely on the distributive consequences of the reform, presumably because they seemed to be more obvious and easier to quantify. Key in this respect was a ruling of the Constitutional Court in 1992 determining that income should be untaxed up to the sub-

sistence level as defined for the purposes of social assistance (see ruling of the German Constitutional Court of 25.9.1992, cited in Hansen 1996, p. 321 footnote 70, see also p. 557). The 1996 tax code aims at securing a higher level of tax free subsistence income allocated to raising children, while at the same time eliminating the peaks in marginal tax rates characteristic of the previous system. The associated costs are borne to an increased extent by companies (with employment greater than 50) which are now responsible for paying cash allowances at the same time as wages (OECD 1996 p. 81). The system has thus become increasingly removed from the principles which initially underlay the concept of a social market economy: promoting the efficiency and growth potential of the economy has become less and less a guidance to the development of the system (OECD 1996 p. 96). On the other hand the reduction in marginal tax rates was combined with a rationalization of the tax base: it was broadened by abandoning a number of privileges held by special groups of taxpayers.

The book under review, which is the doctoral dissertation Mr Reginald Hansen successfully defended on June, 20 1996 at the University of Maastricht, will provide excellent background reading to the ongoing reform debate. The developments sketched above constitute only part of the numerous subjects critically discussed in this book. For according to Dr. Hansen the German income tax system can only be understood by taking a look at its history.

2. Schmoller's and Wagner's contrasting conceptions of income taxation¹

In significant respects Dr. Hansen's book constitutes an attempt to revitalize Schmoller's idea of an income tax in accordance with the concept of ability to pay². The "ability-to-pay" principle as a canon of "just" taxation is notorious for its ambiguity (Rothbard 1970 p. 144). Dr. Hansen discusses the role of the Verein für Socialpolitik and offers a critical overview of the doctrinal debates preceding and following the enactment of the 1891 Prussian Income Tax Code. In his seminal (1863) Schmoller had taken a step toward operationalizing the idea of ability to pay by proposing a definition of income that would become the basis of Schanz's notion of taxable income conceived as "accretion to net wealth" (Schanz 1896)³. This income concept found its way into the favourably received 1874/78 Saxon Income Tax Code (Hansen 1996 p. 514–515). It corresponds to the income definition that later became known in the Anglo-American world as the Schanz-Haig-Simons concept of income taxation. Henry C. Simons based his definition on the earlier definitions of Robert M. Haig and Georg v. Schanz (cited by Shannon III, Esq. 1992 p. 90 footnote 34). Generally speaking, income is defined as the money value of the net accretion to one's economic power (increase of the taxpayer's net wealth) between two points of time. This economically-based concept of taxable income sounds surprisingly modern⁴.

Though the 1874/78 Saxon Income Tax Code served in significant respects as a model for the 1891 Prussian Income Tax Code, the latter basically followed Wagner's entirely different "source principle" as a basis for its income definition, thus adopting a so-called

“schedular” system, i.e. a system in which the source of income affects its taxability (Hansen 1996 p. 516)⁵.

As a result of this combination of two different and in fact mutually incompatible concepts of income taxation, the German tax system has until present been characterized by a dual or hybrid structure. Dr. Hansen is mainly concerned with the practical consequences of this state of affairs. On the one hand it meant that Schmoller’s ideal of an income tax in accordance with ability to pay that would essentially favour greater equality with respect to wealth and income was to be abandoned in favour of a system that offered substantial tax planning opportunities and possibilities of almost complete tax avoidance and, to a lesser extent, tax evasion, particularly for the wealthy.

On the other hand it implied that the German tax law would easily lend itself as a flexible means of implementing various policy goals unrelated to the strictly fiscal requirements of raising revenue. The tax law would become the favourite instrument of interventionism. Thus the role of tax incentives in the history of German tax policy highlights the prevailing German opinion that “nonfiscal” uses or applications of the tax law are generally legitimate.

3. Towards an economic analysis of tax incentives (also tax expenditures, tax subsidies)⁶

The use of the tax law as an instrument of interventionism within the framework of the “social market economy”, especially through the use of tax incentives, constitutes one of the main themes of the book. Dr. Hansen clarifies the complex issues involved by means of a very special concrete example involving so-called “depreciation partnerships” or “loss allocation partnerships”⁷ to which we will return further.

Tax incentives are special tax provisions that deviate from the generally accepted structure of the income tax and that are intended to influence economic behavior. Generally, tax incentives grant special deductions, exclusions, credits or other allowances to reduce the tax on certain income. Many tax incentives are enacted to encourage capital investment.

At the terminological level, the terms “tax expenditure”, “tax subsidy” and “tax incentive” are often used interchangeably. However, certain nuances of meaning do exist. “Tax expenditure” focuses on the implications certain tax provisions have for the budgetary process. It emphasizes the effect those provisions have on government outlays. The term was used since 1967 by Staley S. Surrey, a Harvard tax law professor, who served as Secretary of the Treasury for Tax Policy during the Kennedy administration. “Tax subsidy” focuses on the object of the tax provision from an evaluational standpoint. It implies that the object of the tax provision is something the government ought to support.

Mainstream economists might approach the complex issues surrounding the use of tax incentives as a tax policy instrument by means of the familiar equity-efficiency trade-off framework. Equity and efficiency are usually regarded as the main objectives of tax policy. In the extreme, income taxation might leave everybody with the same net income regardless of how long and how intensive he worked to achieve his income. But this levelling of

the income distribution would be accompanied by huge disincentives to work. On the other hand a poll tax would be the first-best solution if the excess burden of income taxation is to be minimized. But clearly such a tax would not serve in reducing inequality and attaining various distributive goals.

As far as the use of tax incentives to encourage investment is concerned, it is usually considered (see e.g. Shannon III, 1992 p. 84) that both their equity and their efficiency are disputable (see further).

It is certainly tempting to interpret Dr. Hansen's story in terms of the familiar trade-off thesis, but with a few qualifications, for the German situation presents a very special case.

If it would be noticed that the usefulness of the equity-efficiency framework is disputable, it is important to see why this is the case. Its function is at least partly ideological. The problem is that there is no consensus as to how equity relates to justice. Especially classical liberals will suggest that justice and efficiency may by and large coincide. Why then bother about equity? The fact that equity, as opposed to justice, may be more or less quantifiable or "objectively measurable", doesn't make it intrinsically valuable.

With respect to the relation between equity and justice, we simply cannot refuse to take notice of the impact of Rawls ((1972)1973) (see also Rawls((1993)1996) on the thinking about these matters. Dr. Hansen's book doesn't contain any reference to Rawls, but on at least a few occasions his statements seem to come close to something like Rawls's difference principle (see further). The so-called difference principle says that the social and economic inequalities attached to offices and positions are to be adjusted so that, whatever the level of those inequalities, whether great or small, they are to the greatest benefit of the least advantaged members of society (Rawls (1993)1996 p. 6–7). The intuitive idea is that those who have gained more than others are to do so on terms that improve the situation of those who have gained less (Rawls (1993)1996 p. 282).

Moreover the meaning of the equity-efficiency trade-off itself is, we believe, ambiguous. Mainstream political economy interprets the trade-off thesis as expressing an alleged dilemma under capitalism between wealth production and occurrences of "market failure" and inequity. Therefore the judicious use of limited intervention is advocated to preserve laissez-faire capitalism's best features, while at the same time realizing the ideal of, say, greater income equality. Interventionism is thus represented as a politico-economic system that optimally lies between the extremes of laissez-faire capitalism and collectivism, an ideal blend of both systems that manages to avoid the shortcomings of each.

However, we would like to suggest an alternative interpretation of the trade-off thesis. It could also be interpreted as expressing the alleged existence of a tension between the two main varieties of mixed economy interventionism: regulatory-state capitalism on the one hand versus welfare-state capitalism on the other. In regulatory-state capitalism, government uses its coercive powers to alter directly the course of competitive processes in order to promote economic efficiency, broadly construed. Welfare-state capitalism employs political means mainly to redistribute income or wealth directly in order to attain greater equality of outcomes among individuals and groups or a larger measure of security from the vicissitudes of capitalism. The challenge would then consist in finding the sort of interventionist measures, or an adequate combination of interventionist measures of

different sorts, that would reconcile, as far as possible, equity with efficiency. This alternative interpretation of the trade-off thesis fits Dr. Hansen's own descriptions better.

An obvious objection immediately comes to mind: any intervention, regardless of the intent behind it, redistributes income (Posner 1971). Even pure regulation will to some degree produce the effects of a pure transfer (Ikeda p. 153). Perhaps transfer dynamics and regulatory dynamics are fundamentally the same, or at least very similar (Ikeda 1997 p. 40). As we will see, the kind of tax subsidies Dr. Hansen discusses may be rather problematic in this respect.

The German concept of a social market economy clearly embodies elements both of the regulatory-state-type of mixed economy and of welfare-state interventionism. The post-war idea of a social market economy implied that the welfare system would be extended in line with the growth of economic resources (OECD 1996 p. 52). We are not implying that the idea's consistency is wholly unproblematic.

4. The German Economic Miracle and after -

The German Economic Miracle has been credited to the implementation of the idea of the "social market economy". Dr. Hansen rejects the conventional accounts of the German reconstruction after the World Wars I and II insofar as the crucial function of tax incentives - mainly accelerated depreciation for business assets ("rapid write-off") but also investment grants, increased deductions for residential buildings and so on - hasn't been properly acknowledged⁸. According to Dr. Hansen, it was the special combination of high progressivity with a system of tax incentives that provided the impetus for the German Economic Miracle (Hansen 1996 p. 465). One without the other wouldn't work but both together make for wonders. Dr. Hansen forges a novel concept in this context: "fiscally forced investments"⁹. Indeed, in a regime of prohibitively progressive income taxes, the almost only obvious way to avoid incurring tax liability and having to pay these taxes consists of making those capital investments that are eligible for favourable fiscal treatment. According to Dr. Hansen this policy was consciously engineered in order to foster capital formation.

Dr. Hansen's thesis is remarkable. To the extent it is plausible, it is equally remarkable it hasn't been acknowledged in the German public finance literature. Dr. Hansen also suggests it would be naive to believe that tax incentives were a post-World War II invention (see Hansen 1996 p. 519). Accelerated depreciation provides a much cited example. Depreciation is usually based on the useful life of the assets concerned. In case of accelerated depreciation, the increased deduction for depreciation reduces the tax in the year in which it is taken and leads to an improvement in the cash position of the taxpayer (tax deferral). The advantage to the taxpayer is in effect a tax free loan. The example also illustrates that the value of the incentive is a function of the taxpayer's tax bracket (see further).

This state of affairs had some undesirable side-effects however:

a) Tax incentives and catallactic efficiency

From a market process perspective tax incentives raise questions quite apart from equity concerns. On several occasions Dr. Hansen seems to adopt a market process perspective: he recognizes the central importance of the system of relative prices for coordinating individual plans in a market economy. In order to square this insight with a consistent use of the notion of “social market economy” it is necessary to presuppose that it is somehow possible to intervene in the market economy and steer it without totally disrupting the workings of the price system. The arguments of authors as Müller-Armack (see Hansen 1996 p. 247 among others) necessarily presuppose that it is possible to rank the different categories of interventionist measures according to their tendency to disrupt the price system. Thus monetary manipulation and system-wide price controls directly distort relative prices and would immediately be recognized as exceptionally disruptive and for that reason incompatible with the “social market economy”. But other types of measures - say tax expenditures - wouldn't necessarily distort the price system. A commitment to the social market economy would then render the use of the latter sort of measures imperative. It would therefore become possible to steer the economy in a way that essentially complies with the workings of the price system and in this way largely preserves catallactic efficiency¹⁰. It is implied that this is what the use of tax incentives as a policy instrument can accomplish in an almost ideal manner.

However, this story is problematic to the utmost. The disruptive nature of, say, tax incentives may be indirect and less visible, but nevertheless real. First, there could never exist tax incentives, if there was no taxation in the first place. But a neutral tax, i. e. a tax that would not divert the operation of the market from the lines in which it would develop in the absence of any taxation, cannot exist (Mises 1966 p. 737–738; Hansen 1996 p. 458, see also Salin 1985 *passim*). In addition, tax incentives can be seen as praxeologically equivalent to subsidies. Dr. Hansen recognizes there may be reasons to doubt the equivalence, but for the sake of argument, we here assume it holds. To the extent it does, tax incentives will induce resource owners to undertake added investment at the margin in activities that from the perspective of plan coordination may be considered wholly superfluous. The intervention alters the relative value of investments by artificially raising the returns to the target area. To the extent that on the margin the tax incentives encourage some investments that perhaps otherwise would not have been made, they may perhaps be considered “efficient” from the viewpoint of the public authorities supporting them - besides that of the recipients. From the broader market process perspective, however, the overall outcome may be less desirable than otherwise would have been the case. Furthermore, to the extent that the investor would have made the investment whether the tax incentive existed or not, the incentive becomes a pure windfall.

We conclude that from the market process perspective it is at least doubtful whether tax incentive legislation constitutes a policy instrument that can in any meaningful sense be considered efficient in the catallactic sense.

b) Tax incentives and equity

Furthermore, tax incentives raise equity concerns. The use of tax incentives as a policy instrument clearly affects the distribution of income and wealth. Numerous tax avoidance possibilities allow to bypass the progressivity of the income tax system. The effect seems to be a redistribution of income and wealth from the relatively poor to the relatively wealthy¹¹.

Indeed, tax incentives generate an inverted subsidy effect. Because of the nature of the progressive rate structure that characterizes the income-tax system, tax incentives disproportionately benefit the wealthy. A necessary consequence of the progressive rate structure is that incremental reductions of the tax base increase in value as the taxpayer's marginal rate increases. Thus tax provisions reducing the tax base are worth more to the rich and less to the poor. For example a tax incentive deduction of \$100 is worth \$50 to a taxpayer whose marginal tax rate is 50 per cent but only \$10 to a taxpayer whose marginal rate is only 10 per cent. To a taxpayer whose income is so low as not to be subject to income taxation at all, the incentive is worthless.

It is usually considered that since the allocation of direct government subsidies to benefit the rich is difficult to justify, it should be equally difficult to justify an equivalent tax incentive. However, on several occasions Dr. Hansen seems to express the belief that the resulting greater inequality in wealth and income distribution may be justified originally by the necessities of the German Reconstruction and later by the supposedly generated general rise in standards of living. It is implied that greater inequality with regard to wealth and income becomes the price to be paid for economic progress that undeniably benefits the masses (see, e.g. Hansen 1996 p. 337; compare with Rawls's difference principle). From a positive point of view, it is difficult to evaluate the conjecture for lack of empirical evidence. Anyway, it seems that a relatively large share of tax revenue is still derived from those taxpayers who are subject to the higher marginal rates (OECD 1996 p. 77).

c) Tax incentives and the German tax shelter industry -

Since the mid-1960s the situation was altered as tax incentives were increasingly used in real estate tax shelter partnerships, as devices to save taxes and to allow taxpayers in the high brackets to "transform tax liability into wealth"¹². As Hansen points out, these constructions run counter to the purpose of tax incentive legislation¹³.

A partnership is a separate legal entity for civil law purposes but not for German income tax purposes. The characteristic German tax shelter turned around two basic rules. First, the losses of a partnership are allocated to its partners in order to defer taxes otherwise due by the partner on other income. Second, on a subsequent sale of the investment, the investor's capital gains - including the recapture of earlier loss allocations - might be eligible for the special capital gains tax rate of one half of the ordinary income tax rate. In the absence of a pretax profit, the rate differential creates the possibility of a permanent tax saving. However, it is possible to structure the arrangement in such a way

that capital gains realized from the sale of property will not be subject to tax (Hansen 1996 p. 152). Generally capital gains realized from privately held property are not subject to capital gains tax at all in Germany, unless the gain has been realized during the speculation period (two years for immovable property). In this case the income is considered passive investment income and is determined on the basis of the income statement using the cash method, contrarily to income from business activities which has to be determined through the balance sheet according to the accrual method (Hansen 1996 p. 152 footnote 64).

Dr. Hansen explains the leverage effect as a result of debt financing. Due to this effect, tax losses may be allocated to investors beyond 100 per cent of the contribution they made. Indeed, the amount of losses to be allocated to the investor depends crucially on how the total amount of (fixed) assets - or, what should amount to the same, total (long-term) capitalization - relates proportionally to total (long-term) debt¹⁴.

Due to the leverage effect the investor's contribution can more than fully be financed out of tax money.

In fact various alternative arrangements could be considered, such as a GmbH & Co. KG (Hansen 1996 p. 315) which is basically a limited partnership with a corporate general partner - the latter frequently capitalized with the minimum amount allowable -, or a "silent partnership", mostly an arrangement between a "silent partner" and a German limited liability company (GmbH), but the purpose is essentially always the same (see Hansen 1996 p. 314).

Dr. Hansen finally reaches a remarkable conclusion. The fiscal Administration, he contends, has increasingly become engaged in what is essentially a banker's business: the income tax system has become the most important instrument for building and accumulating wealth¹⁵.

d) Tax incentives for investments in East Germany -

Dr. Hansen discusses the economic situation in East Germany as it has been emerging since the ratification of the State Agreement of 18 May 1990 and the Unification Agreement of 31 August 1990. While the State Agreement established the goal of implementing a market economy in East Germany and set forth the terms for the monetary, economic and social union that occurred on 1 July 1990, the Unification Agreement extended the entire legal system of West Germany, including its administrative structure, to East Germany.

Although the State Agreement did not require West Germany to enact specific tax legislation, numerous legislative changes had to be made to accommodate introduction of the West German tax system in East Germany (see also Shannon III 1990 p. 534-547). The West German legislature has also enacted tax legislation that is intended to facilitate investment in the former territory of East Germany (see also Oho and Heinzerling 1991 p. 509-518). In this context Dr. Hansen again endorses the generally accepted view that

the judicious use of tax incentives as an instrument of economic policy will foster the smooth transition of the East German economic system and accommodate its integration with the economy of West Germany¹⁶.

However, it is equally recognized that the problems faced by East Germany today differ significantly from those faced by West Germany after World War II. As far as West Germany is concerned, the vicissitudes of the war had never really jeopardized existing rights of ownership with respect to the means of production and thus possible disputes after the war were to be settled in relatively straightforward manner¹⁷. This state of affairs contrasts sharply with the present situation in East Germany. Indeed, problems regarding the introduction of private property rights in East Germany are intractable and have posed a major obstacle to investment (see also Shannon III 1990 p. 542).

5. The anti-abuse-rule of AO par. 42 -

On several occasions Dr. Hansen refers a bit loosely to the abuse rule of AO par. 42¹⁸ (see Hansen 1996 113, 123, 167 among others). The Anglo-American court practice would treat cases of abuse of legal forms (Hansen 1996 p. 167) according to the apparently simple “substance-over-form” doctrine. Though the German approach may seem more refined, it is not much clearer (see Kramer 1991 p. 97). The rule states that the tax act may not be circumvented by an abuse of possible legal arrangements and that if there is such an abuse, the taxpayer shall be taxed as if he had chosen an adequate legal arrangement. In other words, the tax law cannot be avoided through the abuse of legal forms. In case of such abuse the tax is levied as if a legal form had been chosen that fits into the economic circumstances. Dr. Hansen seems to doubt the effectiveness of the AO par. 42 rule: in many cases it is relatively easy to present an economic rationale even for unusual constructions¹⁹.

Perhaps the legally minded reader will regret that Hansen (1996) contains no systematic discussion of the many interesting problems involved such as how AO par. 42 relates to the methods of analogy and teleological reduction, the doctrine of the autonomy of the tax law and so on.

6. Income taxation and the Methodenstreit -

Strictly from the title, it should be pointed out that readers looking for a balanced treatment of the Methodenstreit may end up disappointed. Dr. Hansen’s treatment of the subject is one-sided and highly selective. He mainly contrasts and compares Schmoller’s and Wagner’s epistemological and methodological preconceptions and he almost exclusively criticizes Adolph Wagner’s. Carl Menger is simply dismissed without serious argument²⁰.

Moreover, one would expect Dr. Hansen to have taken into consideration more recent, twentieth-century contributions to the Methodenstreit²¹.

In particular Hayek has largely reformulated the Austrian methodological position. Hayek also pointed to Comte's influence on the growth of the younger historical school in German economics (Hayek (1952) 1979 p. 384) and thus to an important connection of historicism, especially Schmoller's, with positivism (Hayek (1952) 1979 p. 114). An ongoing connection with positivism seems to be confirmed by Dr. Hansen's reference to Hempel (1952) in footnote 47 on p. 192 of the book.

However considerable Adolph Wagner's influence in the genesis and history of German income-tax legislation may have been, he was at best a figure of secondary importance in the history of economic thought. In a footnote Ludwig von Mises discarded Adolph Wagner as belonging to those authors whose efforts are "evidence of good intentions rather than of scientific sharpness of thought" (Mises (1932) 1979 p. 181).

Coming to terms with the Methodenstreit, especially Menger's debate with the German historicists, particularly Gustav Schmoller, requires the utmost caution. The real differences between German historical economics and Austrian economics related to their divergent views on the objectives of economic research, and the range of problems which the economist aimed to solve. Menger desired to concentrate debate in the Methodenstreit on the risks of taking a one-sided attitude to the development of economic science, he was tolerant of all the avenues of inquiry - statistical or historical, theoretical or applied policy-oriented work (Endres 1997 p. 13–14). Thus we will provisionally settle on a position that can be characterized more adequately as methodological tolerance or even pluralism.

The philosophical side of Dr. Hansen's thesis constitutes, we believe, the most questionable and least convincing part of the book. The book is better read as the author's personal interpretation of German income tax policy in historical and sociological perspective. It is undeniable that the undertitle of the book reflects its main thrust better than the title. Hypothesizing connections between epistemological presuppositions and income tax notions is a risky enterprise anyway.

7. Conclusion

Dr. Hansen's familiarity with the intricacies of German tax law makes the reading of his book a very worthwhile experience. His analysis of the role of "fiscally forced investments" for the understanding of the German Economic Miracle is in line with the authoritarian and statist orientation that German policy has always appeared to embody, especially from the Anglo-American perspective.

However, the story remains largely descriptive and perhaps economists will find it a bit short of praxeological insight. The Austrians have argued that the mixed economy, though largely self-sustaining, is inherently unstable as a system, always in flux, cycling somewhere between the extremes of laissez-faire capitalism and collectivism (for a summary of the arguments, see now Ikeda (1997)).

As Ikeda points out, the transitions from Bismarckian Germany to Weimar to the Third Reich to the German Economic Miracle to Unification, trace a path of fluctuating state power. Thus, the German experience seems to support the Austrian insight regarding the

cyclical behavior of mixed economies (Ikeda 1997 p. 227). Despite the many interesting hints the book undeniably contains, Dr. Hansen's final verdict regarding the internal dynamics of the social market economy remains indeterminate. Furthermore, the whole idea of steering the economy in a market-like manner through the use of tax incentives will appear to Austrians as scarcely more than an ideological rationalization.

Nevertheless, the book's merits are outstanding. Dr. Hansen has carefully constructed his argument out of the very substantial historical and tax literature contained in an impressive bibliography (Hansen 1996 p. 559–663). Moreover he completes the text constructions by means of a fairly extensive and highly innovative appendix, providing unedited copies of documents illustrating some of the most exotic constructions triggered by German tax law. His main argument is novel and one of which German public finance analysis has not taken notice, however surprising this may sound.

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Notes

1. Wagner conceptualized income taxation as "Eingriffsrecht" whereas Schmoller viewed income taxation as "Lastenverteilungsrecht" (see Hansen 1996 *passim*).
2. This is how we translate "eine Besteuerung nach der Leistungsfähigkeit des Steuerbürgers" (see Hansen 1996 p. 36 among others).
3. This is the theory known in Germany as the so-called "Reinvermögenszugangstheorie": "Unter Einkommen verstehen wir ... die Summe von Mitteln, welche der Einzelne ohne in seinem Vermögen zurückzukommen, für sich und seine Familie ... in einer Wirtschaftsperiode verwenden kann". (Hansen 1996 p. 21 among others).
4. Hansen writes: "Grundsätzlich war nach Schmollers Definition in einem Besteuerungsabschnitt alles steuerbar, was verbraucht wurde oder hätte verbraucht werden können, ohne das Vermögen anzugreifen. In dem sächsischen EStG 1874/78 gab entsprechend ein knapper Katalog die wenigen Ausnahmen von dieser allgemeinen Regel an. Leistungsfähigkeit bezog sich auf die ganze Person des Zensiten, nicht auf einen eingeschränkten Teilbereich von Unterhaltsmitteln. Eine strenge Trennung zwischen steuerbarem Markteinkommen und nicht steuerbarer Privatsphäre kannte das Gesetz, anders als später in Preussen nicht." (Hansen 1996 p. 362–363)
5. Hansen states: "In Preussen sollte dann ein anderer Grundgedanke in ähnlich lautenden Vorschriften verankert werden. (...) Zur Sicherstellung vor ungesetzlichen Ausweitungen der Besteuerung in das Stammvermögen sorgte im preussischen Gesetz der Enumerativkatalog steuerbarer Einkünfte. Das Einkommensteuerrecht wurde in Preussen konsequent von vornherein formaljuristisch als Eingriffsrecht nicht unter wirtschaftlichen Gesichtspunkten als blosse Lastenverteilung beurteilt." (Hansen 1996 p. 363)
6. In the remainder of this article, we will translate "Steuervergünstigungen" as "tax incentives".
7. The so-called "Abschreibungsgesellschaften" or "Verlustzuweisungsgesellschaften" (Hansen 1996 *passim*).

8. According to Hansen: "Hohe Steuervergünstigungen haben zusammen mit hohen Einkommensteuertarifen bis heute den Wiederaufbau der Bundesrepublik Deutschland forciert". (sic Hansen 1996 p. 465) And: "Bereits unmittelbar nach Gründung der Bundesrepublik Deutschland zeigte sich die infolge einer von der Besatzungsmacht verordneten hohen Progression des Einkommensteuertarifs ausserordentliche Bedeutung des Wunsches, Steuern zu sparen für die Finanzierung der zum Wiederaufbau erforderlichen Investitionssprojekte. (...) Steuervergünstigungen eigneten sich hervorragend als Ansporn für Finanzierungszwecke und damit zur Auslösung eines sich selbst tragenden Wirtschaftsaufschwungs." (Hansen 1996 p. 299)
9. Admittedly this is a bit awkward translation of "steuerlich forciertes Investitionen" (Hansen 1996 p. 504 among others).
10. The German expression "marktkonform" (or even "formell marktkonform" whatever that may mean, see (Hansen 1996 p. 295)) succinctly expresses the fundamental idea: "Die staatlichen Interventionen (...) durften auf keinen Fall störend in die Marktparameter eingreifen und eine freie Preisbildung durch Wettbewerb behindern. Sie sollten nach der von Müller-Armack geschaffenen Sprachregelung "marktkonform" erfolgen. Hierzu wurde ein reichhaltiges Instrumentarium von Massnahmen entwickelt." (Hansen 1996 p. 247 see also p. 254 and p. 308) And further: "Für Müller-Armack setzte die marktwirtschaftliche Ordnung ..., sofern sie von Dauer sein soll, gewisse Elemente einer zentralen Steuerung geradezu voraus". Diese durfte aber nur "ohne Störung des Marktapparates", also "marktkonform" erfolgen und es musste die erwünschte Anreizstruktur im Preissystem erhalten bleiben. Ein direkter "Eingriff in den Preisapparat" war auszuschliessen. Die Steuervergünstigungen des Einkommensteuergesetzes erfüllten diese Bedingungen in idealer Weise (sic Hansen 1996 p. 254).
11. Dr. Hansen writes: "Denn Steuervergünstigungen im Einkommensteuerrecht stehen einer Besteuerung nach der Leistungsfähigkeit nun einmal entgegen." (Hansen 1996 p. 259) And also: "Der Preis der seit 1949 gegebenen Möglichkeit zur legalen Steuervermeidung, die die Progressionsbelastung bei höherem Einkommen glatt aufhebt, ist eine gewaltige unkontrollierte Umverteilung der Einkommen von unten nach oben." (Hansen 1996 p. 240)
12. This is how we translate the German slogans "Steuern in Vermögen umwandeln" or "aus Steuern Vermögen schaffen" (Hansen 1996 p. 145 and 170)).
13. Dr. Hansen writes: "Die gesetzlich gewährte Steuervergünstigung wurde im Grunde zweckentfremdet." (Hansen 1996 p. 282).
14. Dr. Hansen writes: "Für die konkrete Höhe der anteiligen Verlustzuweisung an die Investoren ist die Relation der aufgenommenen Fremdmittel zu den Aufwendungen für die gesamten Anschaffungs- oder Herstellungskosten des abnutzbaren Investmentobjekts von ausschlaggebender Bedeutung." (Hansen 1996 p. 147 see also p. 528-534).
15. Dr. Hansen writes "Die Einkommensteuer hat sich zum grössten Finanzierungsinstrument bei der Vermögensbildung entwickelt." (Hansen 1996 p. 242, see especially p. 316 and p. 319).
16. Dr. Hansen writes: "Der Einsatz von Steuervergünstigungen des Einkommensteuerrechts kann als technisch ausserordentlich geeignetes und formell marktkonformes Instrument zur Förderung der wirtschaftlichen Eingliederung der neuen Länder bezeichnet werden." (Hansen 1996 p. 295).
17. Hansen writes: "Während in der Bundesrepublik nach dem letzten Krieg die Eigentumsverhältnisse an den Produktionsmitteln in der Regel noch problemlos fortbestanden und in den Fällen eines aus politischen Gründen vorgesehenen Restitutionsanspruchs schnell Rechtssicherheit hergestellt werden konnte, herrscht in den neuen Bundesländern bis heute ein Zustand, den man als Chaos bezeichnen muss." (Hansen 1996 p. 267).
18. AO stands for Abgabenordnung: fiscal code.
19. Dr. Hansen writes: "Gründe zur betriebswirtschaftlichen Rechtfertigung der Gestaltung lassen sich (...) zur Neutralisierung der Umgehungsvorschrift des AO par. 42 leicht formulieren." (Hansen 1996 p. 123).
20. Menger is dismissed as "nur ein Ersatzgegner, der - anders als Wagner - nicht durch Veröffentlichungen von unmittelbarer sozialer Relevanz hervorgetreten war." (Hansen 1996 p. 183) On page 218 we read: "Die praxisfernen Lehren des Wiener Gelehrten Carl Menger konnten für sie (i. e. for Schmoller and Wagner) keine Bedeutung erhalten." (see also footnote 133 on the same page).
21. For more information on the modern Austrian methodological position see the contributions in Boettke (1994).

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