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**Article**

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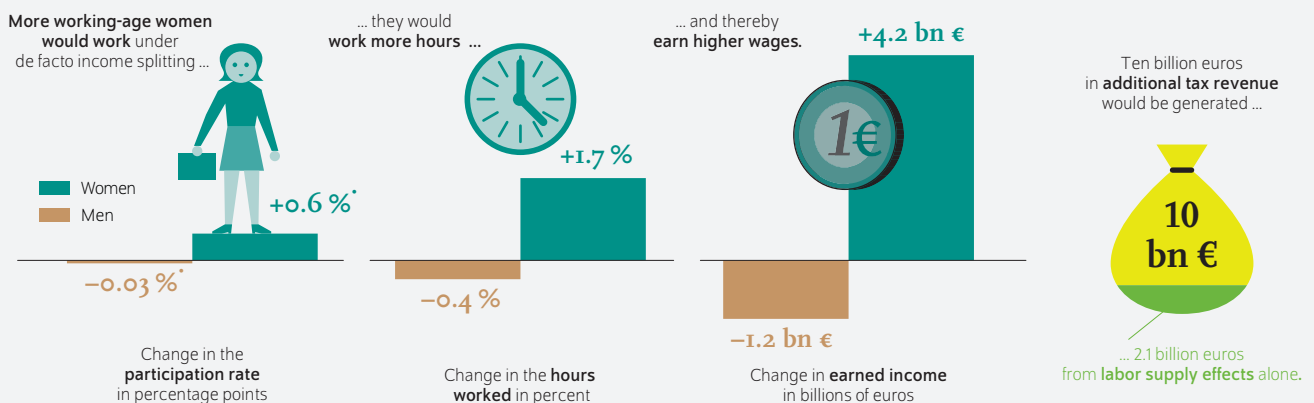
AT A GLANCE

## Reform proposal for marriage taxation in Germany: de facto income splitting with a low transferable amount

By Stefan Bach, Björn Fischer, Peter Haan, and Katharina Wrohlich

- Report analyses possible reforms for *Ehegattensplitting*, the joint taxation of married couples with full income splitting
- De facto income splitting (as with divorced couples) or a transferable personal allowance barely reduce marginal tax burden on secondary earners, only minimally increase women's labor force participation rate
- Additional allowances ease burden on dual income couples with middle and high incomes while tax deductions run into legal issues
- De facto income splitting with a transferable amount equal to the basic personal allowance is a good compromise that fulfills differing requirements
- Reform promotes women's labor market participation and generates additional tax revenue of ten billion euros

### Labor supply effects on married couples with de facto income splitting and maximum transferable amount of 9,696 euros



Source: DIW Berlin calculations using the STSM based on extrapolated SOEP data, distribution v.35, Income Projection 2020 (pre-coronavirus recession), Income Tax Law 2021.

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### FROM THE AUTHORS

“Using the additional tax revenue, the tax burden on families could be eased significantly by increasing the child benefit or child allowance, or by improving childcare infrastructure. Such action would help families with young children now, and much more than the few euros they would have saved under *Ehegattensplitting*.”

— Stefan Bach —

### MEDIA



Audio Interview with Stefan Bach (in German)  
[www.diw.de/mediathek](http://www.diw.de/mediathek)

# Reform proposal for marriage taxation in Germany: de facto income splitting with a low transferable amount

By Stefan Bach, Björn Fischer, Peter Haan, and Katharina Wrohlich

## ABSTRACT

Two traditional options for reforming *Ehegattensplitting*, the joint taxation of married couples with full income splitting, are de facto income splitting (*Realsplitting*) or individual taxation with a transferable personal allowance. However, these proposals do not significantly reduce the marginal tax burden on the secondary earner's income and therefore only minimally encourage married women to participate in the labor market. Another option for reform is an additional personal allowance for married couples, but this concept is difficult to understand and further benefits dual income couples with middle and high incomes. Moreover, alternative methods of taxing married couples in Germany must adhere to specific legal regulations. A satisfactory compromise would thus be de facto income splitting for married couples with a transferable amount equal to the personal allowance. This proposal fulfills the legal criteria, is easily understandable, generates a certain amount of additional tax revenue, avoids burdening the lower and middle income brackets, and encourages secondary earners to participate in the labor market.

Reforming *Ehegattensplitting*, the joint taxation of married couples with full income splitting, has long been a subject of debate in Germany.<sup>1</sup> *Ehegattensplitting* is criticized for benefiting high-earning single earner couples and for establishing a standard of negative work incentives for the secondary earner, usually a woman. Under an individual taxation policy without income splitting, the secondary earner is taxed less. However, policymakers are reluctant to abolish *Ehegattensplitting*, as this would place a greater burden on single earner couples or couples with a low income secondary earner. Reform proposals that consider the maintenance relationship between the partners (as *Ehegattensplitting* does), such as de facto income splitting (*Realsplitting*) or individual taxation with a transferable personal allowance for married couples,<sup>2</sup> reduce the tax advantages of income splitting, but only for high-earning dual income couples or when the income difference between the couples is great. Therefore, the marginal tax burden on the secondary earner is only minimally reduced and even increases in some combinations. This neither encourages married women with children to participate in the labor market nor promotes gender equality in families' work/life balance. More recent proposals by the Advisory Board to the Federal Ministry of Finance (*Wissenschaftlicher Beirat beim Bundesfinanzministerium*, BMF)<sup>3</sup> and the International Monetary Fund (IMF)<sup>4</sup> attempt to increase these effects while maintaining the benefits for single earner couples by introducing additional personal allowances or tax deductions for married couples.

<sup>1</sup> For summaries of this discussion, see, for example, Ulrike Spangenberg, "Der lange Weg zur Individualbesteuerung: Gleichstellungspolitische Perspektiven," *Steuer und Wirtschaft* 4 (2016): 434–353 (in German); Ralf Maiterth and Malte Chirvi, "Das Ehegattensplitting aus Sicht der Steuerwissenschaften," *Steuer und Wirtschaft* 1 (2015): 19–32 (in German); Joachim Englisch and Johannes Becker, "Reformbedarf und Reformoptionen beim Ehegattensplitting," *ifst-Schrift* 510 (2016) (in German; available online. Accessed on September 21, 2020. This applies to all other online sources in this report unless stated otherwise); Maria Wersig, "Der lange Schatten der Hausfrauenehe. Zur Reformresistenz des Ehegattensplitting," *Opladen*; Hermann Buslei and Katharina Wrohlich, "Besteuerung von Paaren – Das Ehegattensplitting und seine Alternativen," *DIW Round-up* No. 21 (2014) (in German; available online).

<sup>2</sup> Under this policy, an amount up to the personal allowance or up to a greater transferable amount is deducted from the taxable income of the higher earning partner. The secondary earner is taxed on this amount.

<sup>3</sup> Wissenschaftlicher Beirat beim Bundesministerium der Finanzen, "Zur Reform der Besteuerung von Ehegatten," *Gutachten* 02/2018: 36 ff (in German; available online).

<sup>4</sup> Victoria Perry, Shafik Hebous, and Alexander Klemm, "Germany: Selected Issues. Tax Pressures and Reform Options," *IMF Country Report* No. 19/214 (2019): 39 ff. (available online).

This Weekly Report compares the effects of the older and more recent proposals for reforming *Ehegattensplitting*. The simulated calculations use data from the last wave of the Socio-Economic Panel in 2018, which is based on income information from 2017. These incomes are extrapolated to the 2020 level, which were expected before the coronavirus recession began and will be able to be reached again in 2021 or 2022 after the crisis has ended. The economic effects of the reforms are calculated using the microsimulation model STSM.<sup>5</sup> The anticipated 2021 income tax law is used, including the proposed changes to the income tax rate, child benefit, child allowance,<sup>6</sup> and the partial abolition of the solidarity surcharge, which was passed in November 2019. Partners are assessed individually when simulating the reform scenarios; only the transferable amounts, additional personal allowances, or tax deductions between the partners are considered. To simulate the effects on the labor market, a structural labor supply model is estimated, whose parameters are used to predict how the labor supply will respond to the various reform scenarios.<sup>7</sup> It is assumed that married couples make labor supply decisions depending on their joint net income. Furthermore, the effects of monthly wage tax deductions by employers are ignored and couples are assumed to make decisions based only on the yearly income tax. Salaried employees are included, but the self-employed are not. The simulations also do not take the possible fiscal reactions of couples to the various scenarios into account, especially in cases of additional corporate earnings or investment income. Such reactions are likely to play a minimal role in the labor supply effects, but could moderately reduce the fiscal revenue effects.

**Individual taxation heavily burdens single earner couples, but significantly reduces marginal tax burden on secondary earners**

*Ehegattensplitting* is a process in which the incomes of both partners are added together and divided in half, with each partner being taxed on half of the joint income. Due to the progressive tax rate, this results in tax advantages (compared to individual taxation) when partners have unequal incomes. The larger the income difference between the partners and the greater the total taxable income, the greater the income splitting savings. *Ehegattensplitting* thus benefits single earner couples taxed at the top tax rates of 42 percent or 45 percent (tax rates for the wealthy) the most. In 2021, the splitting advantage will be 9,128 euros beginning at a taxable income of 116,000 euros; including the solidarity surcharge, the advantage is 11,306 euros. If only one partner is taxed at a rate for the wealthy, the savings increase. For a single earner couple with a taxable income of 550,000 euros or higher, they

5 Viktor Steiner, Katharina Wrohlich, Peter Haan, and Johannes Geyer, "Documentation of the Tax-Benefit Microsimulation Model STSM. Version 2012," *DIW Berlin Data Documentation* 63 (2012) (available online).

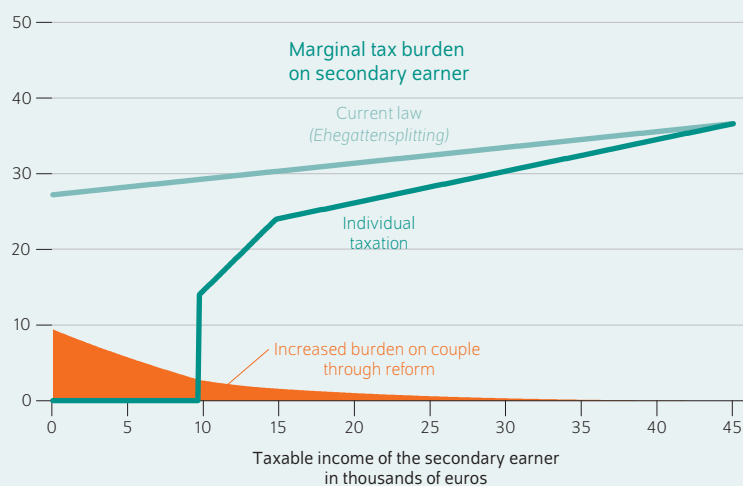
6 Draft bill of the Federal Ministry of Finance, *Entwurf eines Zweiten Gesetzes zur steuerlichen Entlastung von Familien sowie zur Anpassung weiterer steuerlicher Regelungen (Zweites Familienentlastungsgesetz – 2. FamEntlastG)*. Last updated June 30, 2020, 10:11am (in German; available online).

7 Cf. Steiner et al., "Documentation of the Tax-Benefit Microsimulation Model STSM."

Figure 1

**Comparison of *Ehegattensplitting* and individual taxation**

Marginal tax burden on the secondary earner and burden on the couple under this reform in percent of taxable income



Note: For the calculations, a taxable income of 45,000 euros was assumed for the primary earner.

Source: Authors' own calculations using the 2021 income tax rate and the 2021 solidarity surcharge.

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Under an individual taxation policy, couples whose primary or secondary earner have low incomes would be taxed more heavily than previously.

would save 17,366 euros annually. Including the solidarity surcharge, it increases to 18,321 euros, an amount saved each year that is equivalent to the cost of one large compact car.

In 2020, men employed full time have an average taxable income of 45,000 euros from their earned income.<sup>8</sup> For single earner couples, this will result in a splitting advantage of 4,237 euros in 2021, as the solidarity surcharge will no longer be levied on these incomes beginning in 2021. However, the advantage rapidly decreases the more the secondary earner earns: if they earn 10,000 euros annually, the amount decreases to 1,456 euros; if they earn 20,000 euros, it decreases further to 654 euros.

In the following sections, these income effects and the marginal tax burden on secondary earners are illustrated using the example of a couple whose primary earner has a taxable income of 45,000 euros annually (Figures 1 to 7). Under the current policy of *Ehegattensplitting*, both partners are subject to a marginal tax burden of half of their joint taxable income. The secondary earner thus pays a tax rate of 27 percent on the first euro earned and this rate continues to rise as income increases. Accordingly, the secondary earner's net income decreases, along with the motivation to take up or

8 Federal Statistical Office (Destatis), *Verdienste und Arbeitskosten. Arbeitnehmerverdienste 2019* (2019) (in German; available online). Average gross hourly earnings for men, extrapolated to the 2020 level of three percent, 39-hour work week, minus the income-related standard deduction and pension expenses, no other income or special expenses, no extraordinary expenses, no child allowance.

## INCOME SPLITTING

Table 1

### Additional tax revenue generated by Ehegattensplitting reforms, 2021

Quantile according to equivalized gross household income <sup>1</sup>	Individual taxation	De facto income splitting with max. transferable amount of 13,805 euros	Transferable personal allowance	Advisory Board to BMF: Transferable personal allowance and marriage allowance	IMF Proposal 1: Unreduced marriage allowance	IMF Proposal 2: Tax deduction for married couples	De facto income splitting with max. transferable amount of 9,696 euros
Billions of euros							
First decile	0.2	0.0	0.0	0.0	0.0	0.1	0.0
Second decile	0.7	0.0	0.1	0.0	0.1	0.2	0.0
Third decile	1.4	0.0	0.1	0.0	0.2	0.5	0.1
Fourth decile	1.5	0.1	0.1	-0.3	-0.2	0.2	0.2
Fifth decile	2.4	0.2	0.2	-0.3	-0.1	0.6	0.3
Sixth decile	2.2	0.2	0.3	-0.6	-0.7	0.2	0.4
Seventh decile	2.9	0.3	0.7	-0.4	-0.6	0.6	0.6
Eighth decile	3.3	0.6	1.5	-0.1	-1.0	0.8	1.0
Ninth decile	4.5	1.2	2.9	1.3	-0.6	1.8	1.8
Tenth decile	6.6	2.7	5.0	3.9	0.2	3.6	3.5
90–95th percentile	2.9	1.0	2.2	1.5	-0.1	1.5	1.4
Top 5 percent	3.7	1.7	2.8	2.4	0.2	2.2	2.1
<b>Total</b>	<b>25.6</b>	<b>5.3</b>	<b>10.9</b>	<b>3.5</b>	<b>-2.6</b>	<b>8.7</b>	<b>7.9</b>
<i>For information:</i>							
No children	11.8	2.0	5.8	1.7	-2.4	3.0	3.1
Child(ren)	13.8	3.3	5.1	1.8	-0.2	5.8	4.8
Dual earner couples <sup>2</sup>	7.1	1.4	5.5	-1.0	-10.3	-3.2	2.3
Single earner couples <sup>2</sup>	17.8	3.8	4.8	3.9	7.5	11.3	5.5
<i>For information:</i>							
Additional revenue via labor market effects <sup>3</sup>	6.2	1.6	1.1	1.9	6.7	6.0	2.1
<b>Overall impact</b>	<b>31.8</b>	<b>6.9</b>	<b>12.0</b>	<b>5.4</b>	<b>4.2</b>	<b>14.7</b>	<b>10.0</b>
Percent of couple's net household income							
First decile	0.3	0.0	0.0	0.0	0.1	0.1	0.0
Second decile	0.8	0.0	0.1	0.0	0.2	0.3	0.1
Third decile	1.4	0.0	0.1	0.0	0.2	0.5	0.1
Fourth decile	1.3	0.1	0.1	-0.2	-0.1	0.2	0.1
Fifth decile	1.8	0.1	0.1	-0.3	0.0	0.5	0.3
Sixth decile	1.5	0.1	0.2	-0.4	-0.5	0.1	0.2
Seventh decile	1.7	0.2	0.4	-0.3	-0.4	0.4	0.4
Eighth decile	1.7	0.3	0.8	0.0	-0.5	0.4	0.5
Ninth decile	2.0	0.5	1.3	0.6	-0.3	0.8	0.8
Tenth decile	1.8	0.7	1.3	1.0	0.0	1.0	0.9
90–95th percentile	2.1	0.7	1.6	1.1	-0.1	1.1	1.0
Top 5 percent	1.6	0.7	1.2	1.0	0.1	0.9	0.9
<b>Total</b>	<b>1.6</b>	<b>0.3</b>	<b>0.7</b>	<b>0.2</b>	<b>-0.2</b>	<b>0.5</b>	<b>0.5</b>
<i>For information:</i>							
No children	2.4	0.4	1.2	0.3	-0.5	0.6	0.6
Child(ren)	3.1	0.7	1.1	0.4	0.0	1.3	1.1
Dual earner couples <sup>2</sup>	1.2	0.2	0.9	-0.2	-1.7	-0.5	0.4
Single earner couples <sup>2</sup>	5.4	1.2	1.5	1.2	2.3	3.4	1.7
<i>For information:</i>							
Additional revenue via labor market effects <sup>3</sup>	0.4	0.1	0.1	0.1	0.4	0.4	0.1
<b>Overall impact</b>	<b>2.0</b>	<b>0.4</b>	<b>0.8</b>	<b>0.3</b>	<b>0.3</b>	<b>0.9</b>	<b>0.6</b>

1 Equivalence-weighted using the OECD-modified equivalence scale. Quantile classification according to the total population.

2 Single earner couples: the lower-earning partner had a gross income of less than 5,400 euros a year.

3 Assumption: Additional labor supply will be realized to 90 percent at the existing wage level.

Source: DIW Berlin calculations using the STSM based on extrapolated SOEP data, distribution v.35, Income Projection 2020 (pre-coronavirus recession), Income Tax Law 2021.

Table 2

**Labor supply effects on married couples**

Variable	Individual taxation		De facto income splitting with max. transferable amount of 13,805 euros		Transferable personal allowance		Advisory Board to BMF: Transferable personal allowance and marriage allowance		IMF Proposal 1: Unreduced marriage allowance		IMF Proposal 2: Tax deduction for married couples		De facto income splitting with max. transferable amount of 9,696 euros	
	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women	Men	Women
Participation change in percentage points	-0.08	1.52	-0.03	0.37	-0.01	0.55	0.02	0.96	0.10	1.67	0.05	1.63	-0.03	0.56
Change in working hours in percent	-0.52	4.87	-0.27	1.19	-0.37	1.31	-0.30	2.17	-0.11	5.26	-0.41	5.07	-0.35	1.71
Change in aggregate wages in billions of euros <sup>1</sup>	-1.4	10.3	-0.9	3.2	-1.4	3.0	-1.3	4.1	-0.8	10.4	-1.6	10.2	-1.2	4.2

1 Assumption: Additional labor supply will be realized to 100 percent at the existing wage level.

Source: DIW Berlin calculations using the STSM based on extrapolated SOEP data, distribution v.35, Income Projection 2020 (pre-coronavirus recession), Income Tax Law 2021.

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increase gainful employment. In contrast, the marginal tax burden decreases for the primary earner: In the example, they would pay a marginal tax rate of 37 percent under individual taxation instead of 27 percent under *Ehegattensplitting*.

Under the individual taxation policy, both partners are taxed on their own incomes, thereby abolishing the splitting advantages. As a result, single earner couples or couples with a low income secondary earner are more heavily taxed than under the *Ehegattensplitting* policy. At 25.6 billion euros a year, the additional tax revenue from abolishing income splitting is considerable (Table 1). This revenue could be used to provide income and other tax relief or to expand spending programs, such as those for families, childcare, or education.<sup>9</sup> The bulk of the additional revenue is generated from the higher income brackets. However, relative to income, married couples in the middle income brackets are taxed at up to 1.8 percent of their net household income.

The total hours worked by married women would significantly increase under an individual taxation policy (Table 2): Their participation rate would increase by 1.5 percent and their weekly hours worked by almost five percent. A minimal reduction in the labor supply of men would be expected; the weekly hours worked of married men would decrease by 0.5 percent on average. If the additional labor supply is realized to the extent of 90 percent of the existing wages, a further six billion euros in additional revenue from taxes and social contributions would be generated (Table 1).<sup>10</sup> Thus, the entire reform would generate around 32 billion euros in additional revenue.

**De facto income splitting (*Realsplitting*) benefits average earners, thus having few effects on the labor market**

Many countries utilize different forms of individual taxation policies, such as Sweden and Austria.<sup>11</sup> However, this type of policy is not suitable for Germany, as income tax no longer or only partly considers the cash transfers and family support partners pay each other, which is a legal requirement in this country.<sup>12</sup> A pragmatic solution would be de facto income splitting (*Realsplitting*) for all married couples similar to the regulations in place for alimony paid between married couples living separately or divorced couples. The partner with the higher income may deduct a maximum transferable amount of 13,805 euros as special expenses from their taxable income (according to section 10, paragraph 1a, no. 1 of the Income Tax Law (EStG)). The receiving partner has to add the amount to their tax base (according to section 22, no. 1a of the Income Tax Law (EStG)).

In the example of the primary earner with an annual income of 45,000 euros, the marginal burden on the secondary earner starts at an income of 13,805 euros at a rate of 22 percent according to the 2021 income tax rate (Figure 2). When the difference in income between the partners is less than double the transferable amount (in the example, beginning at an income of 17,400 euros for the secondary earner), the transferable amount is reduced accordingly. Then, as under the current *Ehegattensplitting* policy, half of the joint income is reached and *Realsplitting* functions like *Ehegattensplitting*.

9 Stefan Bach, Björn Fischer, Peter Haan, and Katharina Wrohlich, "Ehegattenbesteuerung: Individualbesteuerung mit übertragbarem Grundfreibetrag schafft fiskalische Spielräume," *DIW Wochenbericht* no. 13 (2017) (in German; available online).

10 This is based on the assumption that the additional volume of work is fully subject to social insurance contributions. Revenue is comprised of income tax, the solidarity surcharge, the VAT, the consumption tax, and social security contributions (employee and employer contributions).

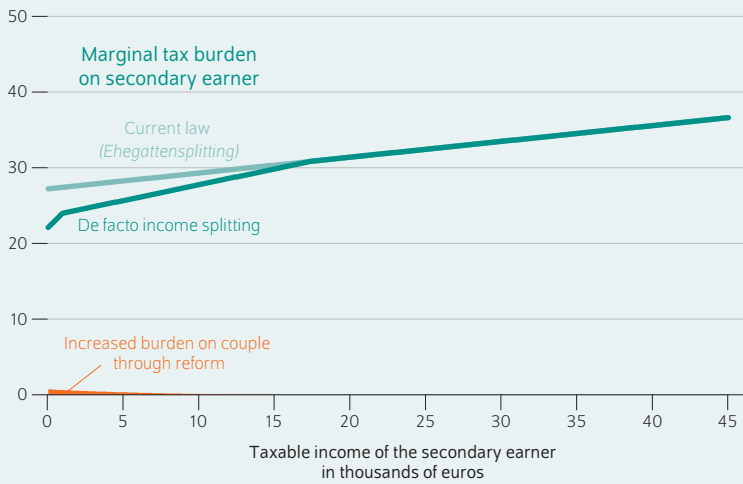
11 An overview can be found in Åsa Gunnarsson, Margit Schratzenstaller, and Ulrike Spangenberg, *Gender equality and taxation in the European Union*. Study for the FEMM Committee, European Parliament (2017) (available online); Herwig Immervoll et al., "An Evaluation of the Tax-Transfer Treatment of Married Couples in European Countries," *IZA DP* no. 3965 (available online).

12 Cf. in particular the German Federal Constitutional Court, *German Federal Constitutional Court Decisions* 82 (1990): 60 (in German; available online).

Figure 2

**Comparison of Ehegattensplitting and de facto income splitting with a maximum transferable amount of 13,805 euros**

Marginal tax burden on the secondary earner and burden on the couple under this reform in percent of taxable income



Note: For the calculations, a taxable income of 45,000 euros was assumed for the primary earner. Maximum transferable amount according to section 10, paragraph 1a, no. 1, sentence 1 of the Income Tax Law (EStG): 13,805 euros.

Source: Authors' own calculations using the 2021 income tax rate and the 2021 solidarity surcharge.

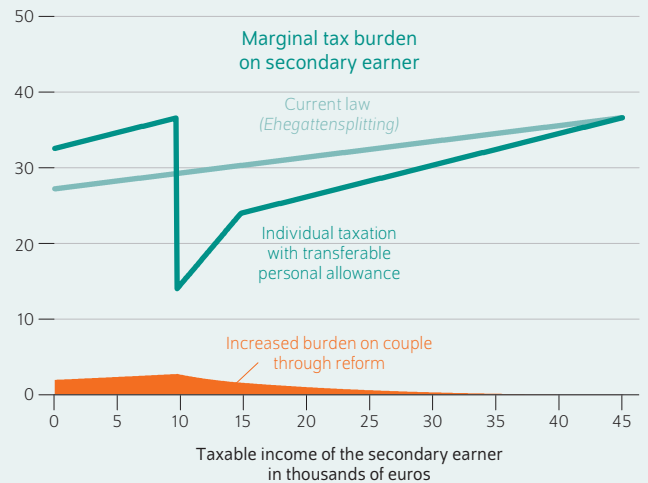
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De facto income splitting only limits the splitting advantages for single earner couples.

Figure 3

**Comparison of Ehegattensplitting and individual taxation with a transferable personal allowance**

Marginal tax burden on the secondary earner and burden on the couple under this reform in percent of taxable income



Note: For the calculations, a taxable income of 45,000 euros was assumed for the primary earner.

Source: Authors' own calculations using the 2021 income tax rate and the 2021 solidarity surcharge.

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One disadvantage of this model is the high marginal tax burden on the secondary earner earning less than the personal allowance, which is partly even greater than under the current Ehegattensplitting policy.

Realsplitting reduces the tax burden on single earner couples; in the example, it is reduced to only 322 euros a year. As a result, however, additional revenue from this policy decreases to 5.3 billion euros (Table 1). Essentially, the reform only limits significant advantages from income splitting and the additional revenue is generated primarily from the upper income brackets.

This reform proposal has a rather small impact on the labor market, as the high marginal burden on secondary earners changes little due to the relatively high transferable amount. The participation rate of married women would increase by almost 0.4 percentage points and the average hours worked weekly would increase by about 1.3 percent (Table 2); the additional income generated by the effects on the labor market is correspondingly low (Table 1).

**Individual taxation with a transferable personal allowance further decreases splitting advantages, but increases marginal tax burden on low-income secondary earners**

Individual taxation with a transferable personal allowance limits the advantages of income splitting to a higher degree; the basic personal allowance, which is either only partly used or not used at all by the secondary earner, is transferred to the main earner. Accordingly, the tax burden on single

earner couples increases to 884 euros a year in the example used. When the secondary earner earns more than the personal allowance, the couple is taxed individually, and taxes increase for high income couples the greater their income difference. Overall, this policy would generate additional revenue of 10.9 billion euros annually (Table 1).

However, one disadvantage of this model is the high marginal tax burden on the secondary earner when they earn less than the personal allowance.<sup>13</sup> The burden increases because the transferable personal allowance is reduced by the secondary earner's income, so 100 percent of the income earned by the secondary earner is taken into account. As a result, the primary earner is taxed on their income at a higher rate and the marginal tax burden on the secondary earner is even higher than under the current Ehegattensplitting policy. This is relevant to a couple's labor market decisions when they make such decisions based on their net household income, as is assumed in the simulation model. When this is the case, the labor market participation of the secondary earner can even decrease. Overall, the labor supply effects of the transferable personal allowance reform are similarly great as in the Realsplitting with a transferable amount of 13,805 euros variant.

<sup>13</sup> Wissenschaftlicher Beirat beim Bundesministerium der Finanzen, "Zur Reform der Besteuerung von Ehegatten," 32 ff.

### Advisory Board to the Federal Ministry of Finance's marriage allowance proposal avoids high marginal burdens on the secondary earner

Complementary to the transferable personal allowance, the Advisory Board to the Federal Ministry of Finance proposes an additional marriage allowance that reduces the high marginal tax burden on the secondary earner.<sup>14</sup> When the secondary earner earns less than the personal allowance, only half of their income is used to calculate the marriage allowance. When they earn more than the personal allowance, 27 percent of their income is used, and this increases with increasing incomes. The allowance is calculated in this manner because with these incomes, the marginal tax burden is added to the secondary earner's own taxes and increases rapidly. The additional personal allowance is granted up to a taxable income of 43,00 euros annually for secondary earners.

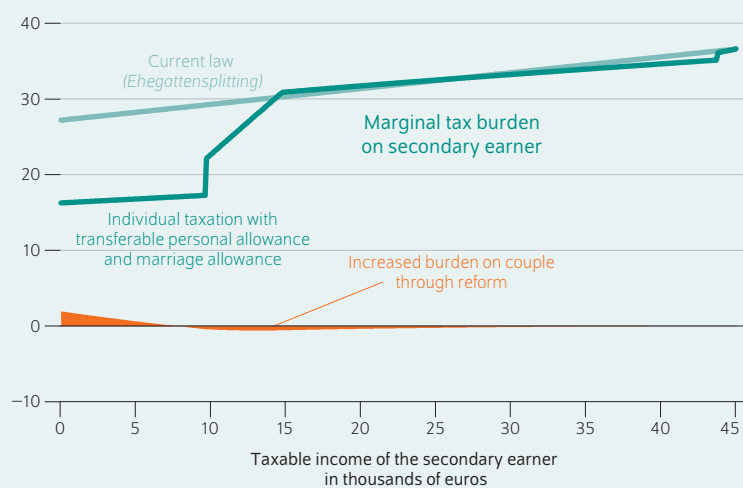
This way, the marginal tax burden on low income secondary earners is significantly lower than under the current *Ehegattensplitting* policy as well as under a transferable personal allowance policy. At the same time, the reduced credit extends the rights to the marriage allowance to high income secondary earners. This phenomenon is well-known from discussions about the "negative income tax" or the universal basic income ("transfer limit"). Under this policy, the marginal tax burden on the secondary earning increases together with their own tax rate at a similar level as under the current *Ehegattensplitting* policy.

In this respect, compared to the transferable personal allowance policy, there are greater incentives to work with a low second income but lower incentives to work with a higher second income. Net, the labor market effects are nearly twice as high as in the variant without the additional marriage allowance. The Advisory Board's proposal would increase the participation rate of married women by approximately one percentage point and their average hours worked weekly by around 2.2 percent (Table 2).

Furthermore, the marriage allowance reduces the tax burden on the average couple with additional earnings—usually earned by the wife—that are one third to two thirds the amount of the primary earner's income. This provides relief to the middle income brackets on average and only generates tangible additional revenue from the top two income deciles. The overall additional revenue from this reform is, at 3.5 billion euros, significantly less than the transferable personal allowance reform. The additional income due to the effects on the labor market increase the additional revenue to 5.4 billion euros.

Figure 4  
**Comparison of *Ehegattensplitting* and individual taxation with a transferable personal allowance and an additional marriage allowance**

Marginal tax burden on the secondary earner and burden on the couple under this reform in percent of taxable income



Note: For the calculations, a taxable income of 45,000 euros was assumed for the primary earner.

Source: Authors' own calculations using the 2021 income tax rate and the 2021 solidarity surcharge.

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The marginal tax burden of low income secondary earners is significantly lower than under current law.

### IMF's unreduced marriage allowance relieves dual income couples but leads to revenue shortfalls

The IMF expanded this concept to include a general unreduced marriage allowance that is granted to all married couples and not calculated according to the secondary earner's income (IWF Proposal 1).<sup>15</sup> This marriage allowance should ensure the minimum subsistence amount (estimated at 15,540 euros according to the minimum subsistence report for 2020) remains tax exempt.<sup>16</sup> Extrapolated to 2021 at three percent (16,006 euros) and minus the primary earner's personal allowance (2021: 9,696 euros), this results in a marriage allowance of 6,310 euros.<sup>17</sup> This amount is significantly less than the second personal allowance, as the couple's subsistence level is reduced by the savings from their joint income.

In this reform proposal, the marginal tax burden on secondary earners is similar to that under the individual taxation policy (Figure 5), while the marginal burden on primary earners

<sup>15</sup> Perry et al., "Germany: Selected Issues," 39 ff.

<sup>16</sup> Bericht über die Höhe des steuerfrei zu stellenden Existenzminimums von Erwachsenen und Kindern für das Jahr 2020 (12th Existenzminimumbericht) (in German; available online).

<sup>17</sup> For tax-optimized allocation, the marriage allowance is deducted from the primary earner when the income difference between the partners is greater than the marriage allowance itself. When the income difference is smaller, the exact income difference is deducted from the higher earning partner and half of the rest of the marriage allowance is deducted from each partner.

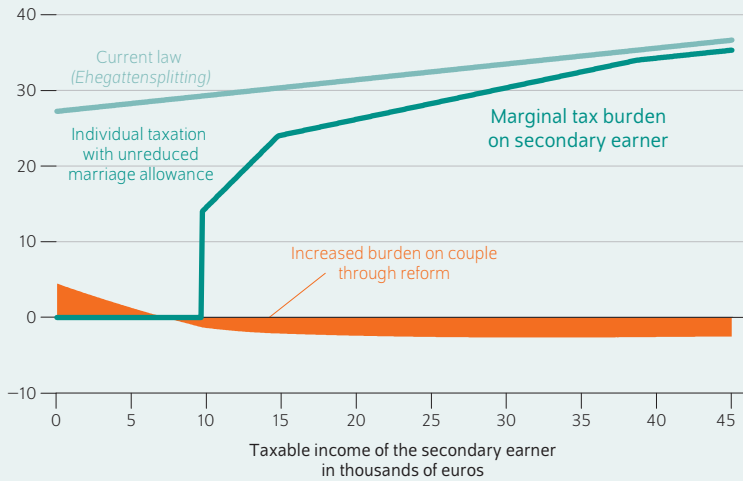
<sup>14</sup> Wissenschaftlicher Beirat beim Bundesministerium der Finanzen, "Zur Reform der Besteuerung von Ehegatten," 36 ff.



Figure 5

**Comparison of *Ehegattensplitting* and individual taxation with an unreduced marriage allowance<sup>1</sup>**

Marginal tax burden on the secondary earner and burden on the couple under this reform in percent of taxable income



1 IMF Proposal 1.

Note: For the calculations, a taxable income of 45,000 euros was assumed for the primary earner.

Source: Authors' own calculations using the 2021 income tax rate and the 2021 solidarity surcharge.

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The marginal tax burden on the secondary earner is similar to that under the individual taxation policy. Unlike under current law, the burden on couples with similar incomes is eased.

is noticeably reduced by deducting the marriage allowance. Advantageously, negative incentives to work on the secondary earner, like in the transferable personal allowance model, are avoided, while positive work incentives for the primary earners are created too. Overall, the labor supply reaction of women under this policy is similar to the reaction under the individual taxation policy. The participation rate of married women would increase by approximately 1.7 percentage points while the average weekly hours worked would increase by over five percent.

Initially, this model leads to a revenue shortfall of 2.6 billion euros annually (Table 1). The significant effects on the labor market, however, increase tax revenue by almost seven billion euros, resulting in a total of four billion euros in additional revenue from this reform. The tax burden on couples with similar incomes is lower than in the status quo legislation (Figure 5). These couples benefit little from income splitting under the *Ehegattensplitting* policy but would receive the entire additional marriage allowance under the IMF's model. This tax relief increases as the partner's income increases, in the end providing the most tax relief to higher earning couples.<sup>18</sup> At the same time, the proposal does not provide tax

relief to single earner couples as much as the transferable personal allowance or marriage allowance models do, as the IMF's marriage allowance is significantly lower than the second personal allowance. In the example, the tax burden on single earner couples increases to 2,010 euros a year (Figure 5).

**IMF's tax deduction for married couples reduces tax burden to level of low income earners**

IMF's second proposal is an individual tax policy with a general tax deduction for married couples (IWF Proposal 2). This amount is to be deducted from the tax debt, not the tax base. This way, the progressive relief of the additional marriage allowance (like the Advisory Board's and IMF's first proposals) is avoided. Instead, the same amount (a tax credit) will be deducted from the tax debt, although no credit is paid out when there is a negative tax debt.

The amount deducted is calculated so that the minimum subsistence level (2021: 16,006 euros) of single earner couples remains tax exempt. According to the 2021 income tax rate, single earner couples (Table) with a taxable income of 16,006 euros have a tax debt of 1,263 euros. Therefore, that amount is set as the tax deduction.

This deduction avoids an increase in tax relief on high incomes and the tax revenue from dual income couples falls significantly. In the case of single earner couples, higher additional tax burdens arise, so that the reform as a whole generates additional revenue of 8.7 billion euros annually (Table 1). The stark effects on the labor market increase tax revenue by six billion euros, resulting in almost 15 billion euros of additional revenue overall.

Under this proposal, the same marginal tax burden applies to both partners as does under the individual taxation policy (Figure 6). It also causes similar labor supply effects as under the individual taxation or the unreduced marriage allowance policies (Table 2).

There are similar policies to reduce the tax burden on single earner couples in many countries, such as Austria.<sup>19</sup> However, such a proposal is likely incompatible with German law. In Germany, private maintenance obligations are regarded as reductions in taxpaying ability. Therefore, it is argued that at the very least, the couple's minimum subsistence level must be deducted from the tax base. Under the progressive income tax rate, the resulting tax relief increases as income increases. For example, tax relief from the IMF's marriage allowance (IMF Proposal 1) increases to 2,840 euros for top earners with the tax rate for the wealthy of 45 percent and the solidarity surcharge. In contrast, the tax relief in the tax deduction variant (IMF Proposal 2) is 1,263 euros for married couples, independent of their income.

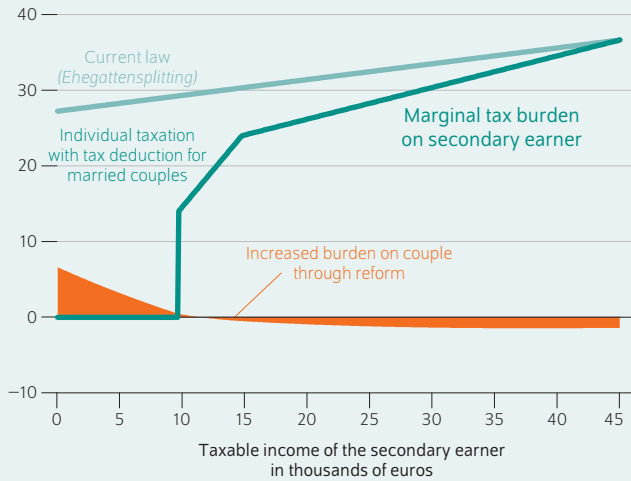
<sup>18</sup> When one partner has a taxable income of 45,000 euros and the other 35,000 euros, this couple would pay 12,076 euros less in income tax (or 2.6 percent of the jointly taxed income) under the IMF's suggestion compared to under the current law.

<sup>19</sup> In Austria, there is a single earner deductible for married individuals with children whose partner has a taxable income of less than 6,000 euros annually. This amounts to 364 euros plus 130 euros for the first child, 175 euros for the second child, and 220 euros for the third child and any further children (in German; available online).

Figure 6

**Comparison of *Ehegattensplitting* and individual taxation with a tax deduction for married couples<sup>1</sup>**

Marginal tax burden on the secondary earner and burden on the couple under this reform in percent of taxable income



1 IMF Proposal 2.

Note: For the calculations, a taxable income of 45,000 euros was assumed for the primary earner.

Source: Authors' own calculations using the 2021 income tax rate and the 2021 solidarity surcharge.

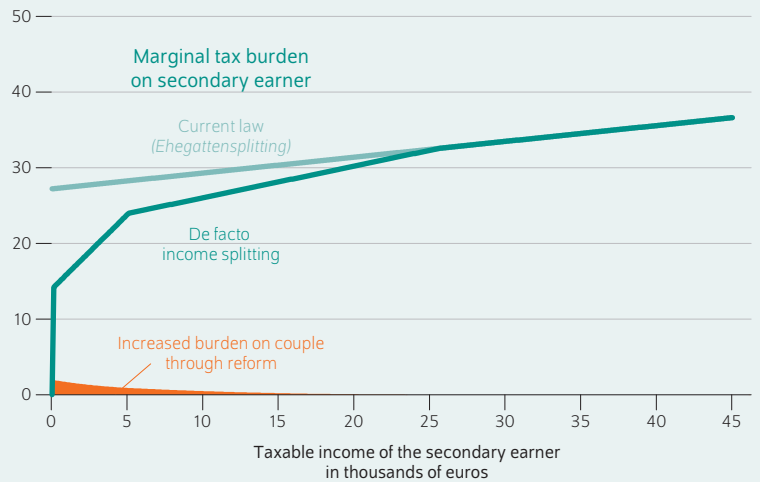
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The same marginal tax burden applies to both partners as under the pure individual taxation policy.

Figure 7

**Comparison of *Ehegattensplitting* and de facto income splitting with a maximum transferable amount of 9,969 euros**

Marginal tax burden on the secondary earner and burden on the couple under this reform in percent of taxable income



Note: For the calculations, a taxable income of 45,000 euros was assumed for the primary earner. Maximum transferable amount corresponds to the basic personal allowance.

Source: Authors' own calculations using the 2021 income tax rate and the 2021 solidarity surcharge.

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The transferable amount is not reduced for low income secondary earners, thereby avoiding high marginal tax burdens on secondary earners.

**Compromise proposal: de facto income splitting (*Realsplitting*) with a transferable amount equal to the personal allowance**

A compromise would be de facto income splitting (*Realsplitting*) with a low transferable amount, as it would result in similar fiscal and labor market effects while simultaneously adhering to the German interpretation of the ability-to-pay principle. Instead of being allowed to transfer 13,805 euros per year between married partners, this proposal only allows the equivalent of the personal allowance (9,696 euros) to be transferred (Figure 7). Accordingly, were this reform to be implemented, the alimony regulations for separated or divorced couples would also have to be adjusted to this amount (section 10, paragraph 1a, no. 1 of the Income Tax Law (EStG)).

Unlike the transferable personal allowance policy, this compromise does not reduce the transferable amount when the secondary earner has a low income. As long as the income difference between the spouses exceeds twice the personal allowance, the transferable amount can be applied without any reduction. This way, the high marginal tax burden on the secondary earner is avoided.

Accordingly, tangible labor supply effects are expected, especially on the average hours worked by married women. Their

average hours worked would increase by around 1.7 percent, a bit less than under the Advisory Board's proposal and significantly less than under the IMF proposals, but more than under the transferable personal allowance variant.

This variant offers the advantages of being more understandable than the marriage allowance and of generating additional fiscal revenue of eight billion euros annually, including labor market effects, of ten billion annually. Instead of burdening lower and middle income couples, couples from the top two income deciles have the greatest tax burden. Furthermore, this reform adheres to the legal requirement that the minimum subsistence level of both partners remains tax exempt.

**Conclusion: Reforming *Ehegattensplitting* could increase women's labor market participation, generate additional revenue**

*Ehegattensplitting* has remained a hot tax policy topic for at least 50 years. Reforming *Ehegattensplitting* is difficult, as reforms must be in accordance with multiple conflicting requirements: Both tax benefits for single earner couples with high incomes and the marginal tax burden of secondary earners must be reduced, thus supporting the labor market participation of secondary earners while simultaneously not taxing the lower income brackets more heavily.

Traditional reform proposals, such as *Realsplitting* with a large transferable amount, maintain the advantages from tax splitting for couples with average incomes. This way, the marginal tax burden of the secondary earner is only minimally reduced. Newer proposals by the Advisory Board to the Federal Ministry of Finance and the IMF attempt to improve work incentives for secondary earners by introducing additional personal allowances. These proposals, however, are either difficult to understand or further benefit dual income couples with average and high incomes, thereby reducing the amount of additional revenue generated. Furthermore, additional personal allowances are likely to create new gender equality issues, as they are deducted from the primary earner, usually a man.

A simple, transparent, and economically prudent solution would be a tax deduction for married couples that is independent of their incomes (IMF Proposal 2). However, this solution, while practiced in many countries, is not suitable for Germany due to ideological and legal reasons.

Overall, *Realsplitting* with a transferable amount equal to the personal exemption could best fulfill the conflicting requirements. This proposal adheres to the legal requirement that both partners are not taxed on their minimum subsistence amount. It increases incentives for secondary earners to work, moderately increases the employment rate of married women, and is likely to create a noticeable rise in their weekly hours worked. Moreover, the proposal is easier to understand than the additional personal allowances and would generate additional fiscal revenue of up to ten billion euros annually, the majority of which would be from couples from the top two income deciles. This additional revenue could be used to relieve taxpayers in general or to improve benefits for families, such as childcare.<sup>20</sup>

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**20** Bach et al, "Ehegattenbesteuerung: Individualbesteuerung mit übertragbarem Grundfreibetrag schafft fiskalische Spielräume."

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