

PRESS RELEASE

## Reforming corporate taxes, reducing investment and financial distortions

- The recently approved corporate tax cut in Germany promises a moderate increase in GDP and investment.
- A more fundamental tax reform that reduces distortions in investment and in the financing choices of firms promises instead a strong long-term increase in investment, income and welfare.
- R&D tax incentives should be simplified. They are effective in stimulating private innovation, thereby contributing to productivity growth.

**Berlin, 12.11.2025** – The German parliament recently decided to gradually cut corporate taxes, which is expected to have a positive effect on investment and firm profits. When taxing firm profits, policymakers generally face a trade-off: On the one hand, these taxes considerably contribute to government revenue. On the other hand, they influence and distort key decisions of firms. “A tax reform that reduces distortions in firms’ investment and financing choices would have significantly larger effects, leading to a much stronger increase in income, employment and welfare in the long term,” says Veronika Grimm, council member. In addition, tax incentives for research and development (R&D) effectively provide incentives for private innovation, thereby fostering long-term growth.

### Worthwhile: neutral design of corporate taxes

The design of corporate taxes (corporate income, local business and personal income tax) can distort firms’ investment, location and financing decisions. In particular, they incentivise debt over equity finance resulting in higher leverage ratios and, ultimately, higher insolvency risk. A more neutral approach of corporate taxation would strengthen investment incentives in the long run, while reducing the incentive for excessive debt. Suitable models have long been suggested in public finance research, for example, the allowance for corporate equity with a tax deduction of the notional cost of equity or the cash flow tax with immediate expensing.

A simulation analysis of various tax reform scenarios in Germany reveals positive long-term effects of such a neutral corporate tax design, including a significant increase in investment, gross domestic product (GDP) and employment. During the transition period, the economy would experience significant fiscal and macroeconomic fluctuations, especially under a cash flow tax. Given the large economic gains, however, moving to a neutral corporate tax design would be worthwhile in the long run.

### Impact of the corporate tax cut in Germany

At 28.5 per cent, the effective tax on corporate profits (combination of corporate income and local business tax) in Germany is high compared with other advanced economies or neighbouring European countries. By 2032, the tax burden in Germany will fall by five percentage points, as a result of the German government’s tax relief programme. This tax cut and the

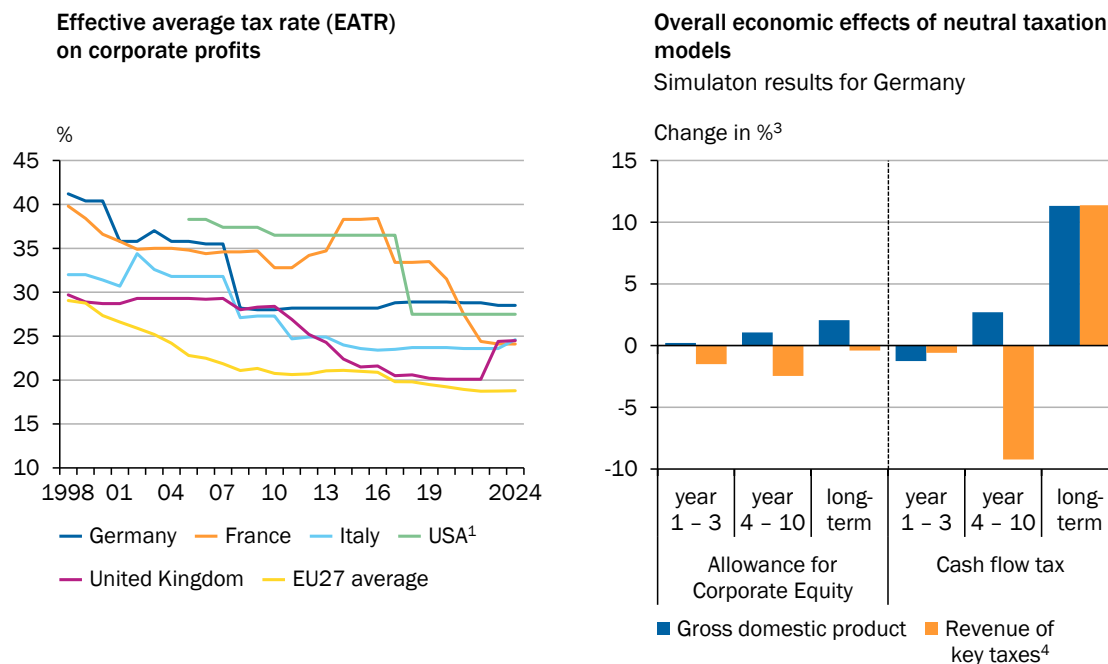
temporary bonus depreciation promises a moderately positive stimulus for investment and GDP, while the total tax revenue will noticeably decline, albeit only temporarily.

In the long run, the simulation analysis suggests positive effects on GDP (1.3 per cent higher) and investment (2.4 per cent higher), as well as moderate welfare gains and employment effects. In addition, the tax cut is likely to be partially passed on to employees via higher wages.

### Simplify R&D tax incentives

Innovation and productivity improvements are crucial for long-run growth. Tax incentives can provide an effective and technology-neutral tool for strengthening firms' incentives to innovate. Germany's research allowance is a significant step in this direction. To facilitate the use of these tax incentives, the application process and documentation requirements should be simplified.

### Tax burden on corporates and prospects for tax cuts and reforms



1 - Data only available from 2005 onwards. 2 - Financed in each case by lump-sum tax. 3 - Compared to the initial balance before the reform. 4 - Total income tax, sales tax, corporate tax, local business tax and capital income tax, excluding revenue from lump-sum tax.

Sources: Neumeier and Stimmelmayer (2025), Spengel et al. (2024)  
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**Press contact:**

Nadine Winkelhaus

Senior media and public relations officer

Phone: +49 611 75-3110

[presse@svr-wirtschaft.de](mailto:presse@svr-wirtschaft.de)