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The End of Germany Incorporated

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In 2000, Germany passed a tax reform that repealed the corporate capital gains tax of 52% on domestic corporate holdings. The law came into effect in January 2002. The expectation was that it would motivate German firms to sell their equity stakes in other firms, altering the network of corporate holdings and corporate control in Germany. The theoretical background is that realization-based taxation of corporate capital gains discourages value-enhancing asset reallocation by creating a “lock-in” effect. This implies that firms hold a sub-optimal portfolio of investments, and that corporations themselves have a sub-optimal set of shareholders.

We seek to carry out two research projects exploiting this law change. First, we have not seen a published research paper that documents the effects of the tax reform on corporate ownership in Germany, although a lot of practitioners and observers have conjectured that the effects ought to be large. Hence, we first would document the effect of the tax reform on corporate equity stakes in other firms and on corporate ownership more generally. Specifically, the tax reform might have had two effects: (i) generally lower the level of corporate ownership and make firms more widely held in Germany, or (ii) reshuffle corporate ownership and block ownership of German firms, with pre-reform blockholders selling and other firms or blockholders buying. Our reading of the limited existing evidence suggests that it was more (ii) than (i), i.e., that the level of corporate and block ownership may not have declined much, but that there may have been a lot of turnover in the blockholders. If that is indeed true, it naturally leads to the second and deeper question: We would want to use the tax-reform to establish a “causal” effect of ownership on, e.g., firm performance or firm investments. The basic idea is that, because of the high capital gains tax before 2002, there are firms with ownership structures that are not optimal. These firms have shareholders who are not the firms’ optimal shareholders but who are trapped by high accumulated capital gains. After the reform, such shareholders sell, and the firms’ ownership structures are improved. The second step is then to examine whether the improved ownership structures lead to higher firm values, better firm performance, or different investment decisions.

We have used the generous funding of the Swiss Finance Institute to start building a comprehensive database of large shareholders in German firms. Building such a database is difficult because many blocks are held indirectly and establishing ultimate ownership is not easy. Once completed, we will share this database with fellow researchers. Because Switzerland’s corporate ownership landscape is somewhat similar to the German one, it is our hope to also gain insights for Switzerland.

Research Team

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Fields of Research

Corporate Finance