

Munich Sydney Conference of The Law and the Economics of Taxation Taxes Compliance in Field and in	Laboratory Experiments Internet of Taxation Interview on with How China has Restructured its	System Failures Visited Comes Research Institute Europe Comes by the Back Door and Taxation and Market Power Research Sharing Burdens	Burden Corporate Tax Incidence Guest Lecture treat and in Taxes and Multinationals Guests	These More the Centrist, are More Disparage Staff Inter- view How Visit Us Conferences Tax Compliance in the	Chinese Restructure the Taxation System Who is Came to Visit Us Conferences Tax Compliance in the	Field and in Laboratory Experiments Workshop at Schliersbergalm Finance and More Back to Door is Laboratory is Research
Taxing And the Market Power Lecture Stories Europe by the Back Door Who is Sharing the Tax Burden	Corporate Taxes Incidence Guest Lecturers Centrist, the More Compliances Interview with Lecturer China is Restructuring its whole Tax System	Visiting Our Institute US Conference Tax Compliance in Field in Laboratories Experiments Workshop in	And Tax Compliance in Field and in Laboratory in Experiments Reset Taxing Compliance Guest Lecture	Corporate Taxes Incidence Guest Lecturers Centrist, the More Compliances Interview with Lecturer China is Restructuring its whole Tax System	Europe by the Back Door Sharing the Burden Corporate Tax Incidence Guest Lecture Institute Centrist Guests Interview China is Restructuring its Tax System	

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A WARM WELCOME TO

Dr. Caroline Heber, Research Fellow
Department of Business and Tax Law



Caroline Heber joined us as a research fellow from the Sydney Law School, where she was a research assistant and completed her Masters of Taxation (MTax). She received her Ph.D. from the Karl-Franzens-University of Graz.

Aart Gerritsen, Research Fellow
Department of Public Finance



Aart Gerritsen studied economics in Utrecht and Groningen, and will receive his Ph.D. from the Erasmus University Rotterdam in February 2014. Since November 2013, he has been working as a postdoctoral fellow at the institute.

Dr. Erik Hornung, Research Fellow
Department of Public Finance



Erik Hornung studied Economics and Technics in Stuttgart and Ottawa and received his Ph.D. in Economics from the University of Munich (LMU). After working with the Ifo Institute and Deloitte, he joined the institute as a postdoctoral fellow in October 2013.

Hendrik Wanger
Head of Administration



After having worked for 21 years as the head of administration at the MPI of Neurobiology in Martinsried near Munich, Hendrik Wanger is now in charge of the administration of two MPIs: the MPI for Tax Law and Public Finance and the MPI for Innovation and Competition.

TAXATION AND MARKET POWER

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It is much easier for a monopolist to pass an increase in taxes onto consumers than it is for a firm exposed to competition. Do you agree? If yes, you are in good company with many people. But you are not in line with standard textbook economics. Kai A. Konrad, Florian Morath and Wieland Müller wondered about the discrepancy between the predictions made by stand-

ard theory and public opinion on the impact of market power on the burden of a tax. They conducted laboratory experiments to analyse the incidence and welfare effects of sales tax increases in monopoly and Bertrand markets. The economists showed that – contrary to public opinion but in line with economic theory – firms with no market power are able to shift a high share of the tax burden to consumers. Intuitively speaking, with Bertrand competition, firms without market power charge prices equal to marginal costs and earn zero profits. Hence, firms cannot bear an additional tax. Either they shift it to the buyers, or they must exit the market.

In contrast, monopolists have already made use of their market power before the tax increase. They bear a large share of the burden of a tax increase: The monopolist's profit can serve as a buffer that enables it to absorb the additional costs. The empirical outcome of the analysis of Konrad, Morath and Müller is close to the textbook prediction as long as the monopolists are dealing with automated demand that emulates consumers behaving in line with textbook economics. For monopolists who offer their goods to real players, things are changing. Some players do not buy at prices they consider too high, even if the price is lower than the monetary value of the goods. The observed monopoly prices are significantly below the monopoly price predicted by standard theory. Therefore, monopolists who face real buyers can shift some of the burden of a tax increase to the consumer. However, the increase is less than half the size of the tax-induced increase in the monopolist's cost.

Konrad, K. A., Morath, F., Müller, W.: Taxation and Market Power. In: Canadian Journal of Economics, forthcoming.

RESEARCH

MORE EUROPE BY THE BACK DOOR



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Mr. and Mrs. Ettwein are Germans. They work in Germany but live in Switzerland. In February 2013, the European Court of Justice (ECJ) decided that the German tax authorities may not refuse to apply the special tariff for married couples to the Ettweins, due to the non-discrimination clause in the Agreement on the Free Movement of Persons (FMP) between the European Union and the Swiss Confederation, signed in 1999. Although the subject of the FMP is the law with respect to foreigners, the ruling of the ECJ indicates that it is also becoming relevant for tax matters. Martina Sunde, lawyer at the MPI for Tax Law and Public Finance, considers this a delicate issue, as it implies a sensitive question: Can European tax law creep into the relationship between Germany, a member state of the European Union, and Switzerland through the back door of the FMP?

In his Advisory Opinion, the ECJ Advocate General had suggested a different decision on the premise that the non-discrimination clause in the FMP is only supposed to protect persons of foreign nationality. According to Sunde, the Advocate General and the ECJ differ in their opinion because the FMP must on the one hand be interpreted in accordance with international legal principles, while on the other hand, the freedom of movement must also comply with EU regulations as stated in the preamble of the FMP. Applying these regulations, however, the ECJ developed its own interpretation in which the principle of practical effectiveness of the EU Law prevails, whereas *ad litteram* interpretations are common in international law. The question of which rule of interpretation applies is also crucial for the FMPs potential relevance for tax matters. An interpretation that gives effect to the spirit of EU law could virtually open the back door for European tax law to apply to Switzerland. Against this background, it will be exciting to see where future jurisprudence leads.

If you read German: http://www.tax.mpg.de/de/pub/aktuelle_meldungen/mehr_europa.cfm

WHO BEARS THE BURDEN OF CORPORATE TAXATION?

To date, the distributional effects of corporate income tax reforms remain unclear. The issue of who actually bears the burden of corporate income tax has not been settled academically. Most economists agree that it falls partly on labour, but there is disagreement about the extent to which the burden is shifted to employees. According to Nadja Dwenger from the MPI for Tax Law and Public Finance and the Berlin economists Pia Rattenhuber and Viktor Steiner, employees benefit less from cuts in corporate taxes than was previously assumed. When tax rates decline, workers can negotiate higher wages with their employers in anticipation of an increase in after-



tax profits. However, on the other hand, higher wages may cause companies to reduce their workforce. This potential decline in the number of employees in response to tax-induced wage increases has been neglected in previous studies on the incidence of corporate taxation.

Dwenger, Rattenhuber and Steiner are the first to take account of the way in which corporate taxation affects employment. Their analysis is based on the so-called right-to-manage model, according

to which wage rates are subject to negotiation, while firms remain free to unilaterally adjust the number of employees once wage rates are set. The researchers found that workers earn 19 to 29 cents more if the corporate tax burden is reduced by 1 Euro. This is about half of the effect estimated in prior literature focusing on wages alone: Assuming constant employment levels, a decrease of 1 Euro in the aggregate corporate tax burden leads to a 47-cent increase in the total wage bill, i.e. in total gross wages payable by all corporations in Germany. The distributional effects of corporate tax reform are considerable: while some employees see their wages rise, others are dismissed because of higher wage costs.

Dwenger, N., Rattenhuber, P., Steiner, V. Sharing the Burden? Empirical Evidence on Corporate Tax Incidence. If you read German: http://www.tax.mpg.de/en/pub/news/sharing_the_burden.cfm

INTERVIEW

HOW CHINA IS RESTRUCTURING ITS TAX SYSTEM



© Wei Xiong

Prof. Wei Xiong

Wei Xiong, Professor of Law at Wuhan University, explains the main priorities for Chinese tax reforms, to what extent the reforms can help to level out inequalities and why courts play a minor role when it comes to Chinese tax policy.

In your opinion, what should the priorities be for the reformation of the Chinese tax system? The most important thing is to push forward the pilot reform, which is the transformation of the business tax into VAT. This will bring two related reforms into place, which are very critical to China's tax reform. The first one is the structural reorganisation of the tax administration and the 2nd one

is the re-allocation of tax revenues among various levels of government.

What is the VAT reform about? Since 1994 we have had a split system of turnover taxes. The coexistence of business tax and VAT has forced taxpayers to pay VAT for their manufacturing revenue and business tax for income from the provision of services. Since the business tax does not provide input tax credits and is imposed repeatedly for each transaction, it is accused of being a cascading tax and of over-taxing service industries. To create a level playing field for all sectors, the reform to combine VAT and the business tax has been initiated. Nevertheless, it is limited to selected industries. The most complex areas like finance, real estate, etc. have been excluded so far and it is believed that they will be covered before 2015.

Why should the tax administration be restructured? We have had a dual system of tax administration and tax collection in China, also since 1994. The State Administration of Taxation (SAT) and its local offices are responsible for the collection of VAT and some other taxes payable to the Central Government. As a matter of fact, the dual system of tax administration gives rise to huge inefficiencies both for the government and for the taxpayers. The collection costs may be as high as 10 percent on average, which is very high compared to 0.5 percent in the USA. Apart from fiscal losses related to public spending, taxpayers have to face two sets of authorities at the same time,

which implies repetitiveness and a waste of time in terms of tax registration, filing returns, tax investigation, etc. At the same time, the SAT and its local offices also face pressure to reorganise as they are not able to fit into the new development of tax administration. In western countries like the USA, taxpayers are treated as clients, which means an equal relationship between the government and taxpayers. This has become the guiding principle underlying the restructuring of the tax administration in China. What the tax authorities should do is to provide improved services according to the taxpayers' needs in order to advance tax compliance.

The property tax reform is, amongst other measures, supposed to re-balance the intergovernmental fiscal relationship in China. Yes, it aims to increase the fiscal revenue of local governments. Confronted with the revenue shortage at the local government level, China introduced an amendment to the natural resource tax in June 2010 first in Xinjiang, and in November 2011 it was implemented in other regions as well. The idea was to raise the tax on specific natural resources and to keep the additional revenue with the local governments. For places that are not rich in natural resources, China has been thinking about reforming the property tax regime by making owners pay more for their properties. Initially, the authority tried to introduce a brand new real estate tax in place of the existing property tax. However, even after almost ten years of research and discussions no consensus could be reached.

What happened next? The most important challenge is that, based on the current progress in the principle of legality, any new tax has to be imposed by the legislature, not by the executive. Maybe in order to circumvent this difficulty, the government decided to introduce a pilot program in Chongqing and Shanghai effectively as of January 1st 2012, without changing the existent property tax system fundamentally. There is an exemption for residential properties in the property tax regulations, which was created by the Central Government in 1986 with the authority of the National People's Congress. This exemption is not applicable in the pilot areas, as the relevant local governments have been authorised to design their own rules to tax residential properties. This is why tax lawyers and tax law professors have continuously raised doubts about the legitimacy of the pilot reform (...).

Read the full interview on our website: http://www.tax.mpg.de/en/pub/news/chinese_tax_reforms.cfm

CONFERENCE

THE LAW AND ECONOMICS OF TAXATION

The “Munich-Sydney Conference on the Law and Economics of Taxation” at the beginning of September, 2013 in Munich marked the launch of a new cooperation between the Max Planck Institute for Tax Law and Public Finance and the University of Sydney. Leading researchers from the University of Sydney, the MPI for Tax Law and Public Finance, the LMU Munich, the University of Oxford and the Ifo Institute met in Munich to discuss their current projects.



Moris Lehner from the LMU Munich gave a profound analysis on the problems of overriding treaties from a constitutional and comparative perspective.



Glen Loutzenhiser from the University of Oxford presented his work on small business taxation in the UK, which the basis of a larger comparative study on small businesses and the taxation of income from employment and investments in the UK and Australia.

Jennifer Hill (front), professor of corporate law at Sydney Law School, offered an overview of ideas regarding the role of shareholders in corporate enterprises over the last century and of how these ideas have influenced legislation and jurisprudence.



HOW TO FIND OUT WHAT YOU WON'T TELL ME



Expecting the tax compliance conference

Tax evasion is a major problem in many countries. Unfortunately, there is still rather limited knowledge about why people pay or don't pay taxes and how they can be motivated to do so. One of the reasons for this is that, even if researchers have full access to the administrative data held by the tax office, it is extremely difficult for them to find out if and to what

extent individuals are tax compliant. This is why researchers mostly rely on laboratory and field experiments to study tax morale and tax compliance. A two-day conference entitled "Tax Compliance in Field and Laboratory Experiments" at the MPI for Tax Law and Public Finance, organised by Nadja Dwenger and Kai A. Konrad, examined how to design tax compliance experiments and the most recent findings in this field.

Academics from around the world gathered to discuss how the determinants of individual behaviour can be identified, what motivates individuals to comply with tax and what a modern tax system must look like to provide the best incentives for tax compliant behaviour. The work presented underlined the importance of traditional enforcement instruments such as audits and fines and discussed the role of recognition through social and monetary rewards. Appeals to tax morale were shown to be another effective way of increasing tax compliance.



Conference participants lined up for a group photo

The results should, not least, be of interest to tax authorities, particularly given the fact that the conference brought together the best scholars working on field experiments on tax compliance.

Please find the conference program, the list of the participants and selected papers in our conference archive: <http://www.tax.mpg.de/en/pub/events/archive.cfm>

GUEST LECTURE

THE MORE CENTRIST, THE MORE DENIGRATION



Prof. Dr. Jan K. Brueckner

Electoral campaigns are not for the faint hearted. There is hardly a political party anywhere that wouldn't run down its opponents. Jan K. Brueckner, professor of economics at the University of California in Irvine and Kangoh Lee, professor at the San Diego State University, have studied the factors that influence negative campaigning. Their analysis generates a clear prediction relating political negativity to centrism. Brueckner presented the findings at the MPI for Tax Law and Public Finance on September 11th 2013.

They used a probabilistic voting model to predict the relationship between the outlay for negative campaigning and the characteristics of political parties. This approach to voting analysis recognises that voting decisions do not only depend on the proximity of the candidates' positions to the political positions of voters but also on random events. These can be so-called political shocks, e. g. a recent terror attack or the so-called valence of a candidate, such as his charisma or his appearance. Due to these random events, the median voter's position is no longer fixed. A candidate no longer tries to move in the space between his opponent's position and the median voter, with the goal of stealing all undecided voters. A better strategy for her or him is to take a position close to the median voter, regardless of the opponents' position. At the same time he or her should try to shift the perceived position of the opponent further away from the preference of the median voter by negative campaigning. According to Brueckner and Lee, positive spending can either push a candidate's perceived position towards the centre or enhance the attractiveness, or valence of the candidate. In any event the following applies: As the candidate's position moves toward the median, the gain from becoming marginally more centrist diminishes. With equal budgets, the more-centrist candidate will spend more money on negative campaigning than his opponent, trying to push his opponent farther away from the median. The more-extreme candidate, by contrast, favours positive spending. An empirical analysis of data from the US Senatorial election from 1992 to 2002 supports the theoretical predictions.

If you read German: http://www.tax.mpg.de/en/pub/news/negative_campaigning.cfm

HOW THE U.S. TAX COURT WORKS



(from left to right) Sime Jozipovic, MPI; Prof. Robert Brauneis, George Washington University Law School; Prof. Michael Dirkis, University of Sydney; James S. Halpern, US Tax Court; Prof. Wolfgang Schön, MPI for Tax Law and Public Finance.

James S. Halpern, who is a Judge of the US Tax Court in Washington and at the same time professor of law at George Washington University, visited the institute and gave an insight into the work of the U.S. Tax Court and its role in U.S. tax litigation.

WOLFGANG SCHÖN'S LECTURE AT DSTJG ASSEMBLY

At its 38th annual assembly, which took place on the 9th and 10th of September 2013 in Berlin, the German Fiscal Association (DStJG –Deutsche Steuerjuristische Gesellschaft) focused on the reform of tax law. As one of the invited speakers, Prof. Dr. Dr. h.c. Wolfgang Schön discussed the role of corporate taxation in income tax law.

DR. PHILIPP AIGNER HONOURED FOR DISSERTATION

Dr. Philipp Aigner's doctoral thesis entitled "Wegfall der Einkunftsquelle bei den Kapitaleinkünften (§ 20 EStG n.F.)" ("Loss of Income Source under § 20 Income Tax Act") was awarded the "Wissenschaftspreis" of the Munich Chamber of Tax Consultants. Philipp Aigner wrote his doctoral thesis at the MPI for Tax Law and Public Finance, which also supported him with a scholarship. He was supervised by Prof. Dr. Monika Jachmann, honorary Professor for Public Law at the Ludwig-Maximilians-University of Munich and Federal Finance Court Judge.

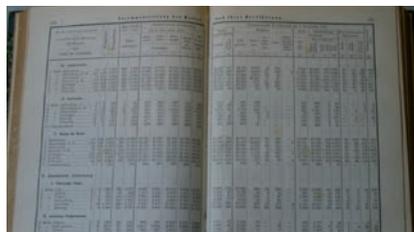
MISCELLANEOUS

KAI A. KONRAD ELECTED TO LEOPOLDINA

Prof. Dr. Kai A. Konrad, Director at the MPI for Tax Law and Public Finance, has been elected to membership of the German National Academy of Sciences Leopoldina, in recognition of his scientific achievements. Founded in 1652, the Leopoldina is one of the oldest science academies in the world and was appointed the German National Academy of Sciences in 2008. Its former members include scientists as Marie Curie, Charles Darwin, Albert Einstein and Max Planck. Currently it is comprised of 1500 members, who are distinguished national and international scholars. As a member of the Leopoldina, Kai A. Konrad will take part in scientific work and events aimed at engaging policymakers and the scientific community in key issues of significance for the future of society.

LEIBNIZ PRIZE FOR YOUNG ACADEMICS

Erik Hornung has been awarded the Prize for Young Academics of the Leibniz Association for his doctoral thesis about the importance of education, migration and technological innovation for economic development. By analysing census data collected by the Royal Prussian Statistical Office over the period 1816-1901, Hornung traces the causal chain leading from education to the diffusion of technologies and economic development. He uses innovative methods and disproves the prevailing opinion that education did not play a role during industrialisation, at least in its first phase. Erik Hornung wrote his dissertation at the Ifo Institute in Munich. In October 2013 he started working as a research fellow at the MPI for Tax Law and Public Finance.



©Hornung

For his work, Erik Hornung digitised and organised data that the Royal Prussian Statistical Office collected over the period 1816-1901. He digitised about 1 million of the historical material's data fields. First, the original sources were photographed and then the data was transferred manually into spreadsheets. The result is a huge database, the Ifo Prussian Economic History Database (iPEHD). Picture: Royal Statistical Bureau (1873), Volume VIII, pp. 234-235.



SELECTED PUBLICATIONS

Schön, W. Das System der gesellschaftsrechtlichen Niederlassungsfreiheit nach VALE. In: ZGR, 2013, Volume 42 (3), pp. 333 - 365.

Konrad, K. Affection, speed dating and heart breaking. Journal of Population Economics, forthcoming.

Xiao, E., and Tan, F. Justification and legitimate punishment. Journal of Institutional and Theoretical Economics, forthcoming.

Osterloh-Konrad, C., and Lagdali, N. Eigen- und Fremdkapital im Steuer- und Gesellschaftsrecht Frankreichs. In: Schön, W. (ed.): Eigenkapital und Fremdkapital. Springer, 2013, p. 373 - 432.

User Cost Elasticity of Capital Revisited

Dwenger, N.

Economica, forthcoming.

To what extent do taxes affect business investment spending? The response of capital to changes in user costs is pivotal to any economic analysis of tax reforms and monetary policy. But for nearly 50 years researchers have lacked consensus about the elasticity of the user cost of capital. In a recent article, Nadja Dwenger from the MPI for Tax Law and Public Finance argues that the prior estimates may differ because one of the two main strands of research neglected the co-integration of capital, its user costs, and sales. Using German firm-level panel data, Dwenger shows that estimates made by a distributed lag model, which has been widely used in prior literature, lead to low estimates of user cost elasticity. Properly accounting for co-integration in an error correction model yields a much larger point estimate of the price elasticity of capital equal to -0.9. This estimate means that a decrease in the user cost of capital by 1 percent, for example, as a consequence of tax reductions, increases the capital stock by 0.9 percent in the long run. Tax reforms and changes in monetary policy thus strongly affect investment decisions.

Eigenkapital und Fremdkapital

Schön, W. (ed.)

Springer, 2013, MPI Studies in Tax Law and Public Finance, Volume 3, 876 pages.



The practice of differentiating between debt and equity for tax purposes is currently the centre of a fierce debate. Suggested reforms that aim to level out the tax advantages and disadvantages of the different forms of finance are being discussed internationally. The recently published volume “Eigenkapital und Fremdkapital” (Debt and Equity) dedicates itself to the task of re-thinking the way in which the borderline between debt and equity is drawn both from a tax perspective and on the basis of private law. The work – the authors of which are all active or former scholars and guests of the MPI for Tax Law and Public Finance – is not only a contribution to the jurisprudential and legal policy debate. Due to its wide-ranging comparative legal analysis it can also be considered an introduction into the national and international practice of corporate finance in tax and company law.

Rechtsschutz gegen rückwirkende Steuergesetze durch die Europäische Menschenrechtskonvention – ein Vergleich mit der Rechtsprechung zum Grundgesetz

Meindl, A.

StuW, 2013, p. 143 - 155.

One of the fundamental issues in tax law is the extent to which legislators may retroactively impose tax liabilities given the taxpayer’s reliance on the previous tax law. The German Federal Constitutional Court (BVerfG) generally prohibits genuine retroactivity where a statute interferes with affairs that have already terminated. But as a rule it accepts de facto retroactivity where it affects affairs that are ongoing. The BVerfG examines whether the legitimate expectation deserves protection by virtue of fundamental rights and the rule-of-law principle, whereas the European Court of Human Rights in Strasbourg (ECHR) weighs the permissibility of retroactive taxation against the right to property by balancing the requirements of public interest and the protection of the individual. In a recent article Angelika Meindl, research associate of the MPI for Tax Law and Public Finance, compares the jurisprudence of the ECHR and

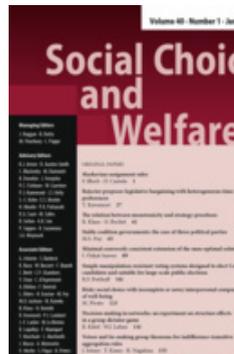
the BVerfG and questions the distinction between genuine and de facto retroactivity. By examining two cases from France and Great Britain Meindl illustrates that the distinction might lose its relevance because the courts will always try to achieve a fair balance.

Volunteering and the Strategic Value of Ignorance

Morath, F.

Social Choice and Welfare, 2013, 41(1), p. 99-131.

Many public goods are provided through the efforts of a single individual; examples include intervening in a fight, household chores, and mythical dragon-slaying. Such situations are often best described as a war of attrition: One volunteer is needed for a certain task, and everyone prefers someone else to volunteer first and bear the cost of providing the item for the public benefit. Typically, there is a negative utility or waiting cost associated with the time until a volunteer is found. Furthermore, the individuals often do not know exactly how costly the act of volunteering will turn out to be. Florian Morath studies the incentives that the individuals have to obtain information about what it will cost them to provide the item ahead of a volunteering game (war of attrition). He shows that the individuals attach a strategic value to the information: they may prefer to remain uninformed and not learn what it will cost them. Not having too much information about the cost or benefit of a public good can help individuals to act more aggressively in the volunteering game. If the time horizon is sufficiently short, then, all things being equal, only one individual will acquire information.



Interested in more scientific research results?



Read the discussion papers of the research fellows of the Max Planck Institute for Tax Law and Public Finance on:

<http://www.ssrn.com/link/Tax-MPG-RES.html>

GUESTS OF THE INSTITUTE

Our guests from August to December 2013: **Pierre Boyer** (University of Mannheim), **Yariv Brauner** (Levin College of Law, USA), **Jan Brückner** (University of California, USA), **Daniele Cané** (Jones Day, Italy), **Luca Corazzini** (University of Padova, Italy), **Tom Cusack** (WZB Berlin Social Science Center), **Michael Dirkis** (Sydney Law School, Australia), **Samuel Häfner** (University of Basel, Switzerland), **Michael Kobetsky** (Melbourne Law School, Australia), **Sebastian Kessing** (University of Siegen), **Tobias König** (WZB Berlin Social Science Center), **Dan Kovenock** (Chapman University, USA), **Sarah Lindeberg** (University of Stavanger, Norway), **Tim Lohse** (Berlin School of Economics and Law), **Axel Möhlmann** (Leibniz Universität Hannover), **Thomas Moutos** (Athens University of Economics and Business, Greece), **Ronnie Schöb** (Freie Universität Berlin), **Lee A. Sheppard** (Tax Analysts, USA), **Wei Xiong** (Wuhan University, China).



IMPRINT

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