Increasing transparency on tax expenditures in Germany

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by *Flurim Aliu (CEP)*[1]*, Robert Grundke (OECD), Christian von Haldenwang (IDOS)*[2]

Since the 1960s, Germany has been among the first countries to publish regular reports on tax expenditures. Today, however, its tax expenditure reporting is incomplete and lacks consistency. Reforms are needed to increase transparency related to tax expenditures and enable a better prioritization of the use of public resources.

Introduction

As argued in the 2023 OECD Economic Survey of Germany, addressing the large accumulated investment backlog and investment needs related to the green and digital transitions will require a large amount of public resources. At the same time, rapid population ageing increases public spending pressures in pension, health and long-term-care systems and exacerbates labour shortages. Lowering labour taxes to improve incentives to raise labour supply, particularly for low-skilled workers and second earners, could further reduce fiscal space. To tackle these challenges while safeguarding fiscal sustainability, it is crucial to increase public sector spending efficiency and better prioritise spending.

To this end, transparency on spending items is key. As in many other countries, the use of public resources to grant beneficial tax treatments (or tax expenditures) is less well reported and scrutinized in Germany than direct spending. Tax expenditures are defined as deviations from a benchmark tax system that typically benefit specific sectors, groups of individuals or activities. Policymakers use them to pursue different objectives, such as attracting investment, promoting employment or fighting poverty.

Like other EU countries, Germany publishes regular and comprehensive reports on tax expenditures. Its official tax expenditures figures are remarkably stable over the years, averaging 0.9 per cent of GDP since 2014, according to the Global Tax Expenditures Database (Redonda et al. 2023). Although significant differences in benchmark tax systems exist between countries influencing estimates of tax expenditures, these figures are considerably lower than those of Germany’s neighbors (such as the UK: 7.5 per cent of GDP or the Czech Republic: 10.5 per cent) or many other OECD member countries (e.g. US: 7.4 per cent; Australia: 8.4 per cent).

However, this does not necessarily mean that Germany has used tax expenditures more prudently than other countries. Germany’s tax expenditure reporting is incomplete and lacks consistency, and its official figures do not provide the full picture. The main reason for this is that Germany does not apply a well-defined tax benchmark, and as a result does not have a transparent list of tax expenditures. This limits tax policy reform discussions. Neither the political authorities – the German Bundestag in particular – nor the general public are currently in a position to fully assess the extent to which tax expenditures are used in the country, or to lead a well-informed debate on their effectiveness for public policy purposes.

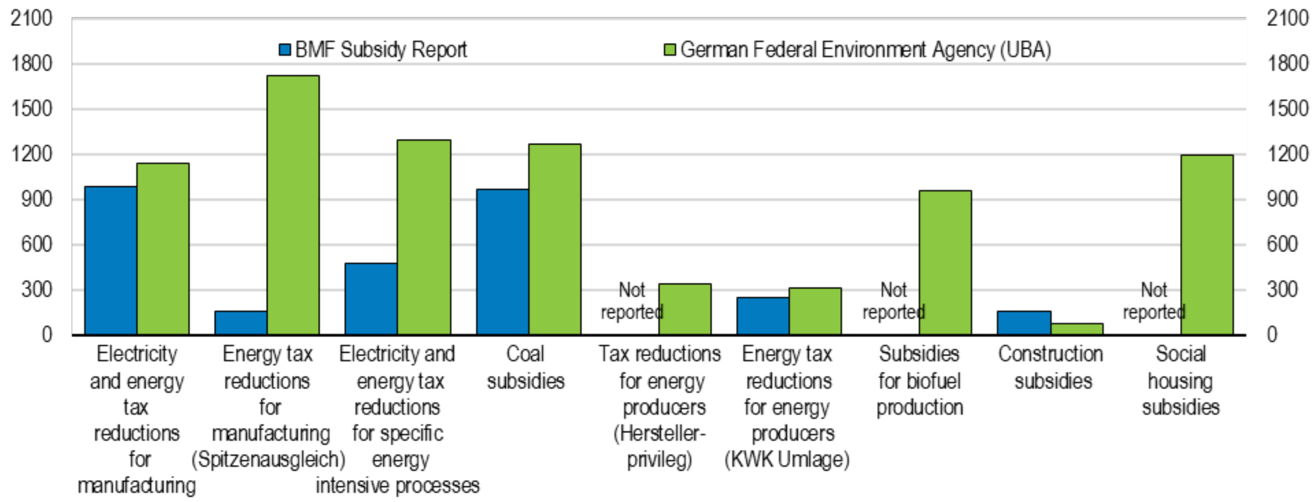
The current state of tax expenditure reporting in Germany

Since 1967, the German government, under the responsibility of the Federal Ministry of Finance (BMF) has issued a “Subsidy Report” every two years, providing information on direct subsidies as well as tax expenditures. However, these reports have considerable limitations.

Apart from information on subsidies granted as transfers, the Subsidy Report provides information on 1.) provisions officially acknowledged as “tax expenditures” as well as 2.) provisions “resembling” subsidies, such as for instance income tax exemptions on donations to political parties, religious or philanthropic organizations, listed in Annex 3 of the report. While information on the former is summarized in provision “sheets” with detailed descriptions of each provision, the revenue forgone and the latest evaluations (if applicable), information on the latter is incomplete and consists of only one summary table with the revenue forgone by provision (where available). No further information on these measures is given in the report, and they are not subject to regular evaluations.

In addition, many provisions are not included, as highlighted in a report by the German Federal Environment Agency (UBA). Of the 35 tax provisions identified by UBA as “environmentally harmful”, 21 do not figure at all in the BMF report. For another 8 provisions the BMF reports revenue forgone figures that are either substantially lower than those estimated by UBA or altogether missing for that year (Figure 1). UBA and BMF figures match almost exactly only for five provisions, and for one provision the BMF reports higher revenue forgone figures than UBA. Different benchmark definitions, assumptions and estimation methods explain these differences.

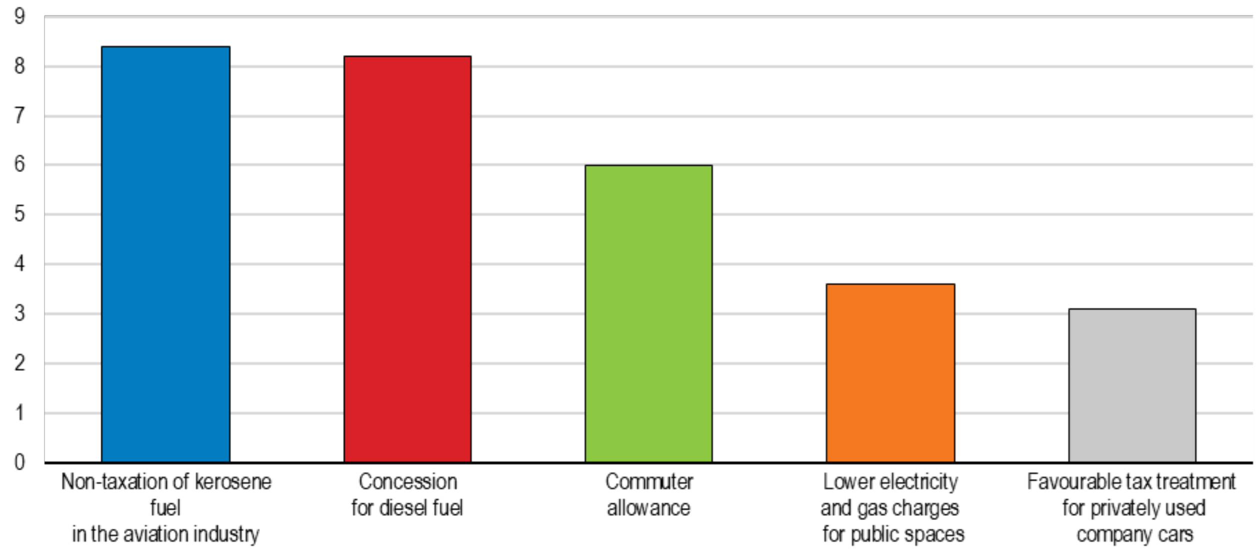
Figure 1. Provisions with different revenue forgone estimates, BMF Subsidy Report and UBA report (2018, Euro million)



Source: BMF (2019), 27. Subventionsbericht des Bundes, Bundesministerium der Finanzen (BMF). Burger, A. and W. Bretschneider (2021), Umweltschaedliche Subventionen in Deutschland, Umweltbundesamt (UBA).

As a result, estimates for total revenue forgone due to tax expenditures are substantially different. For the above-mentioned 35 provisions alone, UBA reports revenue forgone of 68.3 billion euros, while the BMF Subsidy Report only accounts for 5.7 billion euros related to these provisions. While the BMF estimates for revenue forgone are lower for about half of those provisions that are included in both reports, most of the difference comes from the provisions that are not included in the BMF Subsidy Report. Energy tax exemptions for kerosene and agricultural diesel, for example, account for more than 8 billion euros each according to the UBA report.

Figure 2. Large provisions not included in the BMF Subsidy Report but reported by UBA (2018, in Billion. €)



Source: Burger, A. and W. Bretschneider (2021), Umweltschaedliche Subventionen in Deutschland, Umweltbundesamt (UBA).

Other provisions are not reported at all by any governmental agency. Prominent examples are the following tax expenditures for real estate investments, which have been estimated by the German *ifo institute* to amount to a total of EUR 11 billion per year (Fuest, Hey and Spengel, 2021). Capital gains from selling real estate are fully exempted from personal income tax, if the property has been held for more than 10 years, leading to revenue losses of around EUR 6 billion per year. Moreover, profits of real estate companies are fully exempted from the *Gewerbesteuer*, which is a municipal-level corporate income tax with an average rate of 15%, entailing a revenue loss of around EUR 5 billion.

Coverage of provisions is not the only issue present in the Subsidy Report. While most of the countries around the world that report on tax expenditures do so annually, the BMF only publishes its Subsidy Report every other year. This is problematic because it detaches discussions of tax expenditures from other budget discussions. Only revenue forgone from the 20 largest tax expenditures (as per the BMF

Subsidy Report) is included in the annual budget plan, providing an incomplete picture of the federal government’s total tax expenditures to the Bundestag.

Germany is also lagging its peers when it comes to progress on estimating the revenue forgone of its tax expenditures (or those “resembling” tax expenditures). Since the 1990s, the Subsidy Report has provided revenue forgone figures for just about half of the listed provisions. For comparison, this share is around 70% in Canada and around 80% in France. The revenue forgone figures that are reported in every iteration also present some inconsistencies over the years. For example, tax expenditure for aviation fuel included in the Subsidy Report shows relatively constant revenue forgone figures over time, despite large oscillations of reported travel intensity and kerosene prices.

Reasons for incomplete and inconsistent reporting

Several factors contribute to the current state of tax expenditure reporting in Germany. To start, the Subsidy Report was not meant to be comprehensive. Based on the 1967 Act to Promote Economic Stability and Growth, it only covers those tax expenditures that aim at supporting enterprises or sectors of the economy, helping them to adjust to new conditions or promoting productivity and growth. Beyond that, what is typically left out of the report falls into three broad categories:

- **Tax expenditures under different labels**: The Subsidy Report considers a provision to be a subsidy (or tax expenditure) only if the respective tax law explicitly designates it as such. For example, lower energy tax rates for diesel as opposed to gasoline are not considered a tax expenditure, even though neither the law nor scientific evidence provide justification for these rate differentials. Similarly, the flat-rate taxation of the use of company cars for private purposes is considered a tax expenditure by the UBA (to the extent that it does not fully capture the average income gain obtained by car users), but is considered a tax simplification measure by the BMF.

- **Tax expenditures from international agreements:** In some cases, tax expenditures are not reported because they are based on international commitments rather than national policy decisions. This is the case for energy tax and VAT exemptions on aviation fuels for international flights, or VAT exemptions on exports. This exclusion from reporting is in line with the practice in many countries, as for example reduced withholding tax rates in tax treaties are typically included within the tax benchmark.
- **Expenditures from governmental fees:** Exemptions from or reductions of certain government fees result in revenue forgone for the government but are not considered as tax expenditures. While in general fees are not taxes, some fees such as royalties for the extraction of sub-soil assets resemble taxes and are treated as tax revenue in some countries such as Chile and Norway. In Germany, waivers of royalties and other fees for the coal industry result in 287 million euros of revenue forgone in 2018.

Germany is not the only country that classifies certain provisions as tax expenditures and others as part of its normal (or benchmark) tax system. This is a common practice in all reporting countries and makes comparisons of tax expenditures across countries complicated (OECD 2020). However, an additional problem in Germany is the lack of a well-defined tax benchmark system, complicating the identification of tax expenditures and estimations of revenue foregone (Thoene, 2012; Thoene 2019). The criteria applied to decide whether or not a specific provision is considered a tax expenditure and included in the BMF subsidy report or whether it is part of the benchmark tax system are not straightforward. Lower VAT rates for food are part of Germany’s benchmark system and not reported, while lower VAT rates for cultural activities are defined as a tax expenditure. Grandfathering clauses (whereby older regulations are treated in one way and younger regulations in another) add another layer of complexity to the issue. Another example is the commuter’s tax allowance, which is considered a tax expenditure by the UBA, but part of the benchmark tax system (income-related expenses) by the BMF.

It should be noted that the Subsidy Report is a Federal Government document, meaning that it has to be approved unanimously by the cabinet of ministers. This helps to explain why changing the current state of official reporting has proven to be so difficult. In contrast, reports from bodies such as the UBA may have more leeway in defining what constitutes a subsidy or tax expenditure. The Federal Audit Office has repeatedly called for a comprehensive reform of tax expenditure reporting and evaluation in Germany, most recently in a report to the Budget Commission of the German Bundestag in May 2022.

It is time to improve tax expenditure reporting

As a first, necessary step towards a comprehensive spending review, which is one key recommendation of the 2023 OECD Economic Survey of Germany, Germany should bring its tax expenditure reporting up to date. Following the example of many other OECD member countries, tax expenditures should be reported annually and as part of the budget plan. Moreover, existing annual spending reviews could be expanded to include the evaluation of (specific) tax expenditures, which would generate more and better information regarding the impact of those measures.

This should go hand in hand with the establishment of a well-defined tax benchmark system, which would allow a more transparent definition of what constitutes a tax expenditure. All tax expenditures should be subject to regular impact evaluations. Moreover, extending the scope of reporting to also include related measures that are not considered tax expenditures would further raise transparency and follow best practices of countries such as Canada and the UK. A more comprehensive reporting of tax expenditures is key to increase transparency on the use of public resources and enable the parliament to better prioritize public spending.

Footnotes

1. *Flurim Aliu (CEP) * Council on Economic Policies*
2. *Christian von Haldenwang (IDOS) *German Institute of Development and Sustainability*

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