We give away billions!

Executive Summary of the German contribution to the study “Tax Justice & Poverty”

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1 History and context

The research and advocacy project “Tax Justice & Poverty – narrowing the wealth gap and reducing governmental dependence on external financing” was conceived as a three country undertaking with participants in Germany, Kenya and Zambia. One goal was to provide evidence that the developments in taxation law and administration also contributed to, and maintained, increasing inequality and other problematic developments nationally and internationally.

In Germany, the research focused on the situation upon the southern state of Bavaria, one of the most prosperous regions in Germany, and it was supported by its State Ministries of Finance, Interior and Justice Affairs. At its core, data collection took place in interviews with 23 semi-official and 62 informal conversation partners from tax administration, tax consultants, wealth holders, wealth asset managers, police, public prosecutors etc. The title above, for example, is taken from the conversation with a Turnover Tax Special Investigator, who uncovered damage from tax fraud amounting to ca. 1 million Euro. He asked his superiors for permission to investigate and prosecute the case. Permission was refused on the grounds that this would tie up too many resources needed elsewhere – the resulting delays would be unpopular with superiors and other taxpayers. That was commented by the conversation partner: ‘The money is lying in the street and we are not permitted to collect it. We give away billions!’ An isolated exception from the rule? No. According to the Bavarian Supreme Court of Auditors Bavaria alone loses roughly 1 billion Euro annually due to turnover tax dodging (2012).

2 Poverty, wealth gap, public debt

Income- and wealth inequality in Germany are rising, but there is no precise data as to its extent. Regarding poverty, the poverty risk quota is the most common yardstick, which rose from 14.4% (2008) to 16.7% (2015). This, however, covers only cases known to authorities, while hidden poverty (people too ashamed, too illiterate, or prohibited from, collecting social benefits), is not included in the calculation. Also the distribution at the top end of the wealth scale is unknown: In 2013, official statistics set the number of 2.512 “people with considerable income” (i.e. 500,000 Euro or more per year) for the whole of Bavaria, while the Wealth-X/UBS wealth report counted 1,805 ultra wealthy (UHNWIs) for Munich alone (i.e. people with assets of 30 million US-Dollars or more). There is wide consensus that wealth inequality in Germany is among the highest in the world and rising, and that, at the same time, redistribution capacity of the welfare system is decreasing as is social mobility within the country: The accident of birth is for a child increasingly the determinant of its social place in future - more so than any other aspect, e.g. education.

Regarding public debt, Germany right now lives in the extraordinary situation that government is able to earn money by selling bonds. This, however, may not last for ever. Additionally, the so-called “sustainability gap” (i.e. present debt and foreseeable debt) rose in 2015 to 6.2 trillion Euro which in view of the burden to future generations begs for repayment. Debt and interest payment also delay important investments into the future of the country, e.g. into infrastructure or other public services such as day care, care for the elderly or education. A final fairness gap: After World War II, private and corporate wealth holders contributed to the rebuilding of the country on the basis of the “Burden Sharing Law” of 1952. Costs of German unification, the 2007 World Financial and Economic Crisis or the Euro Crisis were covered by increasing debt, while private and corporate wealth holders profited most from it; a major example of redistribution from the bottom to the top.

3 Tax law and tax competition

Developments in tax law are co-responsible for the growing wealth gap. The burden for top earners and top wealth holders decreased over-proportionately. For example: Since 1996, the top rate of Income Tax decreased from 53% to 45%, the rate for income arising from capital to 25% only, the Wealth Tax became suspended etc. The tax burden shifted to indirect taxation (VAT!) and therefore to low and middle income households. This shift was justified by pointing to the options existing for private and corporate wealth holders to relocate residence or headquarter to low tax areas; or to the fact that the administration of direct taxation is costly, while the collection of indirect taxes is cheap – yet another example for redistribution of wealth from the bottom to the top.

The proportionate burden for low and middle income is rising further when Social Security Contributions are taken into the account: Since there is an assessment threshold for top earners, the Social Security Contributions are detached from increasing income, meaning, top incomes profit once more.

Yet another problematic area is the legal low-wage segment with its "atypical" forms of employment and payment: In many areas it is only functioning on account of tax funded subsidies, and the latter will increase if those employed here, being under- or uninsured, grow old and sick.

Bavaria is fuelling tax competition by calling for more "freedom" for the German states in determining tax rates, e.g. regarding the Real Property Tax, the Inheritance and Gift Tax or the Income Tax. At the same time, Bavaria wants to withdraw from (or at least cut contributions to) the Financial Equalization Mechanism, a solidarity scheme supporting poorer regions of Germany so that "comparable living conditions" can be secured all over the country, and domestic migration would be kept at bay.

4 Tax administration

Bavarian tax administration is subject to many pressures arising from the increasing complexity of national and international tax law, legal requirements of government to save on personnel costs, and the huge inflow of new residents and businesses. With consequences: The time to process tax cases is decreasing while its number is increasing. The costs are a lack of time for thorough checks, the loss of revenue and a high incidence of sick-leave. Those working in the ranks have the impression that their practical problems are not being taken seriously by superior agencies.

Regarding computerized processing of tax declarations Bavaria did pioneering and exemplary work. At the same time, every computer is as good as the data entered – if there are mistakes results are flawed and faulty. Overall, benefits and extra-work for employees are on balance: Training has to be done in addition to, and alongside, the regular workload, there are many problems indicated by Risk Management requiring personal checkups, computerization creates new options for cheating etc. Improvements with the established system are ambiguous, for example: The number of computerized "red flags" can be diminished by a more generous programming of the Risk Filters. This, however, implies the risk that tax dodgers are not identified and tax revenue is being lost. Both Bavaria's Supreme Court of Auditors and the Union of Tax Administration Civil Servants are united in the opinion that tax revenue in quantity is lost because of deficits in computerized processing and that for the foreseeable future there is no realistic alternative to replace the trained and experienced civil servant. This is a clear warning against government's intentions to increase the number of fully automated processing of tax declarations for all Germany.

After many years of saving on personnel costs, Bavaria does now open new vacancies in tax administration. Nevertheless it is highly contested between government on the one side, employee representation and trade unions etc. on the other, whether those initiatives are adequate in view of the workload: Even the government's spending watchdog, the Bavarian Supreme Court of Auditors, is convinced that saving personnel in tax administration is saving costs in the wrong place: Tax inspectors generate by far more money than they cost in terms of salaries and insurance: 442 new tax auditors, for example, would cost ca. 30 million Euros and in turn bring in ca. 200 million Euros in surplus revenue (2013). And here an imbalance is growing: While the Bavarian government celebrated "ca. 2,000" job openings in 2013, the Bavarian Federation of Tax Consultants in the same year offered exactly 3,349.

All this substantiates the frequently (though anonymously) voiced suspicion that for Bavaria also tax administration is seen to be an “asset” in the process of “tax competition”.

Since it is primarily through data leaks that tax administration and other investigative services gain major information regarding the “aggressive tax avoidance” and tax evasion of private, corporate and criminal wealth holders, this points to structural deficits within the global “Offshore Capitalism”:

5 Illicit Financial Flows

CD and other data leaks (Offshore-, Luxembourg-, Swiss-Leaks, Panama Papers...) reveal huge financial transfers with the help of shell companies and tax havens beneath or outside governmental and democratic control. The term “Illicit Financial Flows” comprises not only outright criminal and illegal transfers, but also transfers taking place within the grey area of “still legal” and “no longer” legal, if subjected to closer examination. This is the point: Tax administrations and other investigative authorities often lack capacities to investigate and determine whether certain tax planning options are still legal or should be brought to the courts. Tax auditing companies know about those constraints and use this knowledge in developing ways and means of channelling funds outside the reach of the taxman. All too often, therefore, authorities give up investigations even though a well-founded initial suspicion is established; the authorities only seek settlement outside courts rather than placing charges.

In principle, tax authorities are superbly placed to detect strange movements of finance when checking accounts and books – moving beyond tax related crimes to bribery, capital flight, money laundering etc. The research conducted during the past years comes to the conclusion, however, that related agencies are also understaffed and overworked, e.g. police, customs or courts, so that here, too, no adequate potential exists for investigation and prosecution. Conversation partners conclude, however, that this shortage, too, is politically motivated: Germany is, after all, attracting Illicit Financial Flows from all over the worlds and therefore profits. Against that background and for that reason, not only NGOs, but also the Financial Action Task Force is criticizing Germany for its laxness in fighting, for example, money laundering in the real estate, property and construction sector.

All this reflects short-sighted thinking: It should matter to Germans and their government, facing increasing global migration movements, that a state such as Zambia loses on average every year more (2.9 billion US-Dollar) than it had to spend in the 2014 budget (2.7 billion US Dollar).

6 Taxation of private wealth

Since there are already many good proposals and initiatives on the table regarding the taxation of transnational corporations this research decided to look closer into deficits surrounding the taxation of private wealth. The research is concerned about the concentration of private wealth, because it runs parallel with a concentration of power. For example: Owners of shares not only receive regular income from dividends, but also have the power to influence policy and operations of the business. One has to be aware, of course, that small and medium family businesses normally care for their workers, the environment and the region within which they produce. This is to be distinguished from the anonymous ownership of larger businesses via shares or investment funds.

Another worry is the increasing separation of the national and international "Top 1%" from the rest of society, yet another result of decreasing social mobility. At the same time, this detached 1% impacts upon all society if they try to impose their views and preferences on all citizens via direct or indirect lobbying or their simple "entanglement" with other administrative or political elites. Here the question indeed arises, whether Germany, too, drifts into an "inheritance oligarchy" (Stiglitz), "patrimonial capitalism" (Piketty) or "economic feudalism" (Freeman). At the point, however, where capital no longer serves society, but perverts into an instrument of dominance, it is, according to social ethicists, about time to counteract such dominance.

7 Shadow Economy and Black Labour

Finally, the Shadow Economy and Black Labour are locations where billions in taxes and social security contributions are being lost. The spectrum of perpetrators is wide and reaches from ordinary citizens who want to earn "gross = net" to organized economic crime when, for example, the owner of construction companies hides illegal labour via sub-contracting chains. There is a considerable overlap to the formal low-earning segment since many legal options there can be misused for cheating which makes uncovering of misuse difficult for authorities. Conversation partners from there admit that they can at best scratch the tip of the ice-berg since everybody (customer, employer, workers) profits and nobody is interested in cooperating with the authorities.

The Shadow Economy follows market laws, as do Illicit Financial Flows: As long as reasonably expected profits outweigh foreseeable risks they will flourish. Legal reforms and more personnel alone will remain on the level of combating symptoms only. Combating root causes calls for national and international reforms of the financial system, development cooperation, and economic relations, as well as labour markets.

8 Ethical criteria and judgment

As in other areas of highly emotional social debates, so also the dispute surrounding poverty, inequality, debt and taxation is charged and determined by underlying differences in world views. If you trust some, "more market" is key to more welfare. At the same time others try to convince that more regulation is called for. Both positions can be argued and backed up with a lot of statistical and other forms of "objective evidence". This research concludes that the past decades of market dominance and Trickle-Down Theory failed to improve the situation of poverty and inequality substantially. On the contrary.

This research argues that liberalization and the subsequent mobility of capital in the era of financial globalization is linchpin for the deficits reported previously. To that, states responded with "location" and "tax competition" in the attempt both to prevent private and corporate wealth holder from leaving their country and to attract others to settle down within their jurisdiction. Wealth Managers, the OECD, IMF and many others criticize this development because, in the end, the constant undercutting will leave states with no longer adequate funds to finance public needs and tasks. In the words of a German constitutional judge: Those will win tax competition who offer Zero Rates, resulting in Zero Revenue – which will be the death of modern statehood.

This research rejects a market-conforming democracy and calls for democracy-conforming markets and a return to social market economic reforms. The emergence of monopolies and oligopolies must be prevented, and taxation in accordance with the Principle of Ability to Pay has to be reinstated which says in its core that: 'the equal needs to be treated equally and the unequal unequally'; the latter being also a guiding principle for any redistribution system trying to restore once more social and income mobility within any given society.

Any social-ethical discussion of tax justice is yet in its infancy. Well-known representatives of social justice, such as John Rawls, only treat this topic in the sidelines and margins. It is only their disciples who discover its relevance, e.g. in the different treatment of taxation of capital and labour or the emergence of inequality of opportunity when large inheritances and gifts privilege some "without their own merit" over others. Equally Catholic Social Teaching did not devote adequate attention to this topic. However: Given attempts to bring about a new balance between the individual and the communal, the interests of living and future generations, or to understand criteria and characteristics of the "good life", suggestions regarding taxation policy emerge which are very different from those short-term and short lived discussions which normally determine social public debate.

9 Political recommendation

Of course, there are alternative ways to combat poverty and inequality. For Catholic Social Teaching, social bargaining among social partners always enjoyed priority, including strong trade unions and a resulting "primary distribution" via decent wages. Between capital and labour, however, a growing imbalance is noted. New and "catchy" concepts such as Inclusive Capitalism, Social Responsible Investment, Corporate Social Responsibility or foundations have to be treated with caution since there are disadvantages and all too often hidden agendas with those promoting them. All that makes the pragmatic focus on taxation related issues more attractive.

Calls for a "simplification of taxation laws" are illusory: Standardizing and "Generalizing" laws and tax bills will bring about a flood of legal redress and complaints due to "unfair treatment" on part of the authorities, resulting in legal verdicts, resulting in corrections of laws, leading back to the well-known complexity of the here and now.

Since "tax competition" is the linchpin behind everything, any improvement will depend on the states' ability to replace competition with cooperation. If this is the case, tax evasion and other forms of Illict Financial Flows can be combated effectively. Then national and international legal loopholes can be clarified and, with that, the options for, and amount of, aggressive tax planning can be diminished. Then it can be determined which Offshore Constructs serve primarily private, corporate and criminal interests and which serve the common good – the former then can be simply prohibited. Then transparency of beneficial ownership of remaining Offshore Constructs can be agreed upon and relevant data exchanged between different tax administrations; this is being licit even more since (at least some) national and European judicial rulings agree that the right to privacy in tax affairs is not an absolute right, but also has a social component which is open to political discussion and reform. Then the enforcement of national law and international standards will be possible across borders, whereby one should, holding to the principle of subsidiarity, consider whether

- there should be specialized units for private and corporate Large Taxpayers on the national level
- all administrative units investigating and prosecuting financial crime (tax fraud investigators, police, customs, Financial Intelligence...) should be centralized on a national, perhaps even European, level.

Another large area of concern should be "Ecological Taxation" which up to now either is of marginal importance or is taxation for other purposes (e.g. filling deficits in Social Security or lowering the cost of labour). One approach could be a review of the VAT system in accordance to social justice and ecological criteria.

Regarding the restoration of the Principle of Ability to Pay, the following seems to be reasonable:

- Equal national and international transparency regarding the financial and wealth situation of all tax subjects towards tax administrations. Until this is implemented, the state has to secure adequate quantitative and qualitative checks into the tax honesty of wealth holders.
- Privileges regarding the taxation of income from capital as opposed to labour are abandoned. Such income is taxed with the general progressive Income Tax Rate whose top rate will be increased to 50%.
- The Wealth Tax will be reinstated in order to acknowledge the contribution of the community to the growth of large fortunes. Tax dues arising here can be netted with tax dues arising with Income Tax ("Intelligent Wealth Tax").
- "The purpose of Inheritance Tax is to prevent the accumulation of large fortunes in the hands of few." (Article 123 of the Bavarian Constitution). Therefore all fortunes beyond the 1000-fold of a German median fortune (right now everything above 65.4 million Euro) will be subjected to a tax of at least 50%. Legator and heir can be given a say in how that money will be spent ("fiscal subsidiarity")
- Beyond the principle residence, all other possession of real property will be subject to a stiff Real Property Tax and Real Property Transfer Tax by taking care that those costs cannot be forwarded to those renting property or houses.

A final area needs to be the reform of social welfare systems. Since this was not a focus of this research, no detailed recommendations are given. Important would be, however, a reform of the contribution system, also in accordance with the Principle of Ability to Pay.

10 Result and Outlook

Right now, Germany and Bavaria profit from a boom in tax revenue. This must not cloud the view regarding (1.) how it is achieved, (2.) what else would be possible and (3.) what normally is overlooked.

How it is achieved: The research demonstrates that the tax burden is increasingly unfair. One must also remember that Germany and Bavaria, because of their participation in tax competition and other reasons, profit at the cost of others.

What else would be possible: The research demonstrates that much more revenue could be collected. In doing that, some areas, e.g. combating tax evasion and fraud and the enforcement of laws, must not be played off against others, e.g. the restoration of taxation in accordance with the Principle of Ability to Pay and a restored Wealth Tax.

What is normally overlooked: Hardly anybody tries to balance the short term benefit against the long term, the Global Common Good against the Local, the complicating and the simplifying. However: This will lead, in the long run, to the loss of welfare for all. We have to make the foundational choice between a provincial politics and a politics addressing the needs of the global network-society: The former is advanced both by those who participate or even advance market mechanisms and, by doing so, strengthen its volatility and instability, and by those trying to stop globalization mechanisms with the erection of borders of all sorts. The latter is attempted by those aiming for a new balance between global markets on the one side, and efficient regulation based upon the enforced rule of law on the other.

Growing global interconnectedness with finance or migration demands that also the interest of developing or poor nations have to be considered and taken into account: African states, for example, indeed would be in no need of official development aid if they were able to tax fair and square that which is produced in, and exported from, their countries or if Illicit Financial Outflows could be stopped. Any support of their tax administrations would be worthwhile, both for combating corruption and for restoration of taxation in accordance with the Principle of Ability to Pay in these countries: There, too, live ultra-wealth people, avoiding and evading taxation. A tough and lengthy project? Certainly. But extremely worthwhile from the point of view of all those who seriously and sustainably want to do something against poverty, inequality, climate change, migration and “terrorism”.

11 Further Information

In German:

- Alt, Jörg (2016) Wir verschenken Milliarden. Erkenntnisse des Forschungsprojekts „Steuergerechtigkeit und Armut“. Echter Verlag: Würzburg. ISBN 978-3-429-03961-5
- Alt, Jörg/Zoll, Patrick (2016) (Eds.) Wer hat, dem wird gegeben? Besteuerung von Reichtum: Echter Verlag: Würzburg. ISBN 978-3-429-03913-4

In English:

- More information regarding the German Country Report can be found on the project website http://www.taxjustice-and-poverty.org/results/germany/country-report.html
- General information regarding the project as such: www.taxjustice-and-poverty.org