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The German Federal Court of Audit's observations of and comments on tax administration and tax compliance

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The *German Federal Court of Audit*'s observations of and comments on tax administration and tax compliance

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Abstract:

Auditing institutions, such as the German Federal Court of Audit (BRH), provide information on public revenue and public spending. The question of how to increase tax compliance has been of frequent interest. Unfortunately, information from German taxpayers' declaration behaviour (beyond the official income statistics and tax statistics) was neither systematically collected, nor otherwise made accessible for systematic research.

However, the BRH selectively observes taxpayers' and tax administrators' behaviour and, on the basis of its audit experiences, comments on tax enforcement and tax compliance. Such recommendations are not just increasingly given by the BRH, but also increasingly considered in political decision making processes. Although the findings are not a representative sample of the German taxpayers' behaviour, they make up available information on tax compliance behaviour in Germany and, therefore, are worth discussing in light of modern economic theories of tax compliance. The reported facts are an appropriate foundation of case studies.

Keywords: supreme auditing institutions, German Federal Court of Audit, tax administration, tax compliance, tax evasion, tax morality, transactional costs, fiscal sociology

JEL Codes: H26, H83, K34, K42, P16, Z13

1. Introduction

In modern democratic societies tax revenues are the main source of public revenue, and supreme auditing institutions make up an essential component of the public budgetary process. In Germany the Federal Court of Audit, Bundesrechnungshof (BRH), is the supreme auditing institution, which examines the federal budget, as well as public sector activities of the federation, and makes recommendations based on its audit experiences.[1]

Due to their monitoring function, supreme auditing institutions are appraised as being generally welfare increasing, not only from a welfare economic perspective,[2] but also from a constitutional economics perspective,[3] and again from a new institutional economics perspective.[4] There is no doubt about the auditing institutions' "crucial importance for a well-functioning political and administrative system".[5] However, empirical investigations are rather rare. The results of recent empirical studies on local auditing institutions in Switzerland, kommunale Rechnungsprüfungskommissionen, hint at such institutions' relevance in political decision making,[6] and on taxpayers' subjective willingness to pay taxes.[7]

In democratic societies taxation is not given externally, but developed further and further within the political decision making process.[8] Taxpayers have an impact on political decisions, when they vote by voicing their opinions on political parties, political programmes or both. Recent empirical findings for the USA[9] and for the Swiss cantons[10] hint at the significance of voting in answering the question of why taxpayers comply with taxation. Already in the 1920s, the fiscal sociologist Otto Veit stated that taxpayers' willingness to pay taxes increases when taxpayers can vote on taxation and public spending.[11] The example of the Swiss cantons was already mentioned by Schmölders in a plea for behavioural economic research.[12]

Auditing institutions, such as the German Federal Court of Audit (BRH), provide information on public revenue and public spending, not only addressed to the government and the parlia-

[1] See the German Federal Court of Audit's homepage on http://www.bundesrechnungshof.de in German and on http://www.bundesrechnungshof.de/en/1024.html in English.
[2] Brümmerhoff / Wolff 1974, 477 ff., and Haller 1975, 259.
[3] Kitterer 1990, 173, Mitschke 1990, and Bartel 1993, 616 and 631.
[4] Frey / Serna 1990, 244, and Engelhardt / Hegmann 1993, 15 ff.
[5] Frey 1994, 171.
[6] Schelker / Eichenberger 2003, 353 ff., and Eichenberger / Schelker 2004, 239 ff.
[7] Torgler 2004, 8 ff.
[8] Klein 1997, 138 ff.
[9] Torgler 2003, 242 ff.
[10] Frey 2004, 50 ff., Torgler 2003, 212 ff., 2002, 15 ff., Feld / Frey 2002, 94, Pommerehne / Weck-Hannemann 1996, 166, and Weck-Hannemann / Pommerehne 1989, 545 f.
[11] Veit 1927, 341, and Schöbel 2005, 187 ff.
[12] Schmölders 1953, 232.

ment, but also addressed to the general public. Furthermore, local auditing institutions, kommunale Rechnungsprüfungskommissionen, in the directly democratic cantons in Switzerland have the right to advance alternative political propositions in the political decision making process.[13] Even though the BRH does not have such extensive competencies as local auditing institutions in the directly democratic cantons in Switzerland, the BRH's activities and findings are worth discussing.

Traditionally, the BRH's auditing activities are concentrated on public spending. Only recently, the income side of the public budget has increasingly been considered in the BRH's examinations of the public budget and public sector activities.[14] The BRH selectively observes taxpayers' and tax administrators' behaviour and, on the basis of its audit experiences, comments on tax enforcement. Such recommendations are not just increasingly given by the BRH, but also increasingly considered in political decision making processes, for example, in parliamentary committees' debates on tax issues.[15] The BRH's observations and recommendations, as far as reported and publicly accessible, are not a representative sample of the taxpayers' behaviour, however, an available source of selected cases at the margin and, therefore, a very appropriate foundation of case studies.

Making use of selected case studies at this juncture is also interesting from a methodical point of view. Information from German taxpayers' declaration behaviour (beyond the official income statistics and tax statistics) was neither systematically collected, nor otherwise made accessible for systematic research. In addition to the German tax administration, the BRH and the State Audit Courts have access to taxpayers' declarations, and frequently exercise this source of information, while taking samples of taxpayers' tax declarations.

The BRH's observations of and comments on typical cases of taxpayers' and tax enforcers' behaviour, as far as documented in publicly accessible reports, make up available information on tax compliance behaviour in Germany, directly collected at the place of tax enforcement. Therefore, the reported facts are worth discussing in light of modern economic theories of tax compliance.

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[13] Schelker / Eichenberger 2003, 354.

[14] With reference to the president of the German Federal Court of Audit, Dieter Engels, pointed out in: „Gegen das Tabakdeputat und andere Steuerschlupflöcher", Frankfurter Allgemeine Zeitung, no. 123, 31 May 2005, p. 13, and "Eigensinn der Bundesländer gefährdet die Steuergerechtigkeit", Frankfurter Allgemeine Zeitung, no. 192, 19 August 2005, p. 12.

[15] With reference to Klaus Schleicher, Senior Audit Director and Member of the German Federal Court of Audit, who heads the Division VIII, Taxes, Customs, EU Affairs (interviewed in Bonn on 29 September 2005). See also: Der Präsident des Bundesrechnungshofes als Bundesbeauftragter für Wirtschaftlichkeit in der Verwaltung 2006, 13 ff.

2. Why taxpayers comply with taxation: Three general theoretical approaches

The phenomenon of tax compliance has become a substantial field of research in law, economics, and the social sciences, and still it is prospering.[16] In the literature on tax compliance there can be distinguished three general theoretical approaches to answer the question of why taxpayers comply with taxation. All three approaches have to be considered and cannot be fully separated from each other.

First, taxpayers comply with taxation due to effectively functioning mechanisms of deterrence from tax evasion.[17] Second, tax compliance is stipulated or reached de facto as a consequence of a particular institutional design of tax legislation and tax enforcement, as well as various other institutions, such as democratic systems and public budget auditing. Finally, there is a subjective willingness to pay taxes. Taxpayers are generally willing to contribute to the social community, where they perceive being embedded, and do not only act in defence. In the current economic literature on tax compliance, taxpayers' subjective willingness to pay taxes is synonymously called tax morality,[18] whereas earlier fiscal sociologically oriented writers, for example Veit and Schmölders,[19] have carefully distinguished between tax morality on the one hand and subjective willingness to pay taxes on the other hand.

Since Allingham and Sandmo applied Becker's economic analysis of criminal law to the phenomenon of tax evasion,[20] the deterrence approach made the prevalent pattern of thought in tax compliance research at least for the following two decades. In their conventional expected utility model of income tax evasion, they draw attention to the probability of detection, punishment, tax rate, income level, and taxpayers' risk attitudes. Thereby, they lost sight of further aspects of tax compliance besides deterrence from tax evasion, for example the design of tax regulation and tax enforcement, the context of the democratic system and taxpayers' opportunities to vote on taxation legally (by feet or by voicing their opinions), and the impact of taxpayers' perceptions of the state, society, taxation, public spending, and so on. The outcomes of later empirical investigations have brought back to mind that only a little of the tax compliance observed in fact results from effective deterrence from tax evasion.[21]

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[16] For a survey see: Slemrod / Yitzhaki 2002, Franzoni 2000, and Andreoni / Erard / Feinstein 1998.
[17] Allingham / Sandmo 1972, 323 ff.
[18] Andreoni / Erard / Feinstein 1998, 850 ff.
[19] Veit 1927, 341, and Schmölders 1932, 3 ff.
[20] See Allingham / Sandmo 1972, 323 ff., and Becker 1968, 169 ff.
[21] Dubin / Wilde 1988, 61 ff., and Skinner / Slemrod 1985, 347 f.

Taxpayers do not only consider penalties as being transaction costs of tax evasion, but also transaction costs of income concealment, tax compliance costs, and opportunity costs of cheating on taxation. High transaction costs and opportunity costs of income concealment, as well as low tax compliance costs may stimulate taxpayers' willingness to comply with taxation. Beckmann suggested such an extensive transaction cost oriented approach,[22] which expands the conventional deterrence approach by using a broader New Institutional Economics perspective. He even adds psychological costs and tax morality, but does not ask for what determines tax morality. Unfortunately, there is little empirical research following the broadened, New Institutional Economics based tax compliance approach.[23] However, the BRH, in its examinations of and comments on tax compliance and tax enforcement, forcefully pursues such reasoning.

During the last ten years, more and more economic writers addressed the question of what actually stipulates taxpayers' willingness to pay taxes, besides threatening them with monitoring and penalising.[24] Taxpayers' willingness to pay taxes is determined by various factors, for instance perceived tax burden, perceived equity of taxation, taxpayers attitudes towards public spending, taxpayers political participation rights, and so on. Such an endogenous development of tax morality was already identified by early fiscal sociologists.[25]

All three general approaches – deterrence from tax evasion, institutional design of tax legislation and tax enforcement, and willingness to pay taxes – have to be considered when answering the question of why taxpayers comply with taxation. Specific tax compliance theories can be referred or related to one or more of these basic approaches.

However, the three general approaches cannot be fully separated from each other because they are overlapping; for example deterrence measures can also be interpreted as being transactional costs of cheating on taxation. Moreover, there are interdependencies between the three basic approaches. For instance, a particular tax rule may give rise to tax compliance due to its institutional design, but at the same time influence taxpayers' individual willingness to pay taxes, which could effect tax compliance in the same or even opposite direction. The identification of factors, their relevance in determining tax compliance behaviour, and inter-

[22] Beckmann 2003, 153 ff.

[23] Only recently the Rheinisch-Westfälisches Institut für Wirtschaftsforschung e.V. has prepared an empirical study of tax compliance costs in Germany by order of the German Federal Ministry of Finance: RWI Essen (2003), Ermittlung von Tax Compliance Cost.

[24] Frey / Feld 2002, 6 ff., Torgler 2003, 4 ff., Frey 2004, 50 ff., and Körner / Strotmann 2006, 21 ff.

[25] Veit 1927, 317 ff., and Schöbel 2005, 187 ff.

dependencies among them, requires consideration of all those three general tax compliance approaches.

In fact, the three general approaches become apparent in the BRH's studies of typical cases from selected tax declarations. The BRH's recommendations are based on a widespread understanding of tax compliance behaviour, not just taking penalties, further costs of evasion, and tax compliance costs into account, but also considering existence of a general willingness to pay taxes. The BRH suggested again and again that tax legislators and tax administrators should be oriented in cultivating voluntary tax compliance in addition to deterrence tax evasion. All this will be pointed out after the following short introduction into the legal foundation, internal structure, and functions of the German Federal Court of Audit.

3. Legal foundation, organisation, and functions of the German Federal Court of Audit

The German Federal Court of Audit, Bundesrechnungshof (BRH), is the supreme auditing institution in Germany, which independently examines the federal budget as well as public sector activities of the federation, and makes recommendations based on its audit experiences.[26] The BRH has access to all documents and information requested. Its observations and recommendations are reported in management letters, which are sent to the audited bodies for comment. The BRH's annual reports are addressed to the government, the parliament, and the general public. Some special reports of a particular issue are not publicised.

The BRH examines regularity and compliance of the public budget, and observes public sector activities according to effectiveness and efficiency. Audit priority is traditionally put on regularity and compliance monitoring.[27] Since effectiveness and efficiency evaluation became an additional audit function, regulated by article 114 II of the German constitution and § 88 I of the Federal Budgetary Regulations (BHO) in 1969, this audit function has gained more and more importance.[28]

Efficiency evaluations are based on cost-benefit-analyses, which are oriented in the legislation and the legislators' intention. Political objectives, implemented in legislation, should be

[26] See the German Federal Court of Audit's homepage on http://www.bundesrechnungshof.de in German and on http://www.bundesrechnungshof.de/en/1024.html in English.
[27] Diederich et al. 1990, 57 f.
[28] Grupp 2000, 9 ff., Backhaus 1980, 281, and Grupp 1983, 661 ff.

achieved efficiently,[29] even though identifying legislators' actual intention, and comparing it with the outcomes of public sector activities observed, might be rather difficult.[30]

The political decision making process itself is typically not a matter of evaluation.[31] Thus, political alternatives and opportunity costs of regulation (and of its enforcement) are typically left out. For example, in cases where temporisation of public spending would be beneficiary, the audit court cannot suggest a shift or a spread of expenditure items beyond the fiscal period when this means a breach of the annuality principle of the law on budgetary procedures. However, the BRH recommends legislative changes in cases of regulation that does not conform to legislators' intention.

In the literature on public budget monitoring, supreme auditing institutions have been criticised for not taking political alternatives and opportunity costs into account,[32] especially by economic writers,[33] and in particular from a new institutional economic perspective.[34] Backhaus in general suggested a more economic theories based auditing,[35] first of all having to regard economic theories on the behaviour of the audited bodies, e.g. ministries and public enterprises, and the individuals concerned.

The rejection of a political decision making court of audit is justified with the BRH's independent constitution.[36] In terms of new institutional economics or, more precisely, information economics, the BRH can be characterised as an agent without having a principal,[37] or, instead of this, as an independent body outside existing principal-agent-relationships, for instance the relationship between government and bureaucracy.[38] The independent constitution of the Federal Court of Audit, and also the fact that its members and supporting staff, contrary to members of the parliament, are not democratically elected, are justified with its limited enforcement power. The BRH has neither legislative nor executive nor judicial power, but is an institution of its own kind under the constitutional law.[39] The BRH might lose its imparti-

[29] Arnim 1983, 664 ff.
[30] Diederich et al. 1990, 68 f.
[31] Bundesrechnungshof 2005a, 16, and Backhaus 1980, 281.
[32] Grupp 2000, 20 f.
[33] Rürup 1971, 55, and Reding 1981, 183 ff.
[34] Frey / Serna 1990, 253 f., Frey / Serna 1993, 106 ff., and Frey 1994, 169.
[35] Backhaus 1994, 83.
[36] For the organisation of the collegiate body of the BRH see: Klappstein 2000, 25 ff.
[37] Backhaus 1994, 82.
[38] Streim 1994, 183.
[39] See Grupp 1972, 92 ff., Tiemann 1974, 316 ff., Sigg 1983, 21 ff., and Groß 2004, 200 f. There against, the Austrian Court of Audit is functionally subordinate to the parliament (Rechnungshof 1999, 8 ff.) as being an entity within the legislative branch (Bartel / Schneider 2004, 245). In principle, the Austrian Court of Audit initiates audit activities proactively, but, contrary to the German Federal Court of Audit, can also act on a request of

ality if public sector activities, which derive from forgoing policy advice, have to be evaluated.[40] Hence, giving recommendations in addition to monitoring could contradict the monitoring function.[41] On the other hand, ex ante policy advice might decrease ex post monitoring requirements and simplify ex post evaluations.[42]

Due to the lack of executive power, the German Federal Court of Audit was metaphorically called a knight without a sword,[43] which means that the BRH cannot coerce, but has to achieve acceptance by its audit results and by making publicity. From this, and from a combined Public Choice and Agency Theory perspective, Streim concludes that politicians would not pay attention to recommendations, and, therefore, audit results should in either case be addressed to the voters.[44]

Streim's conclusion is a harsh criticism. The BRH is involved in the process of budget making. Politicians increasingly pay attention to the findings and suggestions, albeit ex ante procedures and ex ante recommendations are not open to the general public. For example, management letters are sent to the agencies, directly affected by an audit (§ 96 I BHO). In the first instance of the auditing procedure, the observed agencies or audited bodies themselves are asked for a response without opening up to the public. Thus, not all audit findings are disclosed and obtainable. The BRH can be described as being a discrete controller.[45]

Although the German Federal Court of Audit does not evaluate political decision making, and rejects giving policy advice, it is legitimated to make recommendations on the basis of its audit experiences (§ 88 II BHO) and, thereby, is giving de facto ex ante policy advice to the audited bodies, ministries, government, parliament, and to the public, even though the BRH, in its publications, hesitates to name it policy advice.[46] Such recommendations on the basis of its audit experiences can be argued as being welfare increasing policy feed back.[47] From the 1980s on, the BRH increasingly gave recommendations on the basis of its audit experiences.[48] In the last years, its recommendations were also considered in the political decision making process more often than before, for example recommendations concerning interest income

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the parliament, the government or a Federal Minister. The Swiss Federal Audit Office *Eidgenössische Finanzkontrolle* is even generally obliged to take audits on behalf of the government (Koller 2002, 55).

[40] Niekamp 2004, 740 f.

[41] Kitterer 1990, 175 ff., and Engelhardt / Hegmann 1993, 30 f.

[42] Gall / Wulle 2000, 854.

[43] Dreßler 1964, 172.

[44] Streim 1994, 170 ff.

[45] See the title of the book by Diederich et al. 1990.

[46] For example, Niekamp (2004, 471) hints at the fact, that the BRH is actually giving policy advice.

[47] Frey / Serna 1990, 244, and Rürup / Seidler 1981, 512.

[48] Diederich et al. 1990, 70 ff.

taxation[49] and value added tax (VAT) compliance.[50] Comments on political consideration or non-consideration of audit findings, as well as comments on legal implementation or non-implementation of suggestions by the BRH can be found in the annual reports, Ergebnisbericht, a re-reflection of selected cases taken from the annual remarks, Bemerkungen, respectively published two years ago.

Traditionally, most of the BRH's auditing activities concerned public spending, but recently, the income side of the public household has increasingly been considered.[51] The BRH observes tax administration more often and, based on its audit experiences, evaluates tax enforcement. Thereby, the BRH also observes and comments on tax compliance. The recommendations implicitly represent the three general approaches of why taxpayers comply with taxation, introduced above in the second chapter.

The BRH's statements have to be considered by the Federal Ministry of Finance in the bills concerned. If there is no satisfying consideration, then the BRH addresses its statements to the budget committee of the German parliament, and participates in their meetings and hearings. Due to the fact that audit findings and advice are increasingly considered in the legislation process, the German Federal Court of Audit can be described better as being a discrete controller[52] instead of using the traditional metaphor of a knight without a sword.[53] In fact, the BRH does have an impact.

4. The BRH's methods and criteria for observing and evaluating tax enforcement

Tax enforcement in Germany is mainly administrated by fiscal authorities at the Federal State level,[54] and for that reason should be the issue of State Audit Courts' monitoring activities. However, the Federal Court of Audit increasingly focuses on tax compliance and tax enforcement because taxes are the major income source of the federal budget.

Whereas outside Germany, for example in the USA, The Netherlands, and Switzerland, tax enforcement and tax compliance were subject to thorough empirical analyses, for instance in

[49] Bundesrechnungshof 2002.
[50] Bundesrechnungshof 2003b.
[51] See: Diederich et al. 1990, 221 f. Also pointed out by the President of the German Federal Court of Audit, Dieter Engels, in: „Gegen das Tabakdeputat und andere Steuerschlupflöcher", Frankfurter Allgemeine Zeitung, No. 123, 31 May 2005, p. 13, and "Eigensinn der Bundesländer gefährdet die Steuergerechtigkeit", Frankfurter Allgemeine Zeitung, No. 192, 19 August 2005, p. 12.
[52] See the title of the book by Diederich et al. 1990.
[53] The metaphor of a knight without a sword was used by Dreßler 1964, 172.
[54] Klos 1988, 36 ff. For a short summary and critical review of the German federal fiscal system see: Baretti / Huber / Lichtblau 2002, 631 ff.

the Taxpayer Compliance Measurement Program (TCMP) (repeatedly carried out by the US Internal Revenue Service (IRS) from the 1960s up to the 1980s)[55], data on German taxpayers' behaviour (beyond official income statistics and tax statistics) were neither systematically collected by any authority, nor otherwise made accessible for research purposes.

In addition to the German tax administration, the BRH and the State Courts of Audit are allowed to take samples of taxpayer behaviour from real tax declarations. The BRH evaluates specific cases of tax compliance and tax enforcement behaviour on the basis of its audit experiences. For example, auditors analysed 400 tax declarations from four tax offices located in four German states to observe interest income declaration and income tax enforcement in this case.[56] More recently, the BRH examined 3.816 income tax declarations from 24 tax offices to observe income tax assessment in case of employed taxpayers.[57] Furthermore, auditors observed cases of airlines' flying staff. In one tax office the BRH examined a sample of persons from flying staff, who stated a change in their place of residence to a foreign country. In many cases, the place of residence was not changed in actuality, but just in the declaration, because they were fleeing taxation.[58]

The BRH does not only increasingly pay attention to tax compliance and tax administration, but the insights and recommendations are also increasingly considered in political decision making processes, for example in parliamentary committees' debates on tax issues.[59] For instance, the implementation of the reverse-charge-model to increase value added tax (VAT) compliance in the building industry was recommended by the BRH,[60] as well as establishing a flat-rate tax on interest income, which is enforced at the source, whereas declaration of interest income is only required if a taxpayer's individual marginal income tax rate exceeds the flat-rate.[61]

The Federal Audit Court's observations and recommendations, as far as reported and publicly accessible, are not a representative sample of taxpayers' behaviour, and do not allow for a total analysis of tax compliance or cheating on taxation, however, the BRH provides a source of typical cases, which is useful for analysing taxpayers' behaviour at the margin, at least to

[55] For an econometric study of TCMP data from the 1982 and 1985 samples see: Feinstein 1991, 21 ff.
[56] Bundesrechnungshof 2002, 10.
[57] Der Präsident des Bundesrechnungshofes als Bundesbeauftragter für Wirtschaftlichkeit in der Verwaltung 2006, 46 f.
[58] Bundesrechnungshof 2004a, 150 ff.
[59] With reference to Klaus Schleicher, Senior Audit Director and Member of the German Federal Court of Audit, who heads the Division VIII, Taxes, Customs, EU Affairs (interviewed in Bonn on 29 September 2005).
[60] Bundesrechnungshof 2003b, 36.
[61] Bundesrechnungshof 2002, 25.

find the three general tax compliance approaches reflected, which is the issue of the following chapter.

The selected case studies of tax enforcement and tax compliance behaviour are based on audit samples and interviews. The BRH directly refers to data from tax declarations, which are available in selected tax offices. Besides tax declarations, tax enforcers' experiences are taken into consideration. BRH staff is typically recruited on the condition that expert knowledge and experiences from suitable public sector employments are available.[62] Most of them are lawyers.

The audit court decides on cases of tax enforcement and tax compliance behaviour according to three criteria: fiscal importance in terms of tax revenue or lost tax revenue, applicability to other tax cases and groups of taxpayers, and general interest in a particular case. Beyond analysis of particular cases, the BRH provides comparative analyses.

In the statements, the audit scope of the case study is described, as well as the significance of the shortcomings found. The latter is discussed on the basis of the frequency of occurrence of a particular case of taxation or non-compliance in relation to the number of cases tested. Observed tax enforcement behaviour is evaluated in light of equal and complete tax enforcement, and according to effectiveness and efficiency of tax rules and tax administration regarding tax rules, legislators' intention, and taxpayers' behaviour.

5. The BRH's activities with regard to tax compliance: Selected case studies

The BRH also investigates tax issues because taxes are the major income source of the federation. The tax compliance and tax enforcement auditing is part of the Division on Taxes, Customs, European Union Affairs.

Due to its limited personnel resources, the BRH's auditing is restricted to selected cases of particular interest and specific groups of taxpayers or tax evaders. However, recommendations on the basis of audit experiences were effective in several cases. Several statements were of great importance; for example suggestions on capital income tax,[63] the abolition of the restriction of loss compensation among different kinds of income, i.e. losses and income from

[62] Bundesrechnungshof 2005a, 17 f.
[63] Bundesrechnungshof 2002.

different sources,[64] and suggestions on value added tax (VAT) enforcement were put into tax legislation.[65]

In the BRH's examinations and recommendations on taxation all three general aspects of tax compliance – deterrence from tax evasion, institutional design of tax rules and tax enforcement, and tax morality – are represented. The following case studies are selected from BRH annual reports "Bemerkungen zur Haushalts- und Wirtschaftsführung des Bundes" and "Ergebnisbericht Folgerungen aus den Bemerkungen", and publicised reports of a particular issue.

5.1 The BRH emphasises the deterrence aspect of tax compliance

The BRH suggested again and again additional tax examinations to increase the probability of detection of cheating on taxes. A higher probability of detection might deter taxpayers from cheating on taxation and increase tax compliance. For instance, the BRH criticised insufficient or inadequate income tax examination in cases of income earned abroad and income earned by foreign employees in Germany,[66] in cases of transfer income received during the employer's insolvency,[67] and in cases of capital income stemming from special endowment policies, which are based on the accumulation of capital.[68]

In several cases, the BRH criticised that tax administrators did not make use of available information due to the restricted personnel capacity of tax offices and the complexity of tax legislation and tax regulations.[69] The personnel capacity in the German tax administration has not significantly changed during the last decades. Therefore, the BRH frequently recommended hiring additional tax administrators to enlarge personnel resources, especially to enlarge monitoring activities and make use of information gained from tax declarations and monitoring. However, this advice typically remained unconsidered.

The BRH also recommended increasing monitoring activities[70] and making tax enforcement more effective by penalising tax evasion and coordination with other member states when

[64] Bundesrechnungshof 2004a, 178 f. The German income tax law, *Einkommensteuergesetz (EStG)*, distinguishes between different sources of income.
[65] Bundesrechnungshof 2003b.
[66] Bundesrechnungshof 2004b, 68.
[67] Bundesrechnungshof 2004b, 69. Transfer income received during employer's insolvency, in German called *Insolvenzgeld*, is not subject to taxation, but affects tax progression.
[68] Bundesrechnungshof 2003a, 61.
[69] Der Präsident des Bundesrechnungshofes als Bundesbeauftragter für Wirtschaftlichkeit in der Verwaltung 2006, 53 ff.
[70] Bundesrechnungshof 2004a, 163.

value added tax (VAT) is evaded in the course of cross-border trade with other European Union member states.[71] When examining VAT evasion, the BRH identified several specific institutional constructions, which were often used to reduce paying VAT illegally, for instance re-imports, sub-contracting, and chains of sub-suppliers.[72] The examinations were focused on the building industry. Besides VAT evasion, the BRH also identified cases of income tax evasion, for instance in the context of illegal employment. The detection of illegal employment by a tax office mostly had no effect on tax enforcement. Hence, the BRH suggested that tax administrators should engage in monitoring activities more often and, thereby, go into more detail, which would require more personnel resources.

Consequently, the BRH has not stopped recommending enlarging personnel resources again and again, for example by the objective of increasing detection of tax fraud in cases of anonymous capital transfers to foreign countries.[73] However, there was no significant rise of staff in the tax administration during the last decades, which might have happen as a consequence of the BRH's advice. In the past years, the BRH more and more often suggested legislative changes. Such recommendations were made not only with regard to equity of taxation, but also to the administrative burden, or in terms of New Institutional Economics, transactional costs of tax administration.

5.2 The BRH considers institutional aspects of tax compliance and tax enforcement

Non-enforcement and unequal enforcement of tax rules are phenomena, which were criticised repeatedly by the Federal Court of Audit, while analysing selected cases according to legal requirements and, thereby, taking tax administrators' experiences into account. For example, the BRH stated unequal tax enforcement in cases of taxation on industrial use of oil and gas.[74] In specific cases of tax deductions, such as deductions of social insurance contributions and church tax, the BRH found unequal application as well as non-enforcement of legal rules.[75]

Due to the vast and still increasing number of tax laws and regulations and frequent changes of the rules, tax enforcement has become more and more complicated,[76] which means an in-

[71] Bundesrechnungshof 2004b, 73.
[72] Bundesrechnungshof 2003b, 18 ff.
[73] Bundesrechnungshof 2004a, 156.
[74] Bundesrechnungshof 2004b, 79.
[75] Bundesrechnungshof 2004a, 164 f.
[76] Der Präsident des Bundesrechnungshofes als Bundesbeauftragter für Wirtschaftlichkeit in der Verwaltung 2006, 27 ff.

crease of administrative burdens or administrative costs, whereas the personnel capacity of the German tax administration did not significantly change over the last few decades. The BRH (and not only the BRH) repeatedly recommended increasing staff of tax offices, but this advice was rarely implemented. Consequently, the BRH more and more often assumes personnel resources to be a given fact, and recommends legislative changes.

While suggesting legislative changes, the BRH addresses institutional aspects of tax compliance and tax enforcement, and recommends political alternatives on the basis of its audit findings. For instance, in cases of foreign athletes participating in sport events in Germany, the BRH suggested refining double taxation agreements to allow for a flat-rate income tax of 25 percent collected from the sport event organiser in Germany, the source of this income.[77] Legislative changes were also recommended in cases of flying personnel from airlines. Several persons of this group of taxpayers did not actually change their place of residence, but reported it in their declarations.[78] For example, seven pilots stated one and the same address in Switzerland, because they were fleeing from taxation.

As outlined above, courts of auditing were traditionally criticised for not taking political alternatives or opportunity costs of alternative regulations into account.[79] However, this has changed. The BRH increasingly engages in evaluating institutional matters, and its argumentation in several cases reflects thinking of administrative costs, for instance in the case of enforcing VAT regulations on cross-border trade with countries outside the European Union,[80] and in the case of a so called minimum taxation.[81] This regulation on the restriction of loss compensation among different kinds of income, i.e. losses and income from different sources, had no or few positive tax revenue effects, but caused tax administrative costs. Therefore, the BRH recommended cancellation of this so called minimum taxation. The criticised regulation was indeed replaced by the legislators quickly.

The BRH also comments on institutional matters while addressing the shortcomings of tax administration, and thereby is addressing the state ministries of finance. In cases of illegal tax deferral, the Federal Court of Audit found shortcomings in tax enforcement.[82] Shortfalls occurred because tax collectors would have made a huge administration effort, meaning administrative costs, to get required information in accordance with existing legislation. In this case,

[77] Bundesrechnungshof 2004a, 157 ff., and 2004b, 71.
[78] Bundesrechnungshof 2004a, 150 ff.
[79] Rürup 1971, 55, Reding 1981, 183 ff., and Frey / Serna 1990, 253 f.
[80] Bundesrechnungshof 2004a, 161 ff.
[81] Bundesrechnungshof 2004a, 178 f.
[82] Bundesrechnungshof 2004b, 78.

the BRH suggested developing an additional tax form, but did not broach the issue of tax compliance costs.

However, in other cases, the BRH considers transactional costs of tax compliance, for instance, very recently, the BRH suggested proof of a legislative change in cases of non-pecuniary donations given to employees instead of additional payments.[83] On the basis of the analysis of two tax audit samples, one provided by a tax office's audit unit Betriebsprüfung, the other by a regional office of the Steuerfahndung, the BRH suggested a flat-rate taxation on non-pecuniary donations, which encourages tax compliance due to much lower transactional costs of compliance.

In examining institutional aspects of tax administration, the BRH also suggests orientation in the subsidiarity principle,[84] which became a constitutional principle of the European Union, since the European Court of Justice ruled on the Cassis de Dijon. The BRH suggests establishing a federal tax agency by the objective of lowering interdependence costs of state tax enforcement.[85] Furthermore, interdependence costs result from tax enforcement disincentives of equalising transfers among federal states.[86]

The BRH suggests that at least information, which is required in striving for equity of taxation, should be collected at the federal level, and local tax offices should have access to it if local tax offices have enormous difficulties getting such information from elsewhere, for instance in cases of international groups of companies, where the Federal Tax Office, Bundesamt für Finanzen, has responded on the BRH's observations and suggestions, while developing a centralised database of companies,[87] and in cases of transfer income received during employer's insolvency.[88]

Moreover, the BRH considers institutional aspects when criticising tax rules as being easily evaded. Such a criticism implies consideration of transactional costs of tax evasion. As already mentioned above, the BRH identified specific institutional designs of illegal VAT re-

[83] Bundesrechnungshof 2005b, 161 ff.
[84] For the meaning of the principle of subsidiarity see: Backhaus 1999, 136 ff.
[85] „Gegen das Tabakdiputat und andere Steuerschlupflöcher: Europäische Rechnungshöfe suchen engere Kooperation", Frankfurter Allgemeine Zeitung, no. 123, 31 May 2005, p. 13, and "Eigensinn der Bundesländer gefährdet die Steuergerechtigkeit: Der Präsident des Bundesrechnungshofs, Dieter Engels, verlangt härteres Durchgreifen des Finanzministers", Frankfurter Allgemeine Zeitung, no. 192, 19 August 2005, p. 12.
[86] Baretti / Huber / Lichtblau 2002, 631.
[87] Bundesrechnungshof 2003a, 58.
[88] Bundesrechnungshof 2004b, 69.

duction at relatively low transactional costs of tax evasion, for instance constructions of re-import, sub-contracting, and chains of sub-suppliers.[89]

The selected cases, taken from the BRH's annual reports and publications of a particular issue, demonstrate the Federal Court of Audit's orientation in institutional aspects of tax administration and tax compliance. The BRH, in its observations and recommendations, considers tax administrative costs, transactional costs of tax compliance, as well as transactional costs of tax cheating. The relevance of these aspects becomes very clear in particular cases of costly administration, which has no budgetary effect.

In fact, the BRH considers opportunity costs of alternative regulations when recommending legislative change. However, tax administrative costs, tax compliance costs, and transactional costs of tax evasion of a tax regulation should be discussed more explicitly and more systematically. In such an analytical framework tax morality aspects could also be added. Tax morality aspects are only implicitly addressed in several cases presented in the publications.

5.3 The BRH implicitly considers tax morality aspects of tax compliance

In its publications, the Federal Court of Audit does not explicitly consider tax morality aspects, however, besides emphasising deterrence from tax evasion and transactional costs of tax administration, tax compliance, and tax cheating, assumes taxpayers have a general willingness to comply with taxation. Determinants of taxpayers' general willingness to pay taxes[90] are implicitly reflected in the BRH's observations, audit findings, and recommendations.

The BRH frequently comments on excess expenditures and their justification by politicians and bureaucrats. Thereby, the BRH has a monitoring function, which might cultivate taxpayers' general willingness to comply with taxation. The relevance of this monitoring function was noted from a welfare economic perspective,[91] from a constitutional economics perspective,[92] and from a new institutional economics perspective.[93]

Frey pointed out that there is no doubt about the auditing institutions' "crucial importance for a well-functioning political and administrative system".[94] The outcomes of recent empirical

[89] Bundesrechnungshof 2003b, 18 ff.
[90] For empirical analyses see: Körner / Strotmann 2006, 21 ff., Frey 2004, 50 ff., Torgler 2003, 4 ff., and Frey / Feld 2002, 6 ff.
[91] Brümmerhoff / Wolff 1974, 477 ff., and Haller 1975, 259.
[92] Bartel 1993, 616 and 631, Mitschke 1990, and Kitterer 1990, 173.
[93] Engelhardt / Hegmann 1993, 15 ff., and Frey / Serna 1990, 244.
[94] Frey 1994, 171.

studies on local auditing institutions in Switzerland, kommunale Rechnungsprüfungskommissionen, support this argument.[95] Moreover, taxpayers' subjective willingness to pay taxes could be cultivated.[96]

As already pointed out, the BRH frequently called for uniform application of tax regulations. Equal treatment of equals might strengthen tax morality. The BRH repeatedly observed and criticised non-application and unequal enforcement of tax rules. The president of the German Federal Court of Audit, Dieter Engels, stated that equity of taxation and tax morality suffer from an unequal treatment of equals, inconsistent regulations, discrepancies in tax enforcement, and regional disparities.[97]

6. Summary

In the German Federal Court of Audit (BRH)'s audit activities regarding tax administration and tax compliance, deterrence from tax evasion, institutional aspects of tax legislation and administration, as well as tax morality aspects are represented. However, the BRH is primarily oriented in tax enforcement instead of voluntary tax compliance, and therefore puts emphasis on deterrence, especially monitoring, and thereby frequently comes to the conclusion that additional personnel resources are needed in the tax administration. However, such advice remained mostly unconsidered.

For that reason, the BRH has recently been putting more and more emphasis on institutional aspects of tax legislation, tax administration and tax compliance. The BRH thinks of alternative rules. Its ex-ante advice is increasingly considered in the tax legislation process. In case of tax legislation, the BRH has become a promoter in the continuous process of rule creation, rule adaptation, and replacement of regulations, even though its own personnel resources are very limited. The BRH addresses weaknesses in cases of particular interest by taking samples from taxpayers' tax declaration. The argumentations could be strengthened by more explicitly and more systematically applying new institutional economic theories. In such an analytical framework tax morality aspects could be added. Tax morality aspects, such as excessive public spending and unequal treatment of equal taxpayers by the tax authorities, are subject of the BRH's audit activities. In general, tax issues are not only increasingly examined by the BRH,

[95] Schelker / Eichenberger 2003, 353 ff., and Eichenberger / Schelker 2004, 239 ff.
[96] Torgler 2004, 8 ff.
[97] "Eigensinn der Bundesländer gefährdet die Steuergerechtigkeit: Der Präsident des Bundesrechnungshofs, Dieter Engels, verlangt härteres Durchgreifen des Finanzministers", Frankfurter Allgemeine Zeitung, no. 192, 19 August 2005, p. 12.

but its audit findings and recommendations concerning tax administration and tax compliance are also increasingly considered in political decision making.

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