

***VI EUROSAI TRAINING EVENT:  
SEMINAR ON “BETTER AUDITING OF PUBLIC AIDS AND  
SUBSIDIES”***

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Auditing of State Grants and Subsidies  
Presentation on: Tax subsidies

# TRANSPARENCY AND SUBSIDY REPORT

Audit of the Bundesrechnungshof  
under the auspices of the sub-group on  
>*EUROSAI coordinated audit of tax subsidies*<

As in most OECD countries, fiscal policy in Germany faces a major challenge: sustainably ensuring the existence of a strong community for the benefit of our children and grandchildren.

To achieve this purpose, public finances need to be consolidated and a clear limit must be imposed on the public debt. The issues at stake include the ability to secure, in the long term, the funding of tasks that are vital for our nation's future prosperity, such as research and education, and to expand such activities where possible.

In order to do so, we have to make serious efforts to realise savings potentials elsewhere. An important issue in this field are tax subsidies, meaning the special arrangements of tax law that lead to a reduction of public revenues. When taking a closer look, one often finds that such tax privileges only serve the interests of some groups within society. Legislative provisions granting tax privileges have proliferated to an extent that the system is no longer transparent for all but a few citizens.

This was the motive for the VI EUROSAI Congress held in Bonn last year to address both the audit of public revenues in general but also specifically the issue of tax subsidies.

#### *Coordinated audit of tax subsidies – a EUROSAI project*

In its Conclusions and Recommendations, the VI EUROSAI Congress agreed that "there should be a coordinated audit of tax subsidies that is open to all EUROSAI members".

The objectives of the coordinated audit mission are to:

- enhance the sharing of knowledge,
- enhance communication between EUROSAI members in areas of special interest,
- obtain best practice information,
- strengthen informal networks and
- improve cooperation with academic/research institutions.

A Working Group was set up to coordinate the audit plans of the SAIs and to develop a framework for the coordinated audit.

Subsequently, the Bundesrechnungshof did field work at the Federal Ministry of Finance and found that there was no differentiated and transparent monitoring and reporting of tax subsidies. I would now like to tell you about some of the audit findings while pointing out, at the same time, that especially the potential recommendations formulated still have merely the status of proposals made by the auditors involved.

### *Inadequate control of tax subsidies in Germany*

In its subsidy policy, the Federal Government follows guidelines that are to enhance transparency, the pressure for justifying tax privileges and the potential for controlling the manifold subsidies.

The field work done at the Federal Ministry of Finance has shown that the implementation of the policy guidelines especially in the field of tax subsidies is still highly inadequate. This leads us to demand a formal enactment, something like a Subsidy Principles Act, along the lines of relevant legislation already in force in Switzerland.

One deficiency found was that the requirement to grant new subsidies – if at all – only in the form of direct and time-limited financial assistance with declining amounts was not consistently applied in practice. There are still a large number of tax privileges not subject to any time limit, some of which have been in force since 1918. Contrary to the policy already designed no time limit is imposed on new tax subsidies. This means foregoing an opportunity for Parliament to take decisions free from the pressure of lobby groups.

A vital aspect is the need to define the objectives of new financial assistance schemes in a way that ensuring programme results evaluation, a requirement already set forth in the relevant policy guidelines. However, when looking into statements of legislative intent, we found that unambiguously defined objectives were lacking. Also lacking were

quantitative yardsticks or target indicators that could facilitate programme results evaluation. No deadlines for target achievement were imposed either.

The policy guidelines demand that new subsidies are granted only, if they appear to be the most suitable and efficient tools in comparison with other options.

Moreover, the review is to take more regard to substantive criteria, such as the impact of subsidies on economic growth, on the distribution of wealth and on the environment.

The Joint Rules of Procedure of the Federal Ministries also demand that the costs to the business community, especially to small and medium-sized businesses, as well as the impact of the proposed legislation on the general level of prices and on consumers should also be stated.

For each subsidy scheme, the objective, proposed duration, target achievement and ideas for future arrangements should be stated. While such statements are given for a number of direct financial assistance schemes, they are largely lacking in the field of tax subsidies. Furthermore, the economic, social and ecological outcomes of the tax subsidy as identified by evaluation should be compared to the potential outcomes of other regulatory options.

All this requires a comprehensive comparison of all repercussions caused by any type of legislation or regulation designed to implement policy. Such a wide comparison is never found in practice. Despite the Federal Government's commitment to such assessment, programme results evaluations both before and after an enactment are carried out in isolated cases only. All the types of outcomes mentioned are never stated comprehensively.

This is attributable especially to the fact that the organisational units within the Federal Ministry of Finance and a subordinate agency that are responsible for regulatory impact assessment in the field of taxation do not have the necessary staff and material resources to perform this task.

I would like to add that, following a Dutch example, at least the costs incurred by private-sector entities in order to comply with reporting duties vis-à-vis the Government are identified by means of a standard costing procedure and to be examined by the Regulatory Impact Review Council. In any case, no overall regulatory impact assessment by the Council has been provided for at the Federal Government level.

Evaluations should not be carried out by any body that is at the same time responsible for managing the subsidy programmes. The body entrusted with regulatory impact assessment should be able to build on an existing good reputation. The most important requirement it must meet is credibility. This is why many countries have set up independent bodies of experts to carry out comprehensive regulatory impact assessments, while special public bodies similar to a Supreme Audit Institution are set up in some countries, or the Supreme Audit Institution itself is assigned the responsibility for regulatory impact assessment.

#### *Reporting: Regulatory Impact Assessment for Tax Subsidies*

Regulatory impact assessment must not be an obscure process. Transparent subsidy policy means the provision of comprehensive information to the general public. The results of a regulatory impact assessment in connection with any draft legislation should be published on or before the date of its publication. At the same time, explanations should be given as to how the impact assessments have influenced the legislative proposals.

The results of evaluations made after enactment should be published on a timely basis during the period in which the tax subsidy is in force.

The EU-Commission<sup>1</sup> considers it appropriate (for its own remit) to publish the entire evaluation report. Exceptions should be permitted only in cases where the need for keeping information confidential can be clearly demonstrated.

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<sup>1</sup> EU-Commission, The 2000-2006 Programming Period: Methodological working papers WORKING PAPER NO 8  
b The Mid Term Evaluation of Structural Fund Interventions – URBAN, Item 1.10,  
[http://ec.europa.eu/regional\\_policy/sources/docoffic/working/doc/urban\\_mte\\_en.pdf](http://ec.europa.eu/regional_policy/sources/docoffic/working/doc/urban_mte_en.pdf)

A readable report should be presented to Parliament and the public, describing the programme concerned in its context. The results are to be presented so as to clearly show to any external non-experts how the assessment was carried out. Non-experts must be capable to arrive at the same results when using the same data and the same approach. Therefore, an annex to the report should provide information about the scientific verification of the information sources.

The communication media used should be capable of being identified and accessed without any difficulty<sup>2</sup>. The option of presenting the results at professional events, workshops, in newsletters or at international conferences should also be considered.

At EU-level<sup>3</sup>, each directorate-general should set up a website on the subject of evaluation, enabling interested people to retrieve the evaluation results without any difficulty.

Another option to be considered is continuous reporting in a subsidies database on which information about tax subsidies and their evaluation is also held. Parliament, the Government, the Civil Service and the general public may obtain information via the Web at any time. Switzerland has developed a subsidies database in which 660 individual subsidy schemes are already recorded.

#### *The Subsidy Report of the German Federal Government*

The Federal Government has published subsidy reports every two years since 1967.

These reports reflect only part of the government activities which directly and indirectly influence the economy. In our opinion, however, subsidy reporting should aim at making the Federal Government's subsidy policies fully transparent in all fields.

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<sup>2</sup> Cf. also EVALUATION STANDARDS AND GOOD PRACTICE A. Profile, role, tasks and resources of the evaluation function [http://ec.europa.eu/budget/evaluation/pdf/C\\_2002\\_5267\\_final\\_en.pdf](http://ec.europa.eu/budget/evaluation/pdf/C_2002_5267_final_en.pdf)

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Currently, each subsidy report covers the last four years. The 20<sup>th</sup> Subsidy Report published in March of the current year thus covers the period 2003-2006. It would make sense also to include the medium-term future outcomes, perhaps for a five-year period.

Now we ask ourselves not only whether evaluations should be carried out by independent entities but also whether, in future, the Federal Government should draw up the biannual subsidy reports.

This brings me to the end of my presentation on the transparent monitoring of and reporting on tax subsidies.

To provide you with an actual audit case in which the lack of a clearly defined objective was very detrimental to the federal budget, let me tell you about the following:

#### *Unjustified tax deductions relating to donations made in connection with foundations*

The Foundation Promotion Act provides for a large number of tax privileges both for donors and foundations.

Apart from the existing tax privileges granted in relation to donations, additional tax deductions are permitted (annually and independently of the donor's total income) for the purpose of promoting religious, charitable and other non-profit objectives:

- up to the amount of € 20,450 in the case of donations made to foundations for promoting religious, charitable and other non-profit objectives.
- up to the amount of € 307,000 in the case of donations towards the capital stock of newly established foundations (up to one year after the establishment of the foundation).

As a result, existing foundations not eligible for a tax deduction of this magnitude established new foundations to act as intermediaries for remitting donations to tax-privileged organisations.

The 'new' foundations pursued the same tax-privileged objectives as the existing ones. The former do not engage in fund-raising activities behalf but merely pass on the donations intended to be received by the (old) non-profit foundations. This way, the donors to obtain higher tax relief.

The Bundesrechnungshof believes that the increased tax relief granted is not justified. The Foundation Promotion Act was intended to create incentives for maintaining non-profit foundations. In our view, increased tax relief to the new fund-raising foundations puts these into a better position than existing non-profit organisations. This is not compatible with the stated legislative intent.

The Bundesrechnungshof thinks that the relevant legislative provisions may be amended; in their present form, they do not comply with legislative intent.

Thank you very much for your attention.