

Tax Amnesty 2004/2005 – An Appropriate Revenue Tool?

By Martin Kellner*

A. Introduction

Tax evasion is punishable.¹ However, by tax amnesty the state waives punishment and gives tax dodgers the chance to return to honesty. The “Act To Promote Tax Honesty”² offers people who evaded taxes between the years 1993 and 2002 an opportunity to wipe the slate clean by declaring their concealed income up to 2005. This offer applies to income tax, corporate tax, turnover tax, wealth tax, trade tax, inheritance tax, gift tax and tax deductions pursuant to the *Einkommensteuergesetz* (*Income Tax Act*). Amnesty participants must pay a reduced tax rate of 25 percent on declared income within ten days after the declaration. For income and corporate tax the assessment basis is reduced to 60 percent. Thereby the new law grants the repentant tax evaders a tax rate of 15 percent rather than usual up to 48 percent on the profits they gained in the past ten years.³

Motivating this tax amnesty is the government’s hope to bring capital from foreign bank accounts back into Germany. After the Federal government increased capital gains taxes in the early 1990s, thousands of well-heeled Germans secretly transferred their fortunes into low-tax havens such as Switzerland and Luxembourg. The German law-makers have now enacted an amnesty for the rueful sinners, hoping to fill empty state coffers with at least part of the illicitly abducted money.

Tax amnesty is no novelty in Germany. In the past there were several comparable amnesties. In 1913, just before the First World War, the *Wehrbeitragsgesetz* (*War Contribution Act*) waived tax due and penalties for people who declared their income

* Dr. iur. Martin Kellner is post-doctoral lecturer at the University of Frankfurt, Department of Law, Institute of Public Law, with emphasis on Administrative and Tax Law. M.Kellner@jur.uni-frankfurt.de.

¹ Steuerhinterziehung, § 370 *Abgabenordnung*.

² *Gesetz zur Förderung der Steuerehrlichkeit*, Dec. 23, 2003, BGBl. I, 2928.

³ See for more details Peter Bilsdorfer, NJW 57, 321 (2004); Karsten Randt & Jörg Schauf, DStR 41, 1369 (2003); and the “Merkblatt zur Anwendung des Gesetzes über die strafbefreiende Erklärung,” available at <http://www.bundesfinanzministerium.de>.

and assets for 1914.⁴ During the Weimar Republic and the National Socialist dictatorship other tax amnesties followed.⁵ In 1949, the year of the foundation of the Federal Republic of Germany, two tax amnesties were created. These amnesty programs did not fulfil expectations and until 1988 no new taxation amnesty took place. The Act of 1988⁶ had a much smaller scope of application than the tax amnesty we are concerned with in this report. It only covered capital gain tax and was also connected with a total tax waiver for the periods before 1986. This amnesty was not very successful, either. One reason might have been that a new withholding tax deducted at source was introduced at the same time. Whatever motives might also have been connected with this Act, the stipulated tax relief also failed to tempt those who had already transferred money to safe havens into bring it back to Germany.

B. Legal Classification of Tax Amnesty

Before the tax amnesty can be examined and defined (as done in part III.) it has to be distinguished from other forms of penalty remission. German law already considers the grant of pardon (explained in part I.) and the report to the tax authorities of false or incomplete tax declaration (detailed in part II.).

I. Pardon

A pardon is granted by the executive power in single cases only. Its roots stem from the royal rights of monarchy and it is still reserved for the head of the state.⁷ In the Federal Republic of Germany there are institutions that can grant a pardon at two levels, that is, the *Bundespräsident* (Federal President) and the *Ministerpräsidenten* of the federal states (the heads of government of the *Länder*). The competence of the *Bundespräsident* covers only those crimes that are assigned to the *Bundesgerichtshof* (Federal Court of Justice) as the first instance; the *Ministerpräsidenten* decide about the other cases.⁸

⁴ The so-called "Generalpardon", § 68 Wehrbeitragsgesetz, RGBl. 1913, 505.

⁵ See, Sebastian Düll, VERFASSUNGSRECHTLICHE VORAUSSETZUNGEN EINER STEUERAMNESTIE IM RAHMEN DER NEUORDNUNG DER ZINSBESTEUERUNG 28 (2003).

⁶ Gesetz über die strafbefreiende Erklärung von Einkünften aus Kapitalvermögen und von Kapitalvermögen, 25 July 1988, BGBl. I, 1093.

⁷ Article 60 para. 2 GG.

⁸ Roman Herzog, in GRUNDGESETZ, Feb., 2003, Article 60 note 33 (Theodor Maunz & Günter Dürig eds.).

The institution deciding this act of grace has the right to entirely or partially waive the penalty, to amend the penalty, or to suspend the execution of a sentence. By way of pardon, a juridical decision that is *res judicata* may be corrected.⁹ Under the *Grundgesetz* (*German Basic Law*) this kind of intervention is unusual and represents an exception to the separation of powers. By granting a pardon, the executive intervenes in the judicial sphere. The pardon's function is to be the counterpart of punitive justice in order to balance undue hardship and to eliminate inequities.¹⁰

Therefore, the characteristic traits of the pardon are that it is given by the executive and refers to a single case. These features distinguish the pardon from an amnesty. An amnesty establishes a general rule for a unforeseeable number of cases and is given by the legislative power.¹¹

II. Report to the tax authorities of tax underpayment

German taxation law grants tax dodgers the possibility of wiping out past offences by reporting the false or incomplete tax to the revenue authority and by paying dues. The report retroactively eliminates criminal liability.¹² From the point of view of criminal law, this consequence is exceptional. In some respects, the report is comparable to the abandonment of an attempt to commit an offence. The difference between these ideas is that in the case of the report of underpayment the penal act is already consummated. Therefore, the intentions of the abandonment of an attempt, that is, the protection of the endangered legal interest, can no longer be fulfilled by the report.¹³

Actually, in case of the report to the revenue authority, the legislative motives for exemption from punishment are mainly fiscal. Money that was hidden from the authorities will thus be revealed, which potentially leads to the opening up of new sources of revenue. In this respect, reporting can theoretically be an effective manner of increasing the income of the state. However, in practice the effect of such reports has proven to be minor. The offer of exemption from punishment is the only promise granted by the report as the tax dodger will still retroactively be obliged to pay his dues for the past periods. Delinquents often use the report when

⁹ BVerfGE 25, 352 (358).

¹⁰ *Id.* at 360-361.

¹¹ BVerfGE 2, 213 (219); Roman Herzog, *supra* note 8, at Article 60 note 32.

¹² *Selbstanzeige*, § 371 *Abgabenordnung*.

¹³ Roman Seer, in Klaus Tipke & Joachim Lang (eds.), *STEUERRECHT* § 23 note 55 (17th ed. 2002).

they feel under investigation by the tax authority and anticipate their offences to be cleared up immediately. In this situation the tax authorities are able to discover the non-declared fortunes on their own while the contribution of the taxable person constituted a negligible entity.¹⁴

The correction of a previous tax evasion by the report of underpayment differs from tax amnesty. At the moment of the penal act, the report offers the tax dodger the possibility of returning to tax honesty. By this regulation the legal request of punishment is limited *ab initio*. On the contrary, an amnesty reacts to circumstances of the past. The amnesty presents itself after an offence already has occurred and takes effect thenceforth.¹⁵

III. Tax Amnesty

Tax amnesty is a general overlooking of past offences. For reasons of the rule of law in a democratic order, amnesty can only be enacted by the legislative power.¹⁶ Although amnesty may concern to the implementation of law, the legislature does not interfere with the judiciary. The legislative branch merely exercises its power by making amendments to current law.¹⁷ Because of Germany's federal structure, the legislative authority of the Federation or of the *Länder* must be settled. The *Grundgesetz* assigns the (concurrent) legislative authority in the fields of criminal law, legal procedure, and execution of sentences to the Federal government. In this respect, it is up to the Federal government to push for a tax amnesty.¹⁸

The Act that grants an amnesty must be general. Its unparticular character, certainly is a central trait of every legislative act. However, to be general is problematic for an act that refers to past circumstances. An amnesty will always regulate a defined or at least theoretically definable number of cases. For that reason the German *Bundesverfassungsgericht* (Federal Constitutional Court) has held that the act giving an amnesty needs not to be formulated so abstractly that the number of affected

¹⁴ See, Roman Seer, *supra* note 13, at § 23 note 55; Klaus Tipke, *DIE STEUERRECHTSORDNUNG* 1439 (Vol. III 1993).

¹⁵ See, Sebastian Düll, *supra* note 5, at 32-33.

¹⁶ BVerfGE 2, 213 (222); Detlef Merten, *RECHTSSTAATLICHKEIT UND GNADE* 13 (1978).

¹⁷ See, Joachim Wieland, *Für eine bessere Steuerrechtskultur* (unpublished lecture at the 1st Deutscher Finanzgerichtstag in Cologne, 26 January 2004).

¹⁸ Articles 74 para. 1 no. 1, 72 para. 2; see, BVerfGE 2, 213 (222); 10, 234 (238).

cases cannot be assessed at first sight. A regulation suffices that does not allow making out which and how many concrete cases are affected.¹⁹

One aspect of the recent tax amnesty in particular arouses suspicion. Concerned parties will benefit by exemption of punishment if they pay the reduced due. It seems as if the offender is allowed to pay for his criminal release. The tradition of amnesty shows that it is not unusual for the legislature to expect some kind of contribution from the offender who wants to benefit from an amnesty.²⁰ However, the legislature could enact an amnesty without any service in return. Such a solution would be within the legislative discretion as well. In view of the alternative to claim no retrospective taxes at all, the suspicion against the reduced taxes for tax dodgers can be dispelled. Furthermore, the fiscal ambition to lure illicit money is promoted by this regulation. The little attraction of the report of underpayment reveals that delinquents will not fetch their money from the low-tax havens, if they have to pay the usual taxes retroactively.

C. Constitutional Implications

Several constitutional implications arise from tax amnesty. These implications can be split up into the general requirements of amnesty and aspects of equality.

I. General Requirements of Amnesty

In general, amnesty takes place because of a special cause in history; particularly when the legislative power intends to end a period of time that was characterized by disruption in the sense of law.²¹ Therefore, amnesties generally come along with serious changes in law. For example, an amnesty was discussed in the period of the reunification of Germany, when the German Democratic Republic joined the Federal Republic of Germany and the five *Neue Bundesländer* got a new constitution.²² Typically a tax amnesty occurs when there is a major shift of the tax system or a fundamental reorganization of taxation law.²³

¹⁹ BVerfGE 10, 234 (241-242).

²⁰ E.g., BVerfGE 84, 233 (238); Bernd Schünemann, StVj 1, 6 (1989).

²¹ BVerfGE 10, 238 (241); see, Detlef Merten, *supra* note 16, at 16-17; Uwe Wesel, GESCHICHTE DES RECHTS 566-569 (2nd ed. 2001).

²² See, Jutta Limbach, DtZ 4, 66 (1993); this discussion resumes regularly on annuals, e.g., Uwe Wesel, Die Zeit, 6 Jan. 1995, 3; Friedrich Schorlemmer & Joachim Gauck, DRiZ 77 88-90 (1999).

²³ See, Hans-Wolfgang Arndt, in VERANLAGUNG - ABGELTUNG - STEUERFREIHEIT, BESTEUERUNG VON KAPITALERTRÄGEN IM RECHTSSTAAT 55, 57 (Gerhard Schick ed., 2003); Sebastian Düll, *supra* note 5, at 36-37; Detlef Merten, *supra* note 16, at 27.

Some voices in the literature gather from such empiric findings that an upheaval in law is a necessary condition of an envisioned amnesty.²⁴ Therefore, an amnesty requires a legal 'state of exception' or a situation of uncertainty. Examples for such cases can be that the legislative power considers a past legal situation as closed and itself at the forefront of a new beginning. Another comparable situation is where the government in power finds itself confronted with the question of whether to apply past law that is now – in light of dramatic and paradigmatic changes in the law – considered obsolete. A final example might be situations where the government performs under the awareness of a heightened necessity to engage in a serious balancing of interests and rights, especially after times of wide uncertainty and anarchy.²⁵

It soon becomes clear that the complexity reflected in such situations of change renders most of these allegedly helpful principles or guidelines quite useless. Instead, the bottom line is that in the field of amnesty, just as in any other policy field, the legislature will – to the degree it is mandated – exercise as much political discretion as possible. There is no evidence in constitutional law for a restriction of legislative discretion or for the necessity for an amnesty to be linked to a particular fact situation.²⁶ Therefore, there cannot be a final definitional element or a non-codified legal principle that would stipulate this requirement for an amnesty to be adopted or to come into force.

II. Aspects of Equality

Amnesty implies the waiving of punishment for those who did not declare their income or fortunes to the authorities. In addition, the recent tax amnesty supports tax dodgers by the reduction of financial burden. By that, non-payers are treated differently from people who paid their taxes dutifully and on time. However, Article 3 para. 1 *Grundgesetz* contains the general right to equality (*Allgemeiner Gleichheitssatz*). The question arises from tax amnesty whether the described unequal treatment of tax dodgers and taxpayers is still an expression of the legislature's political discretion or whether it is already arbitrary.

²⁴ Hans-Wolfgang Arndt, *supra* note 23, at 55-57; Sebastian Düll, *supra* note 5, at 36-37; Detlef Merten, *supra* note 16, at 27; Bernd Schünemann, ZRP 17, 137-138 (1984); StVj 1, 3, 25 (1989); ZRP 36, 433-437 (2003).

²⁵ Bernd Schünemann, ZRP 17, 137-138 (1984); StVj 1, 3, 25 (1989); ZRP 36, 433, 438 (2003).

²⁶ See, Joachim Wieland, *supra* note 17.

Principally, it follows from the equality provision in the *Grundgesetz* that like things must be treated alike, and unlike must be treated unlike. Any departure from this principle must be justified on objective reasonable grounds.²⁷ The unequal treatment of tax dodgers and taxpayers is justified on the special intentions of the lawmakers. In case of a tax amnesty, the state refrains from punishment if the taxable person gives up his or her anonymity and opens concealed fortunes or income. By this report of tax dues, amnesty participants will have to pay full taxes not only for the past but future periods as well. In some respects by tax amnesty the government uses the stick and the carrot to collect money.

This tool works effectively only in the cases of tax evaders. Persons who were already assessed do not need a “bridge to legality” and there are no reasonable grounds to extend the partial remission of taxes to people who already paid their taxes. The fiscal motives and the intention to lead people back to legality are reasons justifying the unequal treatment resulting from the tax amnesty.²⁸ It is only a natural consequence of this kind of remission that those delinquents also benefit who did not pay the tax rates provided by law.

D. Summary and Comments

The Tax Amnesty 2004/2005 does not violate the constitution. Neither general principles nor the equality provision are contravened by the amnesty. However, the constitutionality of an act does not yet necessarily make it a wise legislative act.

The legislator’s dilemma is that amnesty programs will be more successful the more they include incentives that the tax dodgers consider attractive. Nothing short of a straight-forward exemption from punishment will cause those people to reveal their hidden fortunes and income. The same effect however, might follow from a report to the tax authorities of false or incomplete tax declaration. Hence, amnesty programs that wipe out past burdens by reducing or even eliminating back taxes are most effective in generating revenues.

This leads us back to the general problem of tax amnesty (but of any other amnesty as well), namely that it allows those to profit who originally offended the law. In case the criminal amnesty is combined with a reduction of the taxation for past periods, this may have a negative influence on honest taxpayers. They may get the impression that paying taxes at the usual rate was a mistake. Besides, they may conceive of a state offering compromises to tax evaders as making a deal with per-

²⁷ BVerfGE 1, 14 (52); 83, 1 (23); 89, 132 (141).

²⁸ BVerfGE 84, 233 (238); skeptically: Bernd Schünemann, ZRP 36, 433-436 (2003).

sons who after all did and do harm the general public. In this light, the tax amnesty might produce the unwanted effect at the other end by hardening disaffection with the state in general and eventually motivating a reduction of the ordinary taxpayers' compliance in the long run.

Moreover, a tax amnesty plays down the criminal meaning of tax evasion and it may be an incentive for people to further evade taxes. Tax amnesty pursues the aim of increasing revenues by opening up concealed tax resources. However, the announcement of the amnesty may make taxpayers aware of the ease of tax evasion. That is, taxpayers may have felt that tax evasion would be quickly discovered and punished, but the amnesty sends the signal that tax authority is unable to enforce the laws. Furthermore, amnesty can bring about expectations of future amnesties thereby reducing taxpayer's compliance after the amnesty. Individuals may decide to pay fewer taxes voluntarily in anticipation that this offence will be forgiven and even rewarded by a reduced tax rate at some point in the future.²⁹ The sometimes made, contradictory argument whereby "honest" taxpayers generally do not appreciate risks and are not likely to change their habits³⁰ is not convincing.

For that reason, tax amnesty should not be viewed as a kind of fiscal panacea to fill budget gaps.³¹ Since periodical amnesties imply the danger of enforcing tax evasion and, by that, to thwart their intentions, the state must - only reluctantly - make a well thought out use of this revenue tool. The Tax Amnesty 2004/2005 is the first German tax amnesty for 15 years. This period seems to be long enough not to tempt people into waiting for the next amnesty. Future development will show whether the promises of exemption and reduction in tax scale are suitable to bring capital back to Germany.

²⁹ Hans-Wolfgang Arndt, *supra* note 23, at 55-59; Lars P. Feld, *in* VERANLAGUNG - ABGELTUNG - STEUERFREIHEIT, BESTEUERUNG VON KAPITALERTRÄGEN IM RECHTSSTAAT 43-45 (Gerhard Schick ed., 2003); Klaus Tipke, *supra* note 14, at 1439.

³⁰ *See*, Wolfgang Joecks, DStR 41, 1417-1418 (2003).

³¹ *See*, the report on the poor success in the first weeks of Tax Amnesty 2004/2005 Frankfurter Allgemeine Zeitung, 23 Feb 2004, 9.