Germany's tax reforms and the fight against tax fraud and evasion

A quarter of all tax revenue in the EU is collected in Germany alone. Given the country's weight in the EU economy, the German tax system plays a key role in facilitating cross-border trade and company growth in the EU, and in strengthening the EU-wide fight against abusive tax practices. However, the publication of the 'cum-ex files' in 2018 revealed that Germany had lost billions in tax revenue because of aggressive dividend arbitrage practices.

Cum-ex files

In October 2018, a team of investigative journalists published the cum-ex files, revealing alleged large tax fraud schemes set up by using dividend arbitrage. While the practice had been known and investigated before, the publication of the files revealed the extent to which Europe had been affected, losing some €55 billion in tax revenue between 2002 and 2012. Cum-ex transactions have been uncovered in several EU Member States, but Germany appears to have been hit the most, with revenue loss estimated at €31 billion, according to the journalist collective.

While a cum-ex transaction could be established with multiple layers of complexity, it generally involved the trading of shares around the day of dividend pay-out. When issuing the dividend to the shareholder, capital gains tax was automatically withheld directly by the company. In some cases, the shareholder could be reimbursed on this tax by claiming a 'tax certificate' issued by the shareholder's bank and sending it to the tax authorities. In cum-ex transactions, the shares were being traded deliberately around the time the dividend was paid to cause confusion as to who owned the shares with (i.e. 'cum') dividend rights (and thus with capital gains tax paid) and who owned those without ('ex') dividend rights. As a result, two or more shareholders were able to claim a tax certificate with their own bank – and thus be reimbursed by the tax authorities – on a tax that was only paid once; the profit gained could then be shared between the traders. In 2012, Germany changed its tax law, obliging banks to both collect the dividend tax and issue the reimbursement certificates, thereby closing the loophole.

On request of the European Parliament, both the European Banking Authority (EBA) and the European Securities and Markets Authority (ESMA) issued reports on cum-ex, analysing the scheme and its scale, and outlining potential solutions. ESMA's key recommendation was to empower national competent authorities for securities markets to share information with tax authorities in order to assist in detecting withholding tax reclaim schemes. During a hearing in the European Parliament in February 2021, a representative from the University of Mannheim stated that the cum-ex practice was still observable in Germany today, despite the 2012 change in the German tax code. Meanwhile, in July 2021, the German federal Court of Justice ruled that cum-ex constituted tax evasion and was therefore illegal.

In the first quarter of 2023, the European Commission is planning to table an initiative on simplifying and streamlining withholding tax procedures to support cross-border investment. The initiative is also expected to introduce additional safeguards to ensure that withholding tax relief procedures cannot be used for abusive tax practices.

Germany and tax under the European Semester

As part of the European Semester, the European Commission issues country-specific recommendations (CSRs) for each Member State, with tailored advice on how to boost growth and jobs while maintaining sound public finances. Under the 2019 Semester, the Commission issued two (inter-related) CSRs covering taxation for Germany:

EPRS | European Parliamentary Research Service

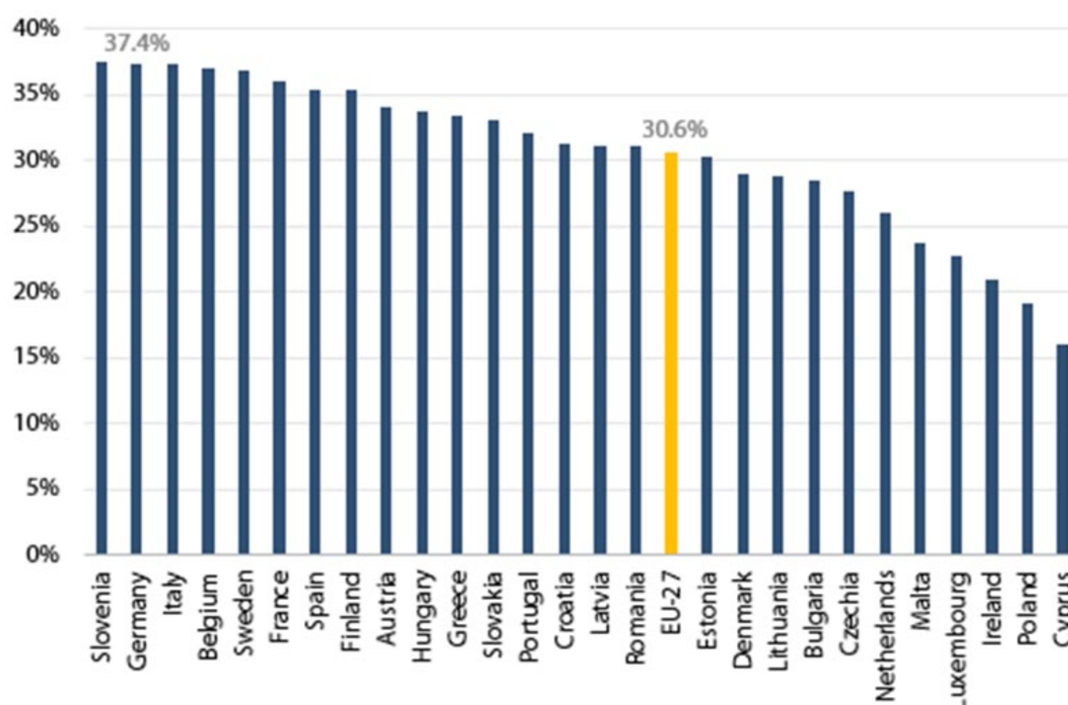
Author: Pieter Baert, Members' Research Service

PE 739.223 – November 2022

EN

- **Shift taxes away from labour to sources more supportive for inclusive and sustainable growth**. As Germany's share of revenues from labour taxes and social security contributions on total tax revenue was the highest in the EU (59.6 % in 2020), Germany was recommended to lower taxes on labour.
- **Reduce disincentives to work more hours, including the high tax wedge, in particular for low-wage and second earners**. Germany has one of the highest tax wedges in the EU for people on low wages, which can discourage citizens from entering the labour market. and businesses from hiring additional staff. The Commission referred in particular to the practice of joint taxation for married couples or civil partners in Germany (*Ehegattensplitting*), which can disincentivise second earners (often women) from working longer hours. In this system, the spouses' income is added up and then halved. After calculating the tax liability on this amount, it is again multiplied by two, resulting in the total of taxes the couple is due to pay. When operating in a progressive tax system, a second earner may face a higher marginal effective tax rate on additional income compared with a person who files separately (particularly if there is a large difference in income between the two spouses).

Tax wedge on two earners with two children (earner 1 = average income, earner 2 = low income), 2021



Data source: Eurostat. The tax wedge measures the difference between the labour costs for the employer and the employee's corresponding net take-home pay. Low wage = 33 % of average income.

With the introduction of the Recovery and Resilience Facility (RRF), Member States' national recovery and resilience plans (NRRPs) must address all or a significant subset of challenges identified in the CSRs for the country to be able to access the funds available under the RRF. The German government submitted its NRRP to the Commission in April 2021, with the Commission endorsing the plan in June later that same year.

To address the tax-related CSRs, the NRRP referred to several tax measures Germany had already implemented between 2019 and 2021, which – according to the plan – had lowered the tax on labour, in turn also benefitting women and second earners structurally. For example, the solidarity surcharge (*Solidaritätszuschlag*) was abolished, social security contributions for low earners were reduced, and the tax relief amount for single parents was doubled.

In its evaluation of the German NRRP, the Commission concluded that, while the plan delivers a 'comprehensive and adequate response' to the challenges outlined by the CSRs, 'further efforts are needed in the coming years … particularly … in areas such as taxes on labour and the tax wedge'.

This document is prepared for, and addressed to, the Members and staff of the European Parliament as background material to assist them in their parliamentary work. The content of the document is the sole responsibility of its author(s) and any opinions expressed herein should not be taken to represent an official position of the Parliament. Reproduction and translation for non-commercial purposes are authorised, provided the source is acknowledged and the European Parliament is given prior notice and sent a copy. © European Union, 2022.