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Fr. Dr. Renata Kusiak-Winter

Universität Breslau

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Vorwort

Prof. Frank Nolden

Rektor

Liebe Leserinnen, liebe Leser,

es ist mir heute eine besondere Freude, Ihnen mit Heft Nr 7 der Meißner Hochschulschriften erstmalig eine englischsprachige Ausgabe unserer wissenschaftlichen Schriftenreihe vorlegen zu können. Die Beiträge zu Heft 7 sind im Rahmen einer internationalen wissenschaftlichen Konferenz mit dem Titel „Current research problems in Administrative studies in Poland and Germany" an der Universität Breslau im Oktober 2016 entstanden. Aufgrund des Umfangs der Beiträge werden die Beiträge zeitnah in Heft 8 der Schriftenreihe fortgesetzt und abgeschlossen.

Die insgesamt fünfzehn Beiträge sowohl deutscher als auch polnischer Autoren/-innen wurden bereits im Vorfeld zu den aktuellen Heften der Schriftenreihe sowohl in der Wroclaw Review of Law, Administration & Economics als auch auf der Internetplattform De Gruyters Open international veröffentlicht. Sie decken eine große Bandbreite verschiedenster Themen aus dem Bereich der öffentlichen Verwaltung und den Rechtswissenschaften ab. So z.B. zu den öffentlichen Aufgaben der Kommunen in Polen und Deutschland, zum Verhältnis zwischen Bürgern und Sozialverwaltung, zur vergleichenden Rechtwissenschaft, zur Ressource Mensch in der Verwaltung oder der Besteuerung der öffentlichen Hand in Deutschland und Polen. Durch die Betrachtung der Themen sowohl aus deutscher als auch polnischer Sicht ergeben sich interessante Gemeinsamkeiten, wie nicht anders zu erwarten aber auch Abweichungen. In jedem Fall stellen die Hefte 7 und 8 der Meißner Hochschulschriften einen kleinen Beitrag zur Stärkung des gegenseitigen Verständnisses in einem zusammenwachsenden Europa der Regionen dar.

Mein besonderer Dank gilt an dieser Stelle Fr. Dr. Renata Kusiak-Winter von der Universität Breslau, die nicht nur bereits die internationale wissenschaftliche Konferenz in Breslau, sondern auch die nachfolgenden Publikationen federführend begleitet hat.

Ich wünsche Ihnen eine angenehme und informative Lektüre.

Ihr Frank Nolden

Meißen im September 2018

FISCAL EQUALIZATION SYSTEMS FOR EUROPEAN STATES – POSSIBILITIES AND RESTRICTIONS FOR THE ARRANGEMENTS IN GERMANY AND POLAND

1 INTRODUCTION AND RELEVANCE OF THE TOPIC

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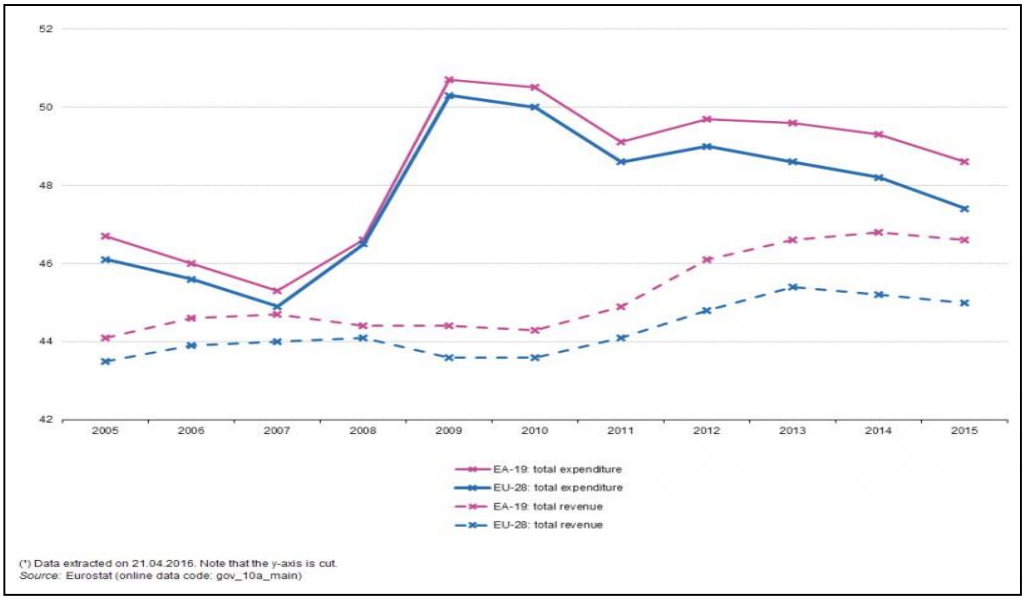
After the extreme decrease of public revenues during the financial crisis 2008-2011, tax revenues steadily increased again. Nevertheless, the fiscal balances of the majority of European countries are still negative, i.e. the amount of public revenues is smaller than the amount of public spending. This paper shows that this net borrowing is independent of the form of government and aims to offer a solution for the avoidance of future financing deficits.

Considering the financial situation of the 28 member states of the European Union, a depiction of their financial balances shows fig. 1.

Considering the sum of public revenues and public spending of all countries in the EU, at no time in the time span of 2006-2014 were the public revenues sufficient to cover public spending. In the chart above, the dotted lines present public revenues. It is irrelevant whether one regards all members of the EU or only the members of the EURO-Zone, there is a financial deficit in all cases. The biggest deficit occurs during the years of the crisis 2008-2011. 2014 and 2015 see a decrease of the deficits in most countries of the EU, due to increased tax revenues.

Financial deficits occur independently of the structure of the states. Distinguishing between different state structures, two groups can be formed. The first group contains the 25 states with a (mostly) centralised state structure. Those are organized as unitary states, some centralised, some decentralised[1]. The second group is formed by only three federally organized states: Austria, Belgium and Germany. With regard to the assignment of duties and finances within the states, in an economic sense, those are not federal countries, though. In those countries, as in the unitary states, the financial allocation is mostly task-related, i.e. according to a juridical approach.

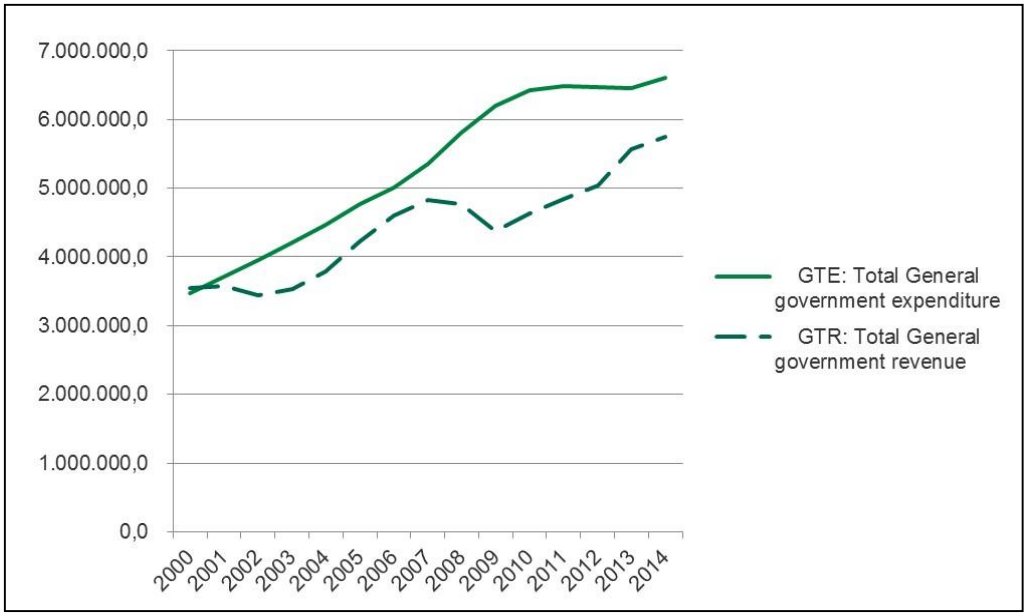


Source: data basedon Eurostat 'Government revenue, expenditure and main aggregates' <http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_main&tl ang=en> accessed 15 October 2016.

Fig. 1 Development of total expenditure and total revenue, 2006–14 (1 000 million €)

Comparing the development of public revenues and public spending in the U.S. as a federal country with a more economically characterised fiscal equalisation system, it is obvious that such an approach does not necessarily lead to balanced financial situations.

1 Information about the European member countries cf. European Union, 'European Union' (2016) <https://europa.eu/european-union/about-eu/countries_de> accessed 15 October 2016.



Source: data based on OECD '12th Government deficit/ surplus, revenue, expenditure and main aggregates' <www.stats.oecd.org> accessed 15 October 2016.

Fig. 2 Public revenues and expenditures in USA (USD in millions)

The relevant literature distinguishes between a mostly public economics-oriented consideration of the income-aspects and a mostly administrative science-based view of the public spending with regards to controlling and regulation. The existing literature for both topics is wide, so there will be some authors referred to exemplarily. For public economics Blankart[2] or Brümmerhoff and Büttner[3] will be cited; for the basics of public economics and especially for this analysis the Jahresgutachten 2014/15 from The German Council of Economic Experts[4] will be referred to. The research of public spending is associated with public management and administration will reference the publications from Budäus and Hilger[5], Glöckner[6] as well as the Bertelsmannstiftung with KGSt[7].

The income side discusses the generation of income in general, as well as its allocation to the different levels of the state. The spending side concentrates on the efficient management of tasks and the resulting consequences for public

2 Charles Beat Blankart, Öffentliche Finanzen in der Demokratie (8th edn, Vahlen 2011).
3 Dieter Brümmerhoff, Thiess Büttner, Finanzwissenschaft (11th edn, De Gruyter Oldenbourg 2015).
4 The German Council of Economic Experts, Annual Report 2014/15 (Bonifatius 2014).
5 Dietrich Budäus, Dennis Hilgers, 'Neues doppisches Haushalts- und Rechnungswesen als Grundlage öffentlicher Ressourcensteuerung' (2010) 5 Betriebswirtschaftliche Forschung und Praxis (BFUP) 62.
6 Andreas Glöckner, Neue öffentliche Rechnungslegung (Nomos 2014).
7 Bertelsmannstiftung, KGSt, Manifest zum öffentlichen Haushalts- und Rechnungswesen in Deutschland, (Bertelsmannstiftung KGSt 2009).

spending. So far, there is no integral approach that combines both aspects. The following text gives a first descriptive introduction by relating the key aspects.

2 FISCAL EQUALISATION SYSTEMS

The majority of the necessary public income stems from taxes, i.e. compulsory levies that do not lead to a direct service in return. Therefore, spending for the provision of public services is not linked with tax revenues. The principle of fiscal equivalence[8], i.e. that the financial contribution covers the costs for the public service, does not apply in this case. In addition, there is the possibility to impose fees for specific purposes, especially at a community level, e.g. for the provision of childcare or infrastructure.

For the organisation of the allocation of finances within the states, i.e. for the constitution of public finance law, there are two approaches: on the one hand, there are juridical regulations for the allocation of public tasks, the resulting spending and the necessary revenues. On the other hand, there are, especially for federal states, suggestions for an economic approach that strongly considers incentives and efficiency in the allocation of public goods and services.

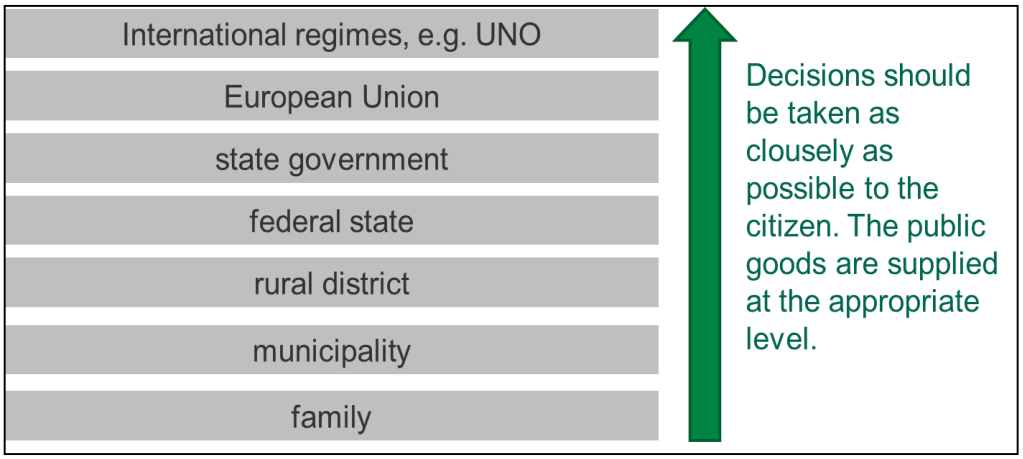
2.1 JURIDICAL APPROACH

In most European countries, the financial constitutions are based on the idea that the political level defines tasks and the levels of provision. The decision about the necessity of fulfilling the public tasks is in the hands of the parliaments of the respective levels. The implementation of the tasks and the following amount of public spending rests with the administration. The collection of the necessary revenues, e.g. taxes or fees, is regulated in the legislation and therefore decided upon by the parliaments. The tasks lead to spending which must be covered by revenues. The financial constitutions of the states legally rule the distribution of revenues among the different levels responsible for fulfilling the tasks[9].

8 Cf. Charles Beat Blankart, Öffentliche Finanzen in der Demokratie (8th edn, Vahlen 2011) 188 et seq.

9 Cf. Bodo Leibinger, Reinhard Müller, Herbert Wiesner, Öffentliche Finanzwirtschaft (13th edn, R. v. Decker 2014) 2.

A possible approach to a distribution of public tasks on the different levels is the principle of subsidiarity[10].



Source: own depiction. For the principle of subsidiarity cf. Brümmerhoff, Büttner (n 6) 337.

Fig. 3 The principle of subsidiarity

This approach assumes that the smallest administrative unit possible is responsible for fulfilling the task. Only if this unit is not able to do so, is the next higher level responsible. In different countries, there are different structures of the respective levels and the assignment of tasks. The responsibility for education, for example, can be organised centrally or decentrally. For the public good defence, on the other hand, there will be a central responsibility in all European states[11].

Generally, this means that with regards to the allocation of finances, the level that is responsible for providing the task is allocated the means to do so. The German financial constitution is based on the principle of connectivity. This means that the level responsible for the task is also responsible for the expenses[12]. As a consequence, the responsible level must dispose of the necessary revenues to do so. A possibility to ensure this is to enable the levels to raise the revenues necessary for their expenses independently. Alternatively, the central level can generate public revenues and allocate them to the other levels according to their tasks.

10 The principle of subsidiarity is regulated in art 5 of the Treaty on European Union. Cf. European Union 'EurLex' <Vertrag über die Europäische Union, Artikel 5 (EUV) und Protokoll (No.2), http://eur-lex.europa.eu/legalcontent/DE/TXT/?uri=celex%3A12012E%2FTXT> accessed 15 October 2016.

11 Cf. Horst Zimmermann, Klaus-Dieter Henke, Michael Broer, Finanzwissenschaft (12th edn, Vahlen 2012) 218.

12 ibid.

If this approach were applied consistently, there should be no negative financial balances as shown in section 1. The reality in the last decades shows increased public spending, and, in most cases, financial deficits, even though laws in almost all countries are explicit with regards to public revenues covering public spending. In addition, at the European level there are the Maastricht criteria stating that the public financial deficit must not be more than 3% of a country's GDP[13].

2.2 ECONOMIC APPROACH

The rather theoretical economic approach[14] assumes that the public service or good and its payment are directly related. In this case, the fiscal principle of equivalence takes effect. The duty of payment is only effective in case of claiming the public service. Due to the connection between provision and payment of the service, there is fiscal competition between regions. This concerns the supply of public goods and services as well as the amount of payment due for their utilisation. Therefore, citizens can vote with their feet by choosing the region best suited to their requirements. Public goods and services exist on a national as well as a regional level. Examples are the national provision of the good 'defence' and the regional provision of infrastructure. There is also the possibility of international public goods such as climate protection. The voting by feet is therefore dependent on the sphere of influence of the public good. The theory of federalism assumes that an efficient allocation of the public good is achieved, because the level with the best information about costs and necessary quantities of the good or service provides them[15].

This concept only works if the necessary information about cost and quantity is available. The development of the financial deficits on a European level shows that either the information is not available or, if it is available, it is not used efficiently. The following section therefore provides a suggestion for the avoidance of financial deficits that applies to countries with juridical as well as economic approaches in their financial constitutions.

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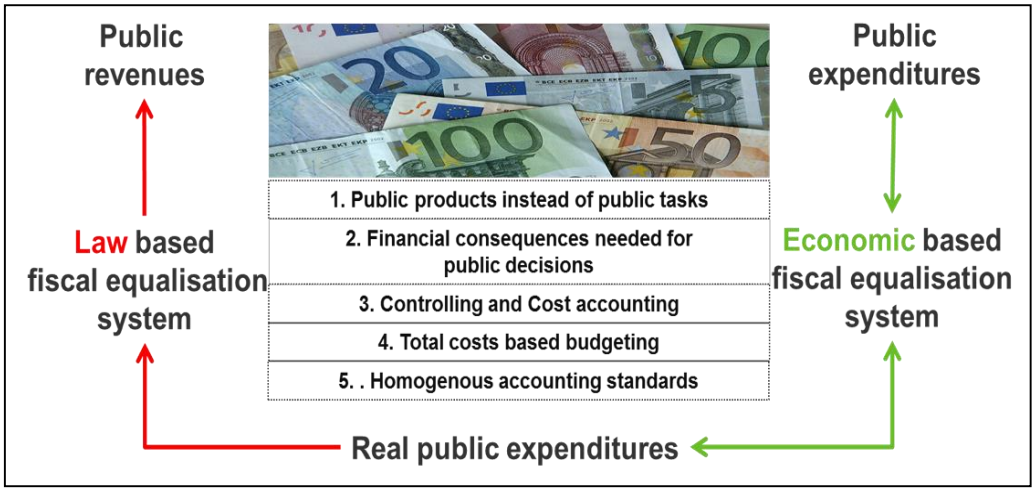
13 Cf. Bundesfinanzministerium 'FiscalRules', <http://www.bundesfinanzministerium.de/Content/DE/Standardartikel/Themen/Oeffentliche_Finanzen/Fiskalregeln/nationale-europaeische-fiskalregeln.html#doc21758bodyText11> accessed 15 October 2016.

14 A complete economic approach cannot be found in any European state. Single components can be found, e.g., in Switzerland.

15 For the theory on federalism cf. Charles Beat Blankart, Öffentliche Finanzen in der Demokratie (8th edn, Vahlen 2011) 613 et seq.

3 SUGGESTED REFORM

It can be shown that financial deficits are mainly independent of the regulation of the allocation of finances within a country. Neither a mainly juridical nor a mainly economically based financial constitution leads to balanced finances. This is mainly due to the regulation of spending by considering needs, leading to an automatic deficit in case of high needs. Spending is considered a target figure and revenues must be determined accordingly to cover spending. The system works like a one-way street in only considering one direction.



Source: own depiction.

Fig. 4 The real economic approach

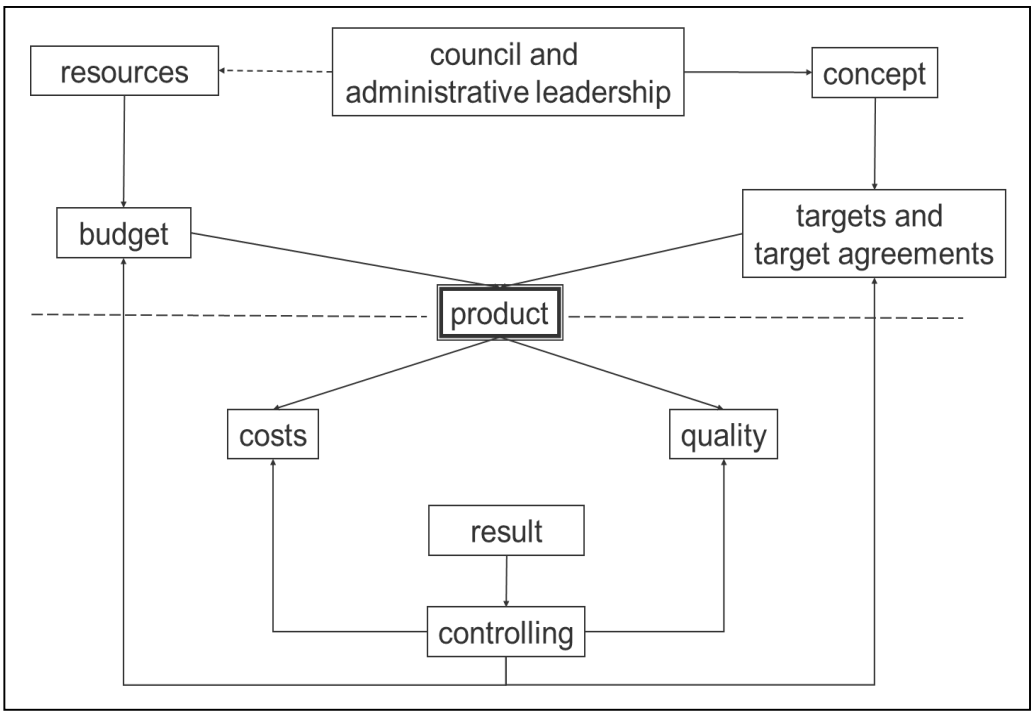
A system solving these discrepancies must therefore also include the spending. Expanding the basic approaches to financial allocation within those parameters, the result is the real economic solution, i.e. a system that leads to an efficient rationing of spending and revenues. Budget controlling is then necessary and further deficits are avoided.

3.1 PUBLIC PRODUCTS INSTEAD OF PUBLIC TASKS

The legal regulations of the allocation of finances are based on the assumption of public task. The formulation and realisation of public tasks focuses on the input side, though. This can be illustrated by the example of a day-care centre. If parents have a legal right for day-care for their children, local authorities must provide a place in a day-care facility. If this is the case, the task is fulfilled. This is the end of the input control. In addition, it is necessary to present the resources necessary to provide the place in the day-care unit. When defining tasks, i.e. the provision of a public service or good, it is not necessary to specify targets such as quality or costs. This is a deficit in the system, because qualified

information about the cover ratio or the satisfaction of the users etc. are not possible.

If public services or goods are presented as products instead, one switches from input- to output control. In this case, the resources needed can be included and it is possible to state targets and to control whether those targets are reached.



Source: based on Gunnar Schwarting, *Effizienz in der Kommunalverwaltung* (2nd edn, Erich Schmidt 2005) 38.

Fig. 5 The product in the new management model

As can be seen in the figure above, the product is the focus of the budget management of the new management model[16]. The strategic decision about the provision of a product is made by the council or the administrative leadership. Based on a guiding principle, targets and target agreements are connected with the product and resources and budgets for the provision of the product are planned. The operative level shows the costs and qualities of the product, which then give feedback to the controlling of aims and budgets. In some cases, this will show that budgets are insufficient and must be increased. Based on this

16 On the new management model cf. Gunnar Schwarting, Effizienz in der Kommunalverwaltung, (2nd edn, Erich Schmidt 2005) 21 et seq. On a community level there is an enhanced version to a community management model, cf. Kommunale Gemeinschaftsstelle für Verwaltungsmanagement KGSt, Das Kommunale Steuerungsmodell (KSM) (KGSt-Bericht 2013, No. 5).

management principle, the decision about such an increase can be made based on better information.

3.2 FINANCIAL CONSEQUENCES OF PUBLIC DECISIONS

The legal approach to the provision of public goods and services only considers the necessity of fulfilling a task. It defines whether a task is necessary or not, but does not stipulate in which quantity it must be provided. Therefore, the necessity is considered independently of direct and indirect middle- and long-term costs caused by the product. In Germany, for example, investments in big projects are decided on without reflection on the follow-up costs of the investments. Fulfilling the task is therefore independent of the product costs and the budget.

3.3 CONTROLLING AND COST ACCOUNTING

To efficiently fulfil public tasks, they must be defined as products. This enables output management for the completion, i.e. efficient provision, of the task. The target-oriented management of administrative units with the help of controlling systems, which are based on a cost- and performanceaccounting system, is crucial for this approach. With the help of those systems, information about targets such as costs, performance and economic efficiency of the provision are available and can be analysed.

A controlling process that is helpful for the administration[17] follows the following steps: planning, controlling, information, management. Planning includes the setting of targets and the determination of a budget for the realisation of the targets. Planning therefore anticipates future situations and weighs different alternatives with the help of objective information to set the targets. These decisions are strategic, i.e. the planning horizon is at least five years. It is crucial for the successful implementation of controlling systems in the public sector that there is an awareness for the necessity that the responsible politicians and the managers have to use the planning system and the planning process. The controller only takes over after the planning, i.e. is responsible for the comparison of targets and actual performance and analyses the reasons for possible discrepancies. This is a necessary addition to the planning process to analyse the achieving of the targets. The information system collects information from both the planning and controlling process and uses this as the base for the

17 On the controlling process for the administration cf. André Tauberger, Controlling für die öffentliche Verwaltung (Oldenbourg 2008) 31 et seq.

work of the management unit. In addition, the information system has a reporting function for the analyses made in the controlling system. If all relevant information is available, management can take measures to correct deviations of the actual performance from the planned situation.

The information necessary for the information system comes mainly from the public accounting as well as the public cost- and performance accounting. To ensure the availability of the necessary data, public budgets must be planned according to double-entry bookkeeping standards. Especially the annual accounts according to these standards provide considerable information on the actual performance due to the availability of data in the balance of accounts, profitability analysis and financial accounting[18].

In addition, budgets based on double-entry bookkeeping are a part of the planning system, because they show monetary consequences of future events for every product. This information is supplemented by an assignation of costs by cost type to their cost unit or cost centre and the resulting information on actual costs of the provision of different public goods or services.

3.4 TOTAL COSTS BASED BUDGETING

Budget regulations and budget institutions in the public administration are necessary to improve budgetary discipline.[19] The target of budgeting is to improve aggregated financial discipline, to attain allocation efficiency (allocation of resources according to the formulation of the political will and objectives) and the technical efficiency (efficient provision of public goods). The improvement of the aggregated financial discipline can be among the macroeconomic targets of a state. Achieving allocative efficiency is a target of the relevant level, and technical efficiency is an operative target for the level realising the provision.[20]

18 Cf. Isabelle Jaenchen, 'Das Sächsische Kommunale Kennzahlensystem. Eine Empfehlung für die sächsischen Städte, Gemeinden und Landkreise (2012) 4(12) Sachsenlandkurier 162.

19 Cf. Angelika Pasterniak, Budgetregeln und die Qualität der öffentlichen Finanzen (1st edn, Deutscher Universitätsverlag 2006) 8.

20 ibid 67 et seq.

In 1998, the World Bank published basic rules for a solid budgeting policy[21]. They are as follows:

- Comprehensiveness and discipline.
- Legitimacy.
- Flexibility.
- Predictability.
- Contestability.
- Honesty.
- Information.
- Transparency and accountability.

Especially for the principle of information, but based on the information also the principles of honesty and transparency, it is necessary to include all costs resulting from the provision of public goods and services. Budgeting based on the inclusion of total costs is therefore essential. To achieve this, it is necessary to change the management system to one based on products, and to transfer the budget and accounting system to double-bookkeeping principles[22].

The product-oriented booking of expenditures and revenues leads to necessary insights for the creation of cost- and performance-accounting systems. If cost- and performance-accounting systems are introduced, necessary information about costs, but also output and outcome, are available. This information is essential for a planned and systematic budgeting.

3.5 HOMOGENEOUS ACCOUNTING STANDARDS

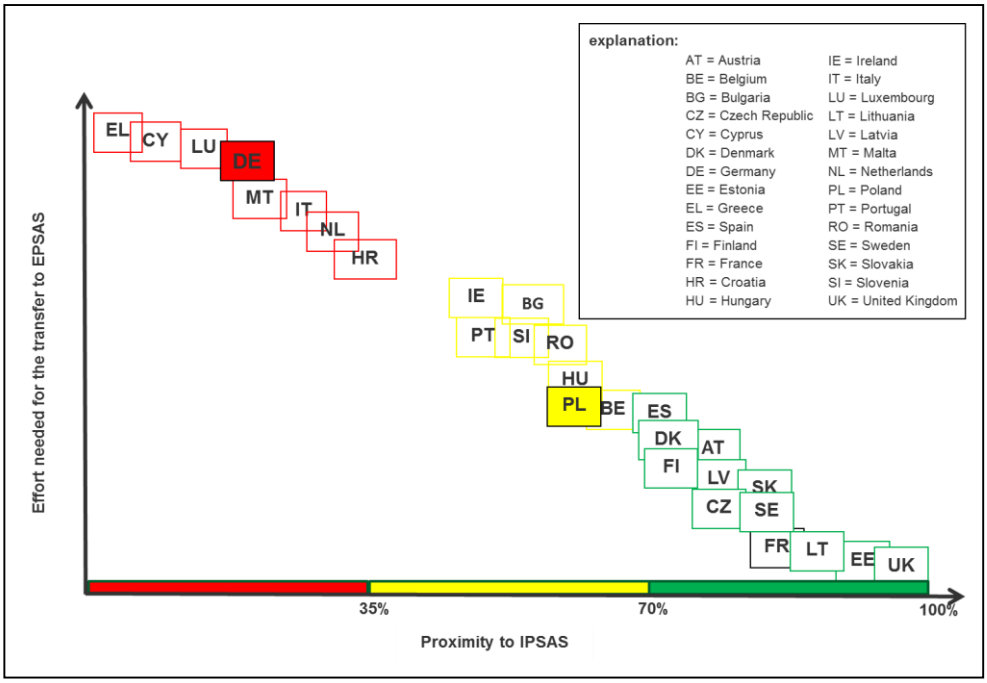
Allocative and technical efficiency can only be realized if the necessary information about the disposable resources and their optimal allocation is available. The predominant system in Europe, the cameralistic accounting, does not provide this information. It only contains information suitable for input-control, but not the necessary data on costs, output and outcome. Therefore, the European Commission strongly promotes the introduction of consistent budget- and accounting standards (EPSAS)[23]. The transfer from cameralistic to double-

21 The World Bank, Public Expenditure Management Handbook (The World Bank Washington D.C. 1998).

22 Rainer Isemann, Christian Müller-Elmau, Stefan Müller, Kommunales Gemeinkostenmanagement (Erich Schmidt 2011) 17 et seq.

23 EPSAS: European Public Sector Accounting Standards based on IPSAS, International Public Sector Accounting Standards, cf. EPSAS 'Towards harmonized European Public Sector Accounting Standards' <www.epsas.eu> accessed 15 October 2016.

entry accounting and the subsequent target-oriented use of the information about costs, output and outcome is essential to produce balanced budgets. The objective of a harmonised solution for all member-states is the provision of comparable budget- and annual account-data for all member-states. Only then is a target-oriented management with the help of the aforementioned instruments possible. The political resistance to the introduction of harmonised European standards, especially in Germany, is large, though. In Germany there are 16 different regulations of the federal states for the districts. The restructuring of the budgets of the Länder follows different standards.



Source: own depiction based on data from Dennis Hilgers 'Die Dispersion der Doppik' <http://www.haushaltssteuerung.de/weblog-die-dispersion-derdoppik-das-neue-oeffentliche-haushalts-und-rechnungswesen-zwischenkommunaler-routine-und-europaeischer-harmonisierung.html.> accessed 15 October 2016.

Fig. 6 State of the realisation of harmonised standards

In addition, the need for reforms as well as the effort needed for the transfer to EPSAS on the German federal level is very high and the proximity to the IPSAS standards very low (less than 35%) compared to other EU member states. Poland has to put considerably lower effort into the transformation and has a much higher proximity to the IPSAS (66%), even though it is not one of the most advanced states in this respect. Almost half the EU member states have a degree of proximity of more than 70% to the IPSAS and therefore a considerably lower effort to transform and lower need for reforms.

4 CONCLUSION

Bringing about the suggested reform is independent of the state structure. Parts of the reform have already been completed in some EU member states, and the development of harmonised budget- and accounting standards on a European level shows a solution to the dilemma. An integrated system with revenues and expenditures leads to considerably higher transparency[24]. Currently, the individual states are working on partial solutions, though, therefore, the introduction of double-entry bookkeeping standards as well as harmonised accounting systems in all EU member states are still lacking.

In addition, a clear assignment of tasks and the accompanying assignment of responsibilities is crucial for a successful realisation of the reform. It is also necessary to transfer public tasks to public products which must then be classified as either tradable goods, e.g., childcare, and sovereign, e.g. defence and security. Tradable goods could be managed as service with return service according to the principle of fiscal equivalence; sovereign goods can be managed as basic requirements.

If the assignment of tasks is clear and costs are transparent due to the parameters introduced above, the revenue competences of the responsible levels must be regulated. This increases institutional congruence and creates better regional identities for the use of public goods.

The relevant instruments to effect the reform are well-known. Therefore, the current task is to increase the willingness to implement the existing instruments.

This paper offers the groundwork for the combination of public income and public spending. Further research should aim at the development of integration approaches for a more efficient public administration.

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THE SYSTEM FOR EQUALIZATION OF LOCAL SELF-GOVERNMENT UNITS REVENUE IN POLAND

1 INTRODUCTION

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Article 166 of the Polish Constitution[1] distinguishes own tasks and allocated tasks, while art 167 sec 2 indicates that revenues of local selfgovernment units (LSGUs) are comprised of own revenues, general subsidies and specific grants from the state budget. These provisions, analysed together, are of importance in delineating the assumed functions of particular types of revenue by local self-government units. The assumed function of own revenues and of the general subsidy is to finance own tasks, while specific grants are designed to fund allocated tasks[2]. In respect of financing own tasks, the primary role is played by own revenues[3]. However, because the sources of own revenues are distributed unevenly across the country, it is necessary for the system of local self-government unit revenues to contain an equalizing mechanism complementing own revenues and allowing local selfgovernment units to finance the performance of own tasks.

1 Constitution of the Republic of Poland of 2 April 1997 (Dziennik Ustaw – Official Journal of Laws of the Republic of Poland (hereinafter: Dz. U.) No 78, item 483 with amendments), hereinafter: the Constitution.

2 The Local Self-Government Revenue Act (Dz. U. 2015, item 513 with amendments) does envision financing of own tasks from targeted subsidies (cf. art 42, 43, 51), but it does not seem that they should be the primary source of financing for own tasks.

3 Teresa Dębowska-Romanowska, Prawo finansowe. Część konstytucyjna wraz z częścią ogólną [Financial law. Constitutional part with general part] (C.H. Beck 2010) 231.

The axiological justification for the functioning of this equalization mechanism can be found in the constitutional principles of social justice (art 2 Constitution), the unitary character of the state (art 3 Constitution) and sustainable development (art 5 Constitution). The need for an equalization mechanism is also indicated in art 9 sec 5 of the European Charter of Local Self-Government (ECLSG)[4]. Under this provision, the protection of financially weaker local authorities' calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. The European Charter of Local SelfGovernment explicitly states there is an obligation for the system of local selfgovernment unit revenues to include a permanent financial equalization system, the function of which is to ameliorate objective differences in revenue and expenses among local self-government units at a given level[5].

The necessity of a system for equalizing local self-government unit revenues is also indicated in the justification for the Local Self-Government Revenue Act (LSGR Act) presently in force: "The draft bill contains a proposal for strengthening the role of the equalization system, whose task will be to correct the imbalances in revenues of local self-government units with reference to average income across the country adjusted for the relevant territorial unit, i.e. commune, county and province. This system is also important in the light of significant differences among regions in Poland. Regardless of the potential for generating own revenues in a given part of the country, all units of local self-government should be equipped to ensure appropriate social and economic development"[6]. Another passage emphasizes that "with consideration to the significant discrepancies in revenue across communes, counties and provinces, an appropriate equalization system will be introduced with the task of protecting the economically weakest units"[7].

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4 European Charter of Local Self-Government, Strasburg, 15 October 1985 (Dz. U. 1994 No 124, item 607, correction Dz. U. 2006 No 154, item 1107).

5 Wiesława Miemiec, `Europejska Karta Samorządu Terytorialnego jako zespół gwarancji zabezpieczających samodzielność finansową gmin – wybrane zagadnienia teoretycznoprawne` [The European Charter of Local Self-Government as a set of guarantees financial independence of commune – selected theoretical and legal issues] (1997) 10 Samorząd Terytorialny 68.

6 Justification to the government draft bill of the Local Self-Government Revenue Act, Sejm Paper No 1732/IV term 21.

7 ibid 6.

The function of equalizing the revenues of local self-government units assumed by the legislator is performed by the general subsidy. This equalizing function of the general subsidy consists in complementing the own revenues of local self-government units with funds from the state budget (vertical equalization) or from the budgets of other local self-government units (horizontal equalization), in order to help all units accomplish their own tasks to a degree that meets at least the minimum standards in conditions of differing potential for self-government entities across the country to generate own revenue. In other words, imbalances in access to potential own revenue sources leads to the necessity of equalizing those revenues to the level assumed by the legislator as sufficient to ensure the potential for all local selfgovernment units to finance the performance of own tasks. The equalizing function of the general subsidy is thus always linked to own revenues (the general subsidy complements own revenues) and own tasks (whose performance, alongside own revenues, is financed by the general subsidy). In relations between the state budget and the budgets of LSGUs, the vertical divide is of primary significance. It consists in transfers of money to LSGUs; these transfers constitute state budget expenditures in the legal form of subsidies and grants[8]. The horizontal divide, which is of a complementary nature with respect to the vertical, consists in receiving and redistributing a portion of funds from some LSGUs pursuant to criteria defined by statute, and then transferring them to other LSGUs[9].

The general subsidy is made up of the equalization component, the balancing component (in respect of provinces – regional) and the educational component[10]. An equalizing function is only performed by two portions of the subsidy – the equalization component, which comes from the state budget, and the portion derived from payments by LSGUs, id est the balancing (regional) portion[11]. Attention is drawn to this fact by the justification for the Local Self Government Revenue Act, which does not list the educational component in the context of the assumed equalizing function performed by the general subsidy: "differences in revenues will be equalized by the equalizing component as well as the balancing component (communes, counties) and regional component (provinces)

8 Zbigniew Ofiarski, Subwencje i dotacje jednostek samorządu terytorialnego [General subsidies and specific grants for the local self-government units] (Difin 2002) 24.

9 Hanna Sochacka-Krysiak, Finanse lokalne [Local finances] (Poltext 1995) 31.

10 Art 7 sec 1 LSGUR Act.

11 In the case of communes, this includes from the surplus of the complementary amount of the equalizing component of the general subvention (art 21 sec 1 LSGR Act).

of the general subsidy"[12]. In respect of both of the portions their assumed function is the same, whereas they are distinguished by different sources of financing (state budget vs budgets of LSGUs). The assumed function of the educational component is also different. As in the case of the equalization and balancing (regional) components of the general subsidy, it serves as a supplement to the own revenues of LSGUs. The grounds for this supplement is not, however, the need to correct for the potential to generate own revenues, but rather to ensure that LSGUs have sufficient funding to perform tasks related to education. This means that the amount of funding due to a given LSGU is independent of that unit's own revenues, therefore it follows that the educational component does not serve to equalize own revenues. The value of the educational component in the general subsidy is derived from criteria set out in the relevant decree of the minister responsible for matters of education and child welfare, in particular the types of schools and other institutions operated by LSGUs, the professional rank attained by teachers, and the number of pupils attending those schools and institutions[13]. It should be emphasized that what is being discussed here is the assumed function of the educational component in the general subsidy from the perspective of criteria used in determining its amount. From the perspective of LSGU expenditures, the educational component does not differ from other portions of the general subvention as LSGUs are free to dispose of funds received from that portion of the general subsidy as they see fit[14].

In summarizing the foregoing deliberations it should be concluded that the assumed function of the general subsidy in respect of its equalizing and balancing (regional) components is the aforementioned equalizing function. Prior to proceeding to a presentation and examination of how the equalizing and balancing (regional) components of the general subsidy perform their assumed functions, we should first answer the question of whether the general subsidy should equalize only the uneven access of LSGUs to potential sources of revenue, or whether they should also serve to equalize uneven spending burdens. Invoking art 9 sec 5 of the ECLSG it would seem that equalization applies to both revenues and expenses of particular LSGUs[15]. The problem arises, however, of

12 Justification to the government draft bill of the Local Self-Government Revenue Act, Sejm Print No 1732/IV term, 6.

13 Art 28 sec 6 LSGR Act.

14 Art 7 sec 3 LSGR Act.

15 Andrzej Niezgoda, `Subwencja ogólna i wpłaty jednostek samorządu terytorialnego do budżetu państwa jako elementy finansowego mechanizmu wyrównawczego` [The general subsidies and payment of local self-government units to the state budget as part of the

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how to objectively account for uneven expenditure levels when determining the value of the equalization, particularly in light of the absence of legal regulation concerning the standardization of costs for the performance of public tasks by LSGUs. It would seem that one solution is to account for expenditure burdens when calculating the number of residents in a given LGSU, which along with tax revenue levels is used in calculating the level of equalization. Taking into account particular expenditure needs should primarily affect large cities in which many people using communal services do not have a place of residence. The proposed mechanism can take the form of a population conversion factor, such as the one which was applied under the Act on financing communes and the Local Self-Government Unit Revenue Act in effect during the period 1999-2003[16], and which is successfully employed in Germany[17].

A doctoral discourse will be conducted using a legal-dogmatic method, therefore, on analysis of the legal regulations.

2 EQUALIZATION COMPONENT OF THE GENERAL SUBSIDY

The primary role in equalization of objective inequalities in the level of own revenues generated by LSGUs is – and should be – played by the equalization component of the general subsidy coming from the state budget. In accordance with the constitutional principle of adequacy, it is the State which bears the burden of ensuring that LSGUs participate in public revenues to such an extent

financial equalization mechanism] in Jolanta Gliniecka, Edward Juchniewicz, Tomasz Sowiński (eds) Finanse publiczne jednostek samorządu terytorialnego. Źródła finansowania samorządu terytorialnego we współczesnych regulacjach prawnych [Public finances of local self-government units. Sources of financing of local government in modern legal regulations] (CeDeWu 2014) 71-72.

16 The Commune Financing Act of 10 December 1993 (Dz. U. No 129, item 600 with amendments) in art 15 the Local Self-Government Revenue Act of 26 November 1998 in the years 1999-2003 (Dz. U. No 150, item 983 with amendments) in art 22 divided communes into three groups based on population: 1) for communes with fewer than 5,000 residents the population conversion factor was also 5,000; 2) for communes with between 5,000 and 10,000 the population conversion factor was equal to the number of residents; 3) for communes with over 10,000 residents, the population conversion factor was based on a special table under which the largest cities (over 300,000 residents) had a conversion factor based on the formula 354,000 + 125% of the number of residents over 300,000.

17 Cf. Joanna Mackiewicz-Łyziak, Elżbieta Malinowska-Misiąg, Wojciech Misiąg, Marcin Tomalak, Wyrównywanie dochodów jednostek samorządu terytorialnego. Możliwości wykorzystania w Polsce doświadczeń niemieckich krajów związkowych [Equalization of local self-government units revenue. Possibilities of using in Poland experience of the German federal states] (Instytut Badań Nad Gospodarką Rynkową 2008) 155-156.

as necessary for them to maintain at least a minimum of standards in the performance of the public tasks assigned to them[18]. The idea is for the residents of every LSGU in the unitary state of Poland to have access to public services provided by those entities of a similar standard and at a similar price[19]. With a view to the previously-mentioned constitutional principles of social justice (art 2 Constitution), the unitary character of the state (art 3 Constitution) and sustainable development (art 5 Constitution), it is impermissible for there to exist significant disproportions in the quality and level of communal services provided by LSGUs around the country. The assumed function of the general subsidy, i.e. equalization, is supposed to prevent this from occurring. Whether that function is, in fact, carried out is decided by the criteria for equalization that are adopted.

Since the equalizing and balancing (regional) components of the general subsidy are supposed to equalize the uneven distribution of own incomes around the country, the base for calculating the value of the equalization should be the amount of the own revenues belonging to a given LSGU. Comparison of the amount of the own revenues generated by particular LSGUs at a given level should allow for determining a particular average level of those revenues, in order for those LSGUs below the average to receive equalization from the equalizing and balancing (regional) components of the general subsidy.

Enumerations of the own revenues of communes, counties and provinces are contained in art 4, art 5 and art 6 LSGUR Act. These revenues can be classified into one of four basic categories: revenues from public law tributes, which include revenues from local taxes and fees, as well as shares in revenues from income tax, income generated by assets, payments from organizational entities and self-government juridical persons, as well as other incomes like inheritances, bequests and donations to the benefit of LSGUs[20].

It should be emphasized that ameliorating differences in levels of own revenues generated by LSGUs of a given level on a national scale concerns only public law own revenues, and not private law own revenues. This is a result of the constitutional principle of adequacy, which in art 167 sec 1 of the Constitution

18 Dębowska-Romanowska (n 3) 244.

19 Wiesława Miemiec, Prawne gwarancje samodzielności finansowej gminy w zakresie dochodów publicznoprawnych [Legal guarantees of financial independence of the communities in public revenues] (Kolonia Limited 2005) 134.

20 Cf. Rafał Kowalczyk in Ryszard Mastalski, Eugenia Fojcik-Mastalska (eds), Prawo finansowe [Financial law] (Wolters Kluwer 2013) 461 et seq.

obliges the State to ensure participation for LSGUs in public revenues in a manner adequate to the tasks assigned to them. The use of the phrase "public revenues" in this provision should be understood to mean that only in respect of public law revenues does the State have a duty to guarantee them to a given local self-government to the degree that allows it to perform its tasks[21].

Equalization of own revenues in the legal form of the equalizing and balancing (regional) components of the general subsidy will concern imbalances in public law revenues across the country, and thus primarily revenue generated by public law tributes. It is precisely the level of revenues from public law tributes that leads to disproportions in own income levels among LSGUs. The uneven distribution of revenues from public law tributes is most often the result of objective factors over which local self-government units have no influence: geographical location, climate conditions, the presence or absence of raw materials, the quality of soil, and attractiveness for tourists. What follows is that it is precisely the level of own revenues from public law tributes collected by LSGUs which should be used as the criterion for equalization. Such a construction of the equalizing and balancing (regional) components of the general subsidy facilitates performance of the assumed function of those portions of the general subsidy.

In accordance with art 20 sec 1, art 22 sec 1 and art 24 sec 1 LSGUR Act, the equalizing component of the general subsidy from the state budget earmarked for LGSUs is composed of the base amount and a supplementary amount. In calculating the base amount of the general subsidy two criteria are taken into account: the amount of tax revenues and the number of residents in a given LSGU. The concept of "tax revenues" gives rise to certain doubts of a terminological nature, as alongside revenues from local taxes the legislator also includes fees and participation in revenue from income taxes (and in respect of counties and provinces - only that last category); nevertheless, the solution itself should be assessed positively[22]. As has already been indicated, calculation of the

21 Wiesława Miemiec, `Artykuł 167` [Article 167] in Jan Boć (ed.), Konstytucje Rzeczypospolitej oraz komentarz do Konstytucji RP z 1997 roku [Constitutions of the Republic of Poland and the commentary to the Constitution of 1997] (Kolonia Limited 1998) 263.

22 Doubts are raised by art 20 sec 3 LSGR Act, which excludes from the catalogue of communal tax revenues receipts from the inheritance and gift tax, as well as from the market, local, health spa, and dog taxes. These tributes are not, however, of significance in generating meaningful disproportions in the level of own revenues generated by communes at the national level.

value of equalizing funds that a given LGSU should receive is to be based on the value of public law tributes constituting public law revenues of that particular unit. Indeed, it is the disproportions in the level of revenues from public law tributes which are the cause of the equalization system, which is designed to eliminate those imbalances. The construction adopted for calculating the value of the base amount of the equalizing component in the general subsidy thus performs the assumed function of the general subsidy, and it therefore follows that the assumed and the performed function are one and the same.

Equalization of the revenues of LSGUs cannot, however, lead to an extreme form of egalitarianism and a drive to make equal the level of revenues generated by all LSGUs on a given level across the country. This would serve to sap local authorities' motivation to stimulate economic growth locally[23]. For this reason the legislator decided to limit the maximum extent of equalization. In the case of communes, a given unit does not receive the base amount of the equalizing component in the general subsidy if its tax revenues are greater than 92% of the average tax revenues for all communes[24]. However, such a mechanism limiting the maximum level of equalization is not to be found in regulations concerning counties and provinces. In the subject literature this aspect of the general subsidy is at times said to perform a separate stimulating function[25].

In respect of the supplemental amount of the equalizing component in the general subsidy, whether a given commune receives this funding depends on the population density of the commune in comparison to the average population density of the country; the upper limit of the equalization is, in turn, dependent on the value of tax revenues collected by a given commune[26]. In respect of counties, the unemployment rate is the decisive factor as to whether a county receives the supplemental amount[27]. As for provinces, the value of tax revenues plus number of residents in the province (which cannot exceed 3 million)[28]. This

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23 Beata Guziejewska, `Podstawowe założenia subwencji ogólnej dla jednostek samorządu terytorialnego w Polsce na tle konstrukcji teoretycznych` [The basic assumptions of general subsidies for local self-government units in Poland on the background of theoretical constructions] (2004) 11 Samorząd Terytorialny 42; Paweł Swianiewicz, `Transfery z budżetu państwa dla samorządów lokalnych` [Transfers from the state budget for the local governments] (2003) 1 Studia Regionalne i Lokalne 99.

24 Art 20 sec 2 LSGR Act.

25 Elżbieta Kornberger-Sokołowska, Finanse jednostek samorządu terytorialnego [Local self-government units finance] (LexisNexis 2012) 113.

26 Art 20 sec 7-9 LSGR Act.

27 Art 22 sec 7-8 LSGR Act.

28 Art 24 sec 7-9 LSGR Act.

means that in respect of the supplemental amount of the equalizing component in the general subsidy for communes and provinces, the value of public law tributes is taken into account when calculating the extent of equalization. What follows is that, in respect of the supplemental amount of the equalizing component in the general subsidy for communes and provinces, the assumed function of the general subsidy is in fact also performed. This is different in the case of counties, where the value of tax revenues is not factored into calculations of the supplemental amount.

3 THE BALANCING (REGIONAL) COMPONENT OF THE GENERAL SUBSIDY

Along with the equalizing component, the second part of the general subsidy, whose assumed function is to ameliorate the effects of the uneven distribution of own revenue sources, is the balancing (regional) component. Distinctly from the equalizing component, which comes entirely from the state budget, the balancing (regional) component is taken from payments made by LSGUs within the framework of the vertical equalization system, also referred to as the correctional-equalization mechanism[29]. As scholars of financial law indicate, the vertical equalization system is intended to prevent those differences that are of an extreme nature, but not every example of disproportion in own revenues.

The vertical equalization system is composed of two stages. In the first, LSGUs defined by statute make equalizing payments to the state budget. In this manner, the revenues of LSGUs exceeding levels defined by the legislator are collected by the State. The second stage entails transfer of the proceeds of such payments in the legal form of the equalizing component (in the case of provinces – regional) in the general subsidy, to LSGUs indicated using statutorily defined criteria. This is therefore not a "pure" system of vertical equalization, such as in the case of a self-government equalization fund remaining under the control of self-government entities[30]. The transfer of equalizing funds in the legal form of the balancing (regional) component in the general subsidy is performed via the state budget[31].

29 See: Teresa Dębowska-Romanowska (n 4) 244.

30 ibid.

31 Wiesława Miemiec, `Transfery środków pieniężnych pomiędzy budżetem państwa a budżetami jednostek samorządu terytorialnego – wybrane aspekty finansowoprawne`

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The value of tax revenues that determined the value of the equalization within the framework of the equalizing component in the general subsidy is used here to identify LSGUs obliged to remit equalization payments[32]. Payments made by LSGUs are transferred via the state budget to LSGUs in the legal form of the balancing (regional) component of the general subsidy. It would thus seem that, since the assumed function of the general subsidy is to correct the effects of the unequal distribution of own revenues across the entire country, then the criteria used for identifying beneficiaries of the balancing (regional) component in the general subsidy should also be based on the own revenues of LSGUs from public law tributes. In this manner the assumed function of the balancing (regional) component in the general subsidy would be performed.

Under current law, following verdicts of the Constitutional Tribunal addressing the vertical equalization system[33] and the passing of temporary legislation governing that system at the provincial level[34], the decision as to which LGSUs will receive the balancing (regional) component in the general subsidy will primarily depend on selected expenditures and (less frequently) selected revenues of those units. In respect of communes, as much as 75% of the balancing component of the general subsidy is transferred on the basis of a selectively applied expenditures criterion, such as expenditures on housing subsidies[35]. The remaining 25% is divided up according to a selectively applied revenue criterion, i.e. revenues from participation in receipts from personal income tax, agriculture tax and forest tax. In the case of counties, disbursement of 76% of the balancing component in the general subsidy is determined by selected county expenditures, primarily (60%) expenses on road network maintenance, and 24% is transferred

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[Transfers between the state budget and the budgets of self-government units – selected financial aspects] (2010) 1–2 Finanse Komunalne 73.

32 Art 29 sec 1, art 30 sec 1 and art 70a sec 1 LSGR Act.

33 Cf. Przemysław Pest, `Wyrównywanie poziome dochodów jednostek samorządu terytorialnego („janosikowe") – kierunki zmian` [The horizontal alignment of local selfgovernment units incomes ("janosikowe") – trends] in Jolanta Gliniecka, Edward Juchniewicz, Tomasz Sowiński (eds) Finanse publiczne jednostek samorządu terytorialnego. Źródła finansowania samorządu terytorialnego we współczesnych regulacjach prawnych [Public finances of local self-government units. Sources of financing of local government in modern legal regulations] (CeDeWu 2014) 99 et seq.; Wiesława Miemiec, Przemysław Pest, `Wyrównywanie poziome dochodów jednostek samorządu terytorialnego ("janosikowe") w orzecznictwie Trybunału Konstytucyjnego` [The horizontal alignment of local selfgovernment units incomes ("janosikowe") in the Constitutional Tribunal jurisprudence] in Marcin Smaga, Mateusz Winiarz (eds), Dyscyplina finansów publicznych. Doktryna, orzecznictwo, praktyka [The discipline of public finances. The doctrine, case law, practice] (C.H. Beck 2015) 376 et seq.

34 Cf. arts 70a-70c LSGR Act.

35 Art 21a sec 1 LSGR Act.

on the basis of the amount of revenues generated by a given county[36]. In turn, for provinces, in accordance with temporary regulation in effect for the period 2015-2019, the division of the regional component of the general subsidy is determined in 52% by the unemployment rate and 48% by the amount of tax revenues generated by the province[37].

Assuming, as has already been mentioned, that the function of the equalizing and balancing (regional) components of the general subsidy is to complement the own revenues of LSGUs in conditions of differentiated levels of own revenues around the country, the base for calculating the level of equalization should be the public law own revenues of LSGUs. It is precisely the disproportion in the level of own revenues among LSGUs at a given level that determines the necessity of the existence of an equalization system in the legal form of a general subsidy. It follows that the adopted construction of the balancing (regional) component of the general subsidy, based on selected expenditures and selected revenues of LSGUs does not facilitate the achieving of the assumed function of the general subsidy. The criteria for determining the beneficiaries of the balancing (regional) component in the general subsidy should be the value of own revenues from tributes received by LSGUs. Differentiating expenditure needs, as indicated by art 9 sec 5 ECLSG, should be taken into account within the population criterion, and thus in the second – alongside the criterion of tax revenues – element in calculation of the balancing (regional) component in the general subsidy. As was indicated in the first part of the article, the population criterion can take the legal form of the population conversion factor already functioning within the Polish system for revenues of LSGUs. Under present law, the unequal distribution of own revenues across the country is taken into account when determining LSGUs obliged to pay into the state budget funds later earmarked for the balancing (regional) component in the general subsidy, but not when dividing that component among LSGUs.

4 CONCLUSION

The equalization function in the system of revenues of LSGUs is performed by the equalizing and balancing (regional) components of the general subsidy, which is indicated in the justification to the present LSGU Revenue Act. This equalization function consists in complementing own revenues of LSGUs using funds from the

36 Art 23a sec 1 LSGR Act.
37 Art 70b LSGR Act.

state budget (vertical equalization) or the budgets of other LSGUs (horizontal equalization), to facilitate the performance by those entities of own tasks to at least a minimum level of standards, in conditions of differing potential to generate own revenues by LSGUs around the country. The normative justification for the necessity of equalization LSGUs' own revenues can be found in the constitutional principles of social justice (art 2 Constitution), unitary character of the state (art 3 Constitution) and sustainable development (art 5 Constitution), as well as in art 9 sec 5 ECLSG. In order for the assumed equalizing function of the general subsidy to be performed, the primary criteria in determining the value of the equalization should be the amount of own revenues generated by public law tributes paid to particular LSGUs. The equalizing component in the general subsidy, applying tax revenues as the criterion of equalization, performs the assumed function of the general subsidy. However, in respect of the balancing (regional) component in the general subsidy, the criteria for equalizing are selected expenditures and revenues of LSGUs. As a result, the balancing (regional) component does not perform the assumed function of the general subsidy.

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TAXATION OF THE PUBLIC SECTOR IN GERMANY – AN INTRODUCTION

1 INTRODUCTION

This paper reproduces the content of the author's presentation to "*Current research problems in administrative studies in Poland and Germany*" conference held at the University of Wrocław on 21-22 October 2016. It illustrates the fundamental methods and problems concerning taxation of the public sector in Germany based on the examples of corporation tax and value-added tax.

2 DEFINITION "ÖFFENTLICHE HAND"

The German-language term "öffentliche Hand" is essentially a colloquial designation[1] for the public sector that, as a legal concept, is indeterminate in terms of both definition and interpretation. For taxation purposes, the concept is more specifically understood to include legal entities governed by public law ("legal entities of public law" or "l.e.p.l.", in German: "juristische Personen des öffentlichen Rechts" or "jPöR" for short). This encompasses primarily public authorities (e.g. the federal government, federal states, districts, municipalities, municipal associations), publicsector associations, religious affiliations under public law, guilds, chambers of craft and trade, chambers of industry and commerce, and institutions and

1 However, the term is also used in legislation to a limited extent as an indeterminate legal concept, e.g. in sec 141 of the Ninth Book of the German Social Security Code (SGB IX), which refers to "Aufträge der öffentlichen Hand" (public-sector contracts).

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foundations established under public law, e.g. public service broadcasters.[2] Public law status may be conferred by federal or state law. The fundamental tasks of a legal entity of public law (l.e.p.l.) lie in the exercise of public authority for the performance of sovereign functions.

3 THE INCOME TAX TREATMENT OF LEGAL ENTITIES GOVERNED BY PUBLIC LAW

3.1 TAXATION OF ECONOMIC ACTIVITIES ONLY

To the extent that a legal entity of public law (l.e.p.l.) performs the sovereign functions assigned to it, it is generally exempt from income tax.[3] Activities of this nature are not consistent with the underlying principle of income tax law, namely the taxation of activities aimed at generating income. To the extent that a legal entity of public law (l.e.p.l.) performs activities that are not reserved for it by custom and by law[4] but that can also be performed by private individuals, however, this places it in competition with the free economy, meaning that it must be taxed in order to ensure the equal treatment of these activities. As such, taxation is intended to prevent the distortion of competition and ensure fair competition.

3.2 UNLIMITED TAX LIABILITY

In accordance with para 1 sec 1 no 6 Corporation Tax Act (KStG for short), only the commercial operations ("Betriebe gewerblicher Art" or "BgA" for short) of a domestic[5] legal entity of public law (l.e.p.l.) within the meaning of para 4 Corporation Tax Act (KStG) are subject to unlimited corporation tax liability[6]. This

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2 cf. sec 4.1 of the Corporation Tax Guidelines 2015 (KStR 2015). Note: The KStR/KStH are administrative instructions developed by the German Federal Ministry of Finance (BMF) in conjunction with the federal states and published by the BMF.

3 "Sovereign operations" are explicitly discussed in sec 4 (5) sentence 1 of the German Corporation Tax Act (KStG) of 22 April 1999 (BGBl. I 1999, 817), most recently amended by the German Investment Tax Reform Act (InvStRefG) of 19 July 2016, BGBl. I 2016, 1730.

4 cf. sec 4.4 "Sovereign operations/exercise of public authority" of the Corporation Tax Information 2015 (KStH 2015).

5 cf. sec 1.1 (3) sentence 2 Corporation Tax Guidelines 2015 (KStR 2015) – by contrast, the corporation tax liability of a foreign legal entity of public law (l.e.p.l.) is governed by para 2 sec 1 Corporation Tax Act / KStG (= limited tax liability in respect of income generated in Germany).

6 In Germany, the taxation of the income of entities (including entities governed by public law (jPöRs) is governed by the provisions of the Corporation Tax Act / KStG. By contrast,

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means that unlimited tax liability often only relates to a limited portion of a legal entity of public law (l.e.p.l.) that gives the outward appearance of a commercial operation.[7] However, the taxable entity, as such, is not the BgA but the legal entity of public law (l.e.p.l.), and specifically for each individual BgA it operates.[8] As a matter of principle, different activities must be evaluated separately and the resulting income calculated separately.[9] Tax assessment for each individual BgA is performed with respect to the legal entity of public law (l.e.p.l.) as the taxable entity.[10]

3.3 LIMITED TAX LIABILITY

One special feature of legal entities of public law (l.e.p.l.) taxation is that a legal entity of public law (l.e.p.l.) may be subject to unlimited corporation tax liability and limited corporation tax liability simultaneously.[11] If the activities of a legal entity of public law (l.e.p.l.) fail to meet the conditions for classification as a BgA, they are generally not taxable at the level of the legal entity of public law (l.e.p.l.). In particular, this benefits the area of asset management in the form of rental and lease income (para 21 Income Tax Act (EStG for short) or income from capital assets (para 20 Income Tax Act (EStG). As an exception, para 2 no 2 Corporation Tax Act (KStG) states that a legal entity of public law (l.e.p.l.) with domestic income[12] that is fully or partially tax-deductible is subject to limited

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the income of natural persons is governed by the provisions of the German Income Tax Act (EStG).

7 cf. German Federal Finance Court (BFH), verdict of 22 September 1976, I R 102/74, BStBl. II 1976, 793.

8 cf. German Federal Finance Court (BFH), verdict of 13 March 1974, I R 7/71, BStBl. II 1974, 391.

9 cf. para 4 sec 6 Corporation Tax Act / KStG – BgAs may be combined under certain conditions (for more information see German Federal Ministry of Finance (BMF), circular of 12 November 2009, IV C 7 – S 2706/08/10004, BStBl. I 2009, 1303 under A. Combining BgAs.

10 This presents an interesting difference compared with the treatment for value-added tax purposes. A legal entity of public law (l.e.p.l.) can only be a single entrepreneur under German value-added tax law (cf. sec 2 of the German Value-Added tax Act (UStG). In this case, the entity encompasses all of the legal entity of public law (l.e.p.l.)`s activities and must be registered under a single tax number.

11 Note: In accordance with the provisions of para 1 Income Tax Act (EStG), natural persons may not be simultaneously subject to unlimited tax liability for certain income and limited tax liability for other income. At most, their tax liability status may change during the course of the year. In accordance with paras 1, 2 Corporation Tax Act / KStG, the same applies e.g. to corporations.

12 cf. para 8 sec 1 sentence 1 Corporation Tax Act / KStG: The definition of income is governed by the provisions of the Income Tax Act (EStG) and the Corporation Tax Act (KStG). Opinion is divided as to whether para 2 no 2 Corporation Tax Act / KStG defines a limitation on the income specified in para 49 Income Tax Act (EStG) (affirmative: Gerrit

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corporation tax liability. This relates primarily to income from capital assets, as these are generally subject to the provisions on the deductibility of capital gains tax in accordance with para 43 ff. Income Tax Act (EStG). Income covered by para 50a Income Tax Act (EStG) also comes into consideration to a limited extent. The tax deduction is definitive in accordance with para 32 sec 1 no 2 Corporation Tax Act (KStG).

3.4 COMMERCIAL OPERATIONS (BGA)

3.4.1 DEFINITION

In accordance with para 1 sec 1 no 6 Corporation Tax Act (KStG), a legal entity of public law (l.e.p.l.) is subject to unlimited corporation tax liability only to the extent that it conducts commercial operations ("Betriebe gewerblicher Art" or "BgA" for short).[13] In accordance with para 4 sec 1 sentence 1 Corporation Tax Act (KStG), this is the case if: a) a body ("Einrichtung") exists that b) performs a sustainable economic activity c) in order to generate income and that d) is economically distinct within the overall activity of the legal entity of public law (l.e.p.l.).[14]

3.4.2 "EINRICHTUNG"

"Einrichtung" is an indeterminate legal concept whose interpretation is based primarily on the judgements issued by the German Federal Finance Court (BFH). Accordingly, an "Einrichtung" may be deemed to exist on the basis of a specific management team, a closed scope of business, accounting or another characteristic suggesting the existence of a separate entity.[15] Economic

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Frotscher in Gerrit Frotscher, Klaus-Dieter Drüen, Corporation Tax Act / KStG (HaufeLexware GmbH & Co. KG 2008) para 2 Corporation Tax Act / KStG m.n. 28; negative: Sven-Christian Witt in Carl Herrmann, Gerhard Heuer, Arndt Raupach, Income Tax Act (EStG)/Corporation Tax Act (KStG) (21st ed. Verlag Dr. Otto Schmidt KG 2006), 275th instalment, June 2016, para 2 Corporation Tax Act / KStG, m.n. 105).

13 Note: Unlimited tax liability continues to apply in accordance with para 4 sec 2 Corporation Tax Act / KStG even if the BgA is itself a legal entity of public law (l.e.p.l.). Typical examples include district or municipal savings banks under public ownership (whose primary purpose is private economic enterprise), which are subject to the provisions of para 1 sec 1 no 6 Corporation Tax Act / KStG despite themselves being a legal entity of public law (l.e.p.l.).

14 Note: As a matter of principle, public utilities (water, gas, electricity, heat), public transport undertakings and port authorities constitute BgAs in accordance with para 4 sec 3 Corporation Tax Act / KStG.

15 cf. German Federal Finance Court (BFH), verdict of 26 May 1977, V R 15/74, BStBl. II 1974, 813.

independence may also be suggested by characteristics other than organisational characteristics.[16] The level of revenue generated from the economic activity may also be a relevant factor.[17] In sec 4.1 (4) sentence 2 Corporation Tax Guidelines 2015 (KStR 2015), the authorities define a threshold for the latter as annual revenue of EUR 130,000 within the meaning of para 1 sec 1 no 1 Value Added Tax Act (Umsatzsteuergesetz; UStG for short). The threshold is particularly relevant in cases where the activity of the legal entity of public law (l.e.p.l.) is not already clearly delineated from the other activities at an organisational level, e.g. in the case of a public undertaking ("Regiebetrieb") of a municipality.[18]

3.4.3 SUSTAINABLE ECONOMIC ACTIVITY

In income tax law, tax-relevant activities are typically defined by reference to the sustainability principle. The concept described in para 4 sec 1 sentence 1 Corporation Tax Act (KStG) is the same as the concept described in para 15 sec 2 sentence 1 Income Tax Act (EStG).[19] An activity is considered to be sustainable if it is intended to be a repeated activity. This intention is an internal fact that must be verified by reference to external circumstances. Accordingly, if similar actions are actually repeated, an activity can generally be considered to be sustainable. However, a one-off activity that is evidently intended to be a repeated activity may be sufficient for classification as sustainable.[20]

The economic activity of the legal entity of public law (l.e.p.l.) must go beyond pure asset management. The statements by the authorities in sec 15.7 of the Income Tax Guidelines (EStR) 2012 can be applied for definition purposes.[21] For

16 cf. German Federal Finance Court (BFH), verdict of 13 March 1974, I R 7/71, BStBl. II 1974, 391.

17 cf. German Federal Finance Court (BFH), verdict of 26 February 1957, I R 327/56 U, BStBl. II 1957, 146.

18 A "Regiebetrieb" is an unincorporated, legally and economically dependent branch of a municipality that is integrated into the municipal budget. It is distinct from e.g. a municipal enterprise (cf. e.g. para 95 sec 1 no 2 and para 95a of the Municipal Code for the Free State of Saxony (SächsGemO) in the version published on 3 March 2014, SächsGVBl. 2014, 146, and the Regulation on Municipal Enterprises of the Free State of Saxony (SächsEigBVO) of 16 December 2013, SächsGVBl. 2013, 941), which is also unincorporated but which constitutes an independent municipal body in terms of both organisation and budget.

19 cf. Norbert Meier, Thomas Semelka in Carl Herrmann, Gerhard Heuer, Arndt Raupach (eds), Income Tax Act (EStG)/Corporation Tax Act (KStG) (21st ed. Verlag Dr. Otto Schmidt KG 2006), 275th instalment, June 2016, sec Corporation Tax Act / KStG, m.n. 23.

20 cf. sec 15.2 of the Income Tax Information (EStH) and BFH, verdict of 31 July 1990, I R 173/83, BStBl II 1991, 66.

21 cf. Meier, Semelka (n 19) para 4 Corporation Tax Act / KStG, m.n. 28.

example, a municipality does not establish a BgA merely by transferring land for use in exchange for a fee without the performance of any additional services[22] or by generating income from capital assets[23]. Although economic activities are generally performed in competition with other market participants, para 4 sec 1 sentence 2 Corporation Tax Act (KStG) states that participation in the free economy[24] is not a prerequisite. Monopoly status may give rise to a BgA under certain circumstances, e.g. the granting of assigned pitches at a market event.[25] This means that a self-sufficient undertaking ("Selbstversorgerbetrieb") may also be a BgA. Although the economic activities of a legal entity of public law (l.e.p.l.) are evaluated separately as a matter of principle, different activities in accordance with sec 4.1 (3) sentence 3 Corporation Tax Guidelines 2015 (KStR 2015) are also treated as a single entity if this is consistent with prevailing opinion.

3.4.4 GENERATION OF INCOME

In accordance with para 4 sec 1 sentence 2 Corporation Tax Act (KStG), the intention to make a profit[26] is not necessary. para 4 sec 1 sentence 1 Corporation

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22 Note: However, the formation of separate companies using legal forms such as the GmbH (limited liability company under German law) is often encountered in the area of residential letting in particular. The income generated by these companies is generally taxable in accordance with sec 1 (1) no 1 Corporation Tax Act / KStG.

23 Note: However, cf. also sec 3.3; limited tax liability may exist in this respect.

24 To this extent, a BgA may make use of a special variation of the criteria for the delimitation of types of profit income that would otherwise apply in accordance with para 15 sec 2 sentence 1 Income Tax Act / EStG for short.

25 cf. sec 4.5 Corporation Tax Information 2015 (KStH 2015), "Market events (weekly and second-hand markets)".

26 Note: In this respect – in the same way as for the requirement of participation in the free economy (see sec 3.4.3) – the Corporation Tax Act / KStG deviates from the basic requirements that otherwise apply to commercial operations in accordance with para 15 sec 2 sentence 1 Income Tax Act / EStG. This may have consequences for the trade tax liability of the BgA. In accordance with para 2 sec 1 sentence 2 of the German Trade Tax Act (GewStG), a commercial operation with a permanent domicile is subject to taxation, whereby a commercial operation is defined within the meaning of the Income Tax Act / EStG – including the intention to generate a profit and participation in the free economy. cf. Marion Frotscher in Gerrit Frotscher, Klaus-Dieter Drüen, German Trade Tax Act / GewStG, para 2 GewStG, m.n. 50, Haufe-Lexware GmbH & Co. KG Freiburg, Steuer Office Kanzlei-Ed., version dated 6 September 2012; sec 2.1 (6) of the Trade Tax Guidelines (GewStR). Para 8 sec 1 sentence 2 contains a provision with the same wording. As the intention to generate a profit is not a prerequisite, the principles of income tax law concerning hobby activities do not apply and it is possible for a BgA to be permanently loss-making (cf. Ulrich Schallmoser in Carl Herrmann, Gerhard Heuer, Arndt Raupach, Income Tax Act (EStG)/Corporation Tax Act (KStG) (Verlag Dr. Otto Schmidt KG Köln 2006), 275th instalment, June 2016, para 8 Corporation Tax Act / KStG, m.n.28). Also of interest in this respect is the provision of para 8 sec 7 Corporation Tax Act / KStG negating the

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Tax Act (KStG) states that the intention to generate income is sufficient. The generation of income is not required to be the primary objective of the activity, but can also be an ancillary objective.[27] The term "income" corresponds to the definition in para 8 sec 1 Income Tax Act (EStG), meaning that it includes cash as well as non-cash benefits.

Income from economic activities includes fees charged in this context[28].

3.4.5 ECONOMIC WEIGHT

One of the characteristics of a BgA is that its activity must be distinct within the overall activity of the legal entity of public law (l.e.p.l.). However, the benchmark to be applied in this respect is debatable. It can certainly be asserted that the authorities do not follow the case law established by the German Federal Finance Court, which states that the ratio of the BgA's income to the total budget, or a certain portion of the total budget, of the legal entity of public law (l.e.p.l.) may be a relevant benchmark[29]. The benchmark defined by the authorities in sec 4.1 (5) sentence 1 Corporation Tax Guidelines 2015 (KStR 2015) is whether the annual revenue of the BgA within the meaning of para 1 sec 1 no 1 Value Added Tax Act (UStG) sustainably exceeds EUR 35,000. However, this does not represent a fixed threshold[30].

3.4.6 DEFINITION "HOHEITSBETRIEB"

In accordance with para 4 sec 5 sentence 1 Corporation Tax Act (KStG), the operations of a legal entity of public law (l.e.p.l.) that are aimed primarily at the exercise of public authority, known as "Hoheitsbetriebe" (sovereign operations)[31], expressly do not constitute a BgA. The exercise of public authority is typically

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existence of a concealed profit distribution for permanently loss-making operations under certain circumstances.

27 cf. German Federal Finance Court (BFH), verdict of 3 March 2010, I R 8/09, BStBl. II 2010, 502, concerning mediation activities of statutory health insurance companies.

28 cf. Meier, Semelka (n 20) para 4 Corporation Tax Act / KStG, m.n. 25.

29 cf. German Federal Finance Court (BFH), verdict of 11 January 1979, V R 26/74, BStBl. II 1979, 746 and German Federal Finance Court (BFH), verdict of 14 April 1983, V R 3/79, BStBl. II 1983, 491.

30 cf. sec 4.1 (5) sentence 4, 5 Corporation Tax Guidelines 2015 (KStR 2015) – however, the legal entity of public law (l.e.p.l.) may assert a competition situation even if the actual amount falls below this benchmark.

31 For information on trade tax treatment, see para 2 sec 2 of the Regulation on the Implementation of the German Trade Tax Act (GewStDV) – Sovereign operations are not classified as commercial operations.

understood to describe an activity that is reserved for the legal entities of public law (l.e.p.l.) by custom and by law.[32] One feature is the performance of public law functions deriving from governmental authority and serving governmental purposes.[33] Compulsory acceptance due to a legal or official order[34] may also be considered to represent a characteristic of sovereign authority[35]. As a matter of principle, different activities of the legal entity of public law (l.e.p.l.) must be evaluated separately (cf. sec 4.1 (3) sentence 1 Corporation Tax Guidelines 2015 (KStR 2015).

If an area of activity has the characteristics of both sovereign activity and economic activity, the primary intended use for sovereign purposes should be emphasised. This is the case if the areas of activity are intertwined to the extent that precise delimitation is neither possible nor reasonable. In other words, the economic activity must be integrally linked to the sovereign activity and constitute a form of ancillary activity within the framework of the inherently sovereign activity. The inclusion of an intrinsically commercial activity in a sovereign operation alone is not sufficient to satisfy this criterion; the activities must be evaluated separately.[36]

"However, the exercise of public authority is excluded to the extent that the bodies of the entity participate in the free economy and perform an activity whose content is not materially different to that of the activity of a private

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32 cf. German Federal Ministry of Finance (BMF), circular of 11 December 2009, IV C 7 – S 2706/07/10006, BStBl. I 2009, 1597 under I.1.a) Assignment on the basis of federal law, state law, or state law based on federal law with compulsory usage under public law; example: sewage disposal.

33 cf. German Federal Finance Court (BFH), verdict of 21 November 1967, I 274/64, BStBl. II 1968, 218.

34 cf. German Federal Finance Court (BFH), verdict of 25 January 2005, I R 63/03, BStBl. II 2005, 501 and sec 4.4 (1) sentence 1 Corporation Tax Guidelines 2015 (KStR 2015).

35 For example, the operation of parking meters under the terms of road traffic regulations is considered to be a sovereign activity, whereas the provision of off-street parking spaces in multi-storey car parks, underground car parks, or continuous parking areas is considered to be an economic activity (cf. sec 4.5 (4) Corporation Tax Guidelines 2015 (KStR 2015) and sec 4.5 Corporation Tax Information 2015 (KStH 2015), "Parking space management"). Sovereign activities also include household waste disposal (cf. sec 4.5 (6) Corporation Tax Guidelines 2015 (KStR 2015) and funeral services (cf. sec 4.5 Corporation Tax Information 2015 (KStH 2015), "Cemetery administration, grave maintenance etc.").

36 cf. German Federal Finance Court (BFH), verdict of 26 May 1977, V R 15/74, BStBl. II 1977, 813 – Verdict relating to a cemetery administration that performed grave maintenance services and arrangement and support services for private funerals in addition to the sovereign function of funeral services.

commercial enterprise."[37] As the provisions of state law also apply, different evaluations may arise at state level in individual cases.[38] The evaluation must be based on the principles of equal taxation, fair competition and preventing the distortion of competition.

3.4.7 EXCEPTION: PARTICIPATING INTERESTS IN COMPANIES

In addition to performing activities in its own right, a legal entity of public law (l.e.p.l.) may hold participating interests in forms of private law company to the extent that this is permitted by law. This includes interests in both partnerships[39] and corporations[40]. If a legal entity of public law (l.e.p.l.) holds a participating interest in a commercial partnership[41], the opinion of the German Federal Finance Court[42] is that this always constitutes the formation of a BgA. In contrast, the authorities do not consider a participating interest in a corporation to constitute the formation of a BgA unless the legal entity of public law (l.e.p.l.)

37 cf. German Federal Finance Court (BFH), verdict of 12 July 2012, I R 106/10, BStBl. II. 2012, 837, m.n. 9 – Municipal nursery schools are not a sovereign operation even though the obligation to ensure the provision of childcare is regulated by law.

38 cf. Meier, Semelka (n 20) para 4 Corporation Tax Act / KStG, m.n. 71. cf. German Federal Finance Court (BFH), verdict of 29 October 2008, I R 51/07, BStBl. II 2009, 1022 – The verdict addresses the issue of sovereign operations by reference to the example of a municipal crematorium. See also German Federal Ministry of Finance (BMF), circular of 11 December 2009, loc. cit., I.1.b) The operation of a crematorium by a legal entity of public law (l.e.p.l.) without compulsory usage under public law does not constitute a sovereign operation (BgA).

39 This relates primarily to the legal forms of the "Gesellschaft bürgerlichen Rechts" or "GbR" (civil law partnership; para 705 ff. of the German Civil Code (BGB), the "offene Handelsgesellschaft" or "OHG" (general partnership; para 105 ff. of the German Commercial Code (HGB) and the "Kommanditgesellschaft" or "KG" (limited partnership, including the special form of the GmbH & Co. KG; para 161 ff. HGB).

40 This relates in particular to the legal forms of the "Aktiengesellschaft" or "AG" (stock corporation in accordance with the German Stock Corporation Act (AktG) and "Gesellschaft mit beschränkter Haftung" or "GmbH" (limited liability company in accordance with the German Limited Liability Companies Act (GmbHG).

41 Income tax law also refers to a "partnership" within the meaning of para 15 sec 1 sentence 1 no 2 Income Tax Act / EStG.

42 cf. German Federal Finance Court (BFH), verdict of 25 March 2015, I R 52/13, BStBl. II 2016, 172, m. n. 19. In its circular of 8 February 2016 (IV C 2 – S 2706/14/10001, BStBl I 2016, 237), the German Federal Ministry of Finance (BMF) instructs the fiscal authorities to apply the grounds for the verdicts without restriction only up to and including the 2008 assessment period. A further circular is to be issued for assessment periods from 2009 onwards. The authorities are likely to be particularly disturbed by the BFH's finding that a participating interest in a partnership gives rise to a BgA even if the activity would not constitute the formation of a BgA if it were performed directly by the legal entity of public law (l.e.p.l.) (the verdict in question related to a waste management centre with the legal form of a GmbH & Co. KG; waste disposal may constitute a sovereign activity depending on the circumstances).

actually exercises an influence on the management of the corporation[43] or the legal criteria for a company split are fulfilled. However, participating interests in companies that are solely involved in asset management do not give rise to a BgA.[44] Irrespective of the existence of a BgA, the income generated by the corporation itself is taxable in accordance with the general provisions of the German Corporation Tax Act.[45]

3.5 TAXATION OF INCOME

3.5.1 TYPE OF INCOME AND PROFIT DETERMINATION

The income of a BgA always constitutes commercial income within the meaning of para 15 Income Tax Act (EStG) even if the BgA is leased.[46] In the case of commercial income, taxation is based on the profit generated. In accordance with para 4 sec 1 sentence 1 in conjunction with para 5 Income Tax Act (EStG), profit is calculated by comparing the operating assets of an entity at the start and end of the reporting period. If there is no statutory obligation for the entity to keep accounts and regularly prepare financial statements, a simplified method of profit determination using the cash method of accounting within the meaning of para 4 sec 3 Income Tax Act (EStG) may be applied. Non-fiscal obligations to keep accounts and regularly prepare financial statements also apply for tax law (cf. para 140 of the German Fiscal Code (AO). In a specific case, for example, such an obligation may arise from the provisions of the HGB[47] or the state regulations on municipal enterprises[48]. As a matter of principle, the obligation to

43 cf. sec 4.1 (2) sentences 2-5 Corporation Tax Guidelines 2015 (KStR 2015). A small participating interest may be sufficient to assume the existence of a BgA if control and influence are exercised jointly with other legal entities of public law (l.e.p.l.). According to these criteria, participating interests in municipal public utilities would typically give rise to a BgA, for instance.

44 cf. Meier, Semelka (n 20) para 4 Corporation Tax Act / KStG, marginal no 29 for partnerships; sec 4.1 (2) sentence 5 Corporation Tax Guidelines 2015 (KStR 2015) for corporations.

45 cf. sec 4.1 (7) Corporation Tax Guidelines 2015 (KStR 2015).

46 cf. German Federal Finance Court (BFH), verdict of 1 August 1979, I R 106/76, BStBl. II 1979, 716. For information on leased BgAs, see also para 4 sec 4 Corporation Tax Act / KStG. The assumption of commercial income at all times corresponds to the treatment of other taxpayers with unlimited tax liability; see para 8 sec 2 Corporation Tax Act / KStG.

47 47 cf. Klaus J. Hopt in Adolf Baumbach, Klaus J. Hopt, Handelsgesetzbuch, Verlag C.H. Beck, 36th ed., Munich 2014, para 1 m.n. 27 – Entities required to keep accounts include Deutsche Bundesbank, savings banks and public insurance companies.

48 e.g. arising from para 11 sec 1 sentence 3 SächsEigBVO in the case of the Free State of Saxony.

perform double-entry bookkeeping[49] does not exclude the possibility of applying the cash method of accounting. An obligation for solely tax-related purposes is possible if the thresholds set out in para 141 AO are exceeded. For the purposes of profit/income determination, a legally dependent BgA is notionally separated from the legal entity of public law (l.e.p.l.) to the extent that agreements such as rental and lease agreements between the jPöR and the BgA are fundamentally recognised, albeit subject to the restrictive conditions applicable to controlling shareholders under corporation tax law.[50]

3.5.2 SPECIAL FEATURES FOR LEGAL ENTITIES OF PUBLIC LAW

In accordance with para 23 sec 1 Corporation Tax Act (KStG), the income generated by a BgA is initially subject to a tax rate of 15%. To ensure equal tax treatment with the free economy, however, the economic benefits gained by the legal entity of public law (l.e.p.l.) as a result of the BgA must also be taxed. If a GmbH were to distribute taxable profits to its shareholders, for example, this profit distribution would also be taxable as income from capital assets at the level of the shareholders in accordance with para 20 sec 1 no 1 Income Tax Act (EStG). Income tax law achieves a similar effect for the taxation of legal entities of public law (l.e.p.l.) through the provisions of para 20 sec 1 no 10 a and b Income Tax Act (EStG)[51] that were introduced as a result of the German Tax Reduction Act[52]. The legal entity of public law (l.e.p.l.) has limited tax liability in accordance with para 2 no 2 Corporation Tax Act (KStG) for this income, which is subject to withheld capital gains tax in accordance with para 43 sec 1 sentence 1 no 7b and no 7c Income Tax Act (EStG). The withholding of capital gains tax is limited to 15% in accordance with para 43a sec 1 sentence 1 no 2 Income Tax Act (EStG), thereby corresponding to the corporation tax rate set out in para 23 sec 1 Corporation Tax Act (KStG). The withheld tax is definitive in accordance with para 32 sec 1 no 2 Corporation Tax Act (KStG).

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49 e.g. arising from para 72 sec 2 sentence 2 SächsGemO in the case of the Free State of Saxony; cf. BMF, circular of 3 January 2013, IV C 2 – S 2706/09/10005, BStBl I 2013, 59 (including with regard to the special features of regulations on municipal enterprises).

50 cf. sec 8.2 (1) and (2) Corporation Tax Guidelines 2015 (KStR 2015), sec 8.2 Corporation Tax Information 2015 (KStH 2015), "Rental and lease agreements" and "Agreements".

51 For further information cf. German Federal Ministry of Finance (BMF), circular of 9 January 2015, IV C 2 – S 2706a/13/10001, BStBl. I 2015, 111.

52 German Act on the Reduction of Tax Rates and Reform of Business Taxation (StSenkG) of 23 October 2000, BGBl. I 2000, 1433.

4 THE VAT TREATMENT OF LEGAL ENTITIES GOVERNED BY PUBLIC LAW

4.1 PRESSURE FOR NEW LEGISLATION

In addition to the general conditions for classification as an entrepreneur in accordance with para 2 sec 1 Value Added Tax Act (Umsatzsteuergesetz, UStG for short), which also apply to legal entities of public law (l.e.p.l.), to date the treatment of legal entities of public law (l.e.p.l.) for value-added tax purposes has been based in particular on para 2 sec 3 sentence 1 Value Added Tax Act (UStG). According to this provision, a legal entity of public law (l.e.p.l.) performed commercial or professional activities within the meaning of para 2 sec 1 Value Added Tax Act (UStG) only within the framework of its commercial operations (BgA) and agricultural and forestry operations. The existence of a BgA was subject solely to corporation tax criteria (cf. para 1 sec 1 no 6, para 4 Corporation Tax Act (KStG). This resulted in exemption from VAT for activities that, in themselves, were very much performed in competition with the free economy but that were not treated as such on account of the BgA criteria. This related to asset management activities performed by legal entities of public law (l.e.p.l.) as well as assistance services provided between legal entities of public law (l.e.p.l.). Even bodies that were not economically distinct within the overall activity of the legal entity of public law (l.e.p.l.)[53] were exempt from VAT as a result.

However, this treatment did not necessarily result in a tax benefit. As entrepreneur status also provides the option of input tax deduction, VAT may even be the more economically attractive variant for investments in particular. As such, it comes as no surprise to learn that the German Federal Finance Court (BFH)[54] has found itself having to address the VAT treatment of legal entities of public law (l.e.p.l.) in Germany to a growing extent in recent years; this also

53 cf. sec 4.1 (5) sentence 1 Corporation Tax Guidelines 2015 (KStR 2015) – The current threshold for examining this criterion is annual revenue of EUR 35,000 (see also sec 3.4.5).

54 cf. e.g. German Federal Finance Court (BFH), verdict of 15 April 2010, V R 10/09, UR 2010, 646 (permission for the installation of vending machines by a university); German Federal Finance Court (BFH), verdict of 3 March 2011, V R 23/10, BStBl. II 2012, 74 (costs of marketplace renovation); German Federal Finance Court (BFH), verdict of 10 November 2011, V R 41/10, UR 2012, 272 (plaintiff: a municipality in the Free State of Saxony / known as the "sports hall verdict").

involves taking into account the judgements issued by the European Court of Justice (ECJ)[55].

The fact that, by reference to the provisions of art 13 of the Directive on the VAT System[56], the national evaluation of entrepreneur status based on corporation tax criteria is not supported in EU law should not come as a surprise. As such, it can also be concluded that this connection is ultimately no longer relevant based on the BFH's case law.[57] According to the BFH, the evaluation should be based primarily on the form taken by the legal entity of public law`s (l.e.p.l.) activity. If a legal entity of public law (l.e.p.l.) acts on a private law basis, it is treated as an entrepreneur; by contrast, if its activity has a basis in public law, a legal entity of public law (l.e.p.l.) is treated as an entrepreneur only if it enters into competition with other providers. This case law was not generally applied by the authorities. Instead, the legal entity of public law (l.e.p.l.) was merely given the option of invoking the more favourable scenario; however, this would then be required to be applied uniformly for all of its activities. In practice, this meant that taxation was able to follow either the strict wording of national legislation or its interpretation in case law.

4.2 NEW LEGISLATION

4.2.1 GENERAL

The introduction of para 2b Value Added Tax Act (UStG) as a result of the German Tax Amendment Act 2015[58] represented the legislator's response to the case law established by the courts and the need for the national statutory provisions on the VAT treatment of the public sector to be adapted to reflect EU law.[59] Paragraph 2b sec 1 Value Added Tax Act (UStG) clearly incorporates the

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55 cf. e.g. ECJ, verdict of 14 December 2000, C-446/98 "Fazende Publica", UR 2001, 108; ECJ, verdict of 16 September 2008, C-288/07 "Isle of Wight Council", IStR 2008, 734; ECJ, verdict of 4 June 2009, C-102/08 "Salix Grundstücks-Vermietungsgesellschaft", BFH/NV 2009, 1222; ECJ, verdict of 29 October 2015, C-174/14 "Saudacor", UR 2015, 901.

56 Council Directive 2006/112/EC of 28 November 2006, ABl. no L 347 2006, 1 (previously: art 4 (5) of Sixth Council Directive 77/388/EEC of 17 May 1977 on the Harmonisation of the Laws of the Member States relating to Turnover Taxes (ABl. no L 145 1977, 1).

57 For further information cf. Pierre Frotscher, 'Umsatzbesteuerung der Kommunen – Rechtliche Rahmenbedingungen in der EU und im nationalen Recht sowie aktuelle Entwicklungen in der Rechtsprechung (2013) 4 Sachsenlandkurier 254 et seq.

58 Introduced by art 12 no 3 of the German Tax Amendment Act 2015 (StÄndG 2015), legislation of 2 November 2015, BGBl. I 2015, 1834.

59 cf. Bundestag printed paper 18/6094 of 23 September 2015 – Recommended resolution and report of the Finance Committee, 91.

provisions of art 13 sec 1 of the Directive on the VAT System. As a result, the previous connection between VAT and corporation tax law no longer applies. In future, classification as an entrepreneur will be based solely on VAT criteria. Doubts have been raised as to the conformity of the new provision with EU law to the extent that para 2b sec 2 and sec 3 Value Added Tax Act (UStG) supplements the general provision in para 2b sec 1 Value Added Tax Act (UStG) with definitions of the concept of "significant distortion of competition" that are not based on the Directive on the VAT System in this form. As such, the new provision can be expected to be the subject of case law sooner or later, particularly at the level of the ECJ.[60] In addition to the issue of EU law, it is especially notable that the legislator has used a number of indeterminate legal concepts in formulating the new legislation. Based on past experience, this tends to lead to substantially greater scope for interpretation. Accordingly, the authorities are currently preparing a circular on application that will address material legal questions of interpretation; this is expected to be published by the end of 2016 by all accounts.

4.2.2 ENTREPRENEUR STATUS

The classification of a legal entity of public law (l.e.p.l.) as an entrepreneur is initially based on the general criteria of para 2 sec 1 Value Added Tax Act (UStG). These state that a legal entity of public law (l.e.p.l.) is classifiable as an entrepreneur if it performs economic activities, i.e. independent, sustainable activities with the intention of generating income. An exception is granted by para 2b sec 1 sentence 1 Value Added Tax Act (UStG), which states that a legal entity of public law (l.e.p.l.) performing activities in the exercise of public authority is not classifiable as an entrepreneur. Activities are performed in the exercise of public authority if they are based on a special provision of public law, e.g. an act of law, a legislative decree, an international treaty or special provisions of canon law.[61] If treatment as a non-entrepreneur results in significant distortion of competition, however, the legal entity of public law (l.e.p.l.) must be treated as an entrepreneur in accordance with para 2b sec 1 sentence 2 Value Added Tax Act (UStG).

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60 cf. Hans-Herrmann Heidner, 'VAT treatment of the public sector – consequences of case law for the new legislation in para 2b Value Added Tax Act (UStG)' (2016) 2 Umsatzssteuer-Rundschau 45 et. seq. – significant distortion of competition is an autonomous concept of EU law.

61 cf. Bundestag printed paper 18/6094 of 23 September 2015 – Recommended resolution and report of the Finance Committee, 91.

The work establishments of a penal institution serve as a good example of the effect of para 2b Value Added Tax Act (UStG). Based on the judgements issued by the BFH[62], the work establishments of a penal institution do not constitute economic activity, but rather are considered to be sovereign operations[63] as the employment of prisoners forms part of the penal system. As such, this does not result in the formation of a BgA in accordance with para 4 sec 5 sentence 1 Corporation Tax Act (KStG) and no entrepreneurial activity is performed in accordance with para 2 sec 3 sentence 1 Value Added Tax Act (UStG; old version). If the matter is evaluated in accordance with para 2b sec 1 sentence 1 Value Added Tax Act (UStG), it remains the case that the activities are performed in the exercise of public authority; however, the circumstances described in para 2b sec 1 sentence 2 Value Added Tax Act (UStG) are clearly met in respect of the services provided by a modern penal institution, which range from stainless steel barbecues and smoker grills to nesting boxes, small bottle cases and children's toys[64], all of which are currently advertised online as "VATexempt".

These activities on the basis of public law, which could potentially be VAT-exempt, must be distinguished from activities on the basis of private law. Activities of this nature are already excluded from the scope of para 2b sec 1 Value Added Tax Act (UStG) and hence must be evaluated solely in accordance with the criteria of para 2 sec 1 Value Added Tax Act (UStG). In this respect, the new legislation systematically reflects the case law established by the BFH and the ECJ.

4.2.3 GENERAL EXCLUSIONS FROM SIGNIFICANT DISTORTION OF COMPETITION

In accordance with para 2b sec 2 no 1 Value Added Tax Act (UStG), significant distortion of competition does not exist if the (annual) revenue generated by a legal entity of public law (l.e.p.l.) from similar activities is not expected to exceed EUR 17,500. This is an irrebuttable legal presumption. Annual revenue in relation to this threshold must be forecast at the start of the year. The definition of what exactly is meant by "similar" has a considerable influence on actual taxation, and hence is likely to occupy the courts. The effect of this provision must be

62 cf. German Federal Finance Court (BFH), verdict of 14 October 1964, I 80/62 U, BStBl. III 1965, 95.

63 cf. Meier, Semelka (n 19) para 4 Corporation Tax Act / KStG, m.n. 76 "Work establishments of penal institutions".

64 cf. The product range of the penal institutions of Lower Saxony state at https://jvashop.de.

scrutinised, as the threshold could be utilised multiple times if different activities are performed. For example, if a legal entity of public law (l.e.p.l.) has four separate areas of activity, it may arrange for revenue of up to EUR 70,000 p.a. to be taxexempt. This would significantly exceed the maximum permitted taxexempt total revenue of EUR 17,500 for small entrepreneurs.[65]

In addition, para 2b sec 2 no 2 Value Added Tax Act (UStG) states that there is no significant distortion of competition if similar services performed on the basis of private law are tax-exempt without right of waiver in accordance with para 9 Value Added Tax Act (UStG). This provision relates to an area in which there are no concerns of distortion of competition from a VAT perspective, as a potential competitor would also be nonoptionally exempt from VAT. However, this explicitly excludes activities covered by the optional tax liability provided by para 9 Value Added Tax Act (UStG). To this extent, a legal entity of public law (l.e.p.l.) should also be able to benefit from input tax deduction by exercising the option provided by para 9 Value Added Tax Act (UStG), thereby preventing itself from being subject to a competitive disadvantage[66]. In practice, this is likely to apply primarily to the letting of land or buildings, which is fundamentally tax-exempt in accordance with para 4 no 12 a Value Added Tax Act (UStG; with no entitlement to deduct input tax in accordance with para 15 sec 1 and sec 2 no 1 Value Added Tax Act (UStG), but for which an option is fundamentally provided by para 9 sec 1 Value Added Tax Act (UStG) (with input tax deduction e.g. for investment costs in buildings in accordance with para 15 sec 1 Value Added Tax Act (UStG).

4.2.4 SERVICES PROVIDED TO OTHER LEGAL ENTITIES OF PUBLIC LAW

With specific reference to services provided between legal entities of public law (l.e.p.l.), para 2b sec 3 Value Added Tax Act (UStG) describes additional exceptional situations in which there is not assumed to be any significant distortion of competition, meaning that no VAT is levied. According to the grounds of the legislation[67], the provisions are justified in light of demographic change, the shortfall in public funds and the leveraging of synergy effects by harnessing the existing material and human resources to minimise costs and hence reduce the burden on citizens. The provisions relate to sovereign functions

65 cf. para 19 sec 1 sentence 1 and (3) Value Added Tax Act (UStG).

66 cf. Bundestag printed paper 18/6094 of 23 September 2015 – Recommended resolution and report of the Finance Committee, 91.

67 ibid.

as well as public welfare services, particularly in the area of inter-municipality cooperation.

If the statutory provisions mean that services can be performed by legal entities of public law (l.e.p.l.) only, there is no competition with other providers. Accordingly, para 2b sec 3 no 1 Value Added Tax Act (UStG) states that there can be no significant distortion of competition in such cases. The essence of para 2b sec 1 sentence 1 Value Added Tax Act (UStG), namely that the exercise of public authority does not involve entrepreneurial activity, therefore applies accordingly. The examples cited in the grounds of the legislation[68] include joint administrative districts for registry offices and public order offices or the activities of joint local residents' registration offices. However, there is some doubt as to how apposite these examples really are. If two municipalities establish a "joint" registry office, for example, this formulation suggests that the expenses of establishing the registry office are shared between the parties. At first glance, at least, it is therefore not immediately obvious as to where there is supposed to be a potential exchange of services requiring prevention by way of a provision such as para 2b sec 3 no 1 Value Added Tax Act (UStG).

Paragraph 2b sec 3 no 2 Value Added Tax Act (UStG) of the new legislation undoubtedly provides the greatest scope in terms of interpretation. This provision states that there is no significant distortion of competition even if the cooperation is determined by shared public interests. This is typically the case if the criteria set out in para 2b sec 3 no 2 sentence 2 a to d Value Added Tax Act (UStG) are fulfilled: a) the service provision has a long-term basis in public law (e.g. public contract, international treaty; question: what constitutes "long-term"?), b) it involves the maintenance of public infrastructure and the performance of a public function that is incumbent upon all parties (e.g. technical infrastructure or education), c) it is remunerated solely in the form of cost reimbursement (how is this determined, not least since it tends to be unlikely that cost accounting is performed with the required depth?) and d) services are provided primarily to other legal entities of public law (l.e.p.l.) (question: what constitutes "primarily"?). The grounds of the legislation[69] state relatively succinctly that the aforementioned criteria are based on EU public procurement law. However, the provisions of public procurement law are

68 ibid, 92.
69 ibid.

supposed to apply only to the extent that they are compatible with the Directive on the VAT System.

It is clear to see that the provisions of para 2b sec 3 no 2 Value Added Tax Act (UStG) provide a legal entity of public law (l.e.p.l.) with significant leeway while simultaneously entailing a not insubstantial risk of a different interpretation in case law to that which was applied in concluding the respective agreements.[70] In addition, there may be an issue in terms of distortion of competition due to the exclusion of other market participants.

4.2.5 CATALOGUE OF ENTREPRENEURIAL ACTIVITIES

In nos 1-4, para 2b sec 4 Value Added Tax Act (UStG) starts by reproducing the catalogue of public-sector activities that are always considered to be entrepreneurial as set out in the old version of para 2 sec 3 sentence 2 Value Added Tax Act (UStG). The catalogue is supplemented by a reference in para 2b sec 4 no 5 Value Added Tax Act (UStG) to Annex I to the Directive on the VAT System (cf. art 13 sec 1 para 3 of the Directive on the VAT System). The extended scope of the new legislation is likely to remain manageable, as the activities listed in Annex I are also considered to have been typically taxable as BgAs under the previous legislation.

4.3 TRANSITIONAL ARRANGEMENT AND OPTIONAL APPLICATION

The new version of para 2b Value Added Tax Act (UStG) came into force on 1 January 2016[71]; according to para 27 sec 22 sentence 1 Value Added Tax Act (UStG[72]), however, it is applicable for the first time only to revenue generated after 31 December 2016. This gives a legal entity of public law (l.e.p.l.) just under a year to adapt to the new legal conditions.

Furthermore, para 27 sec 22 sentence 3 Value Added Tax Act (UStG) provides legal entities of public law (l.e.p.l.) with the option of submitting a declaration to the tax office stating that they intend to apply para 2 sec 3 Value Added Tax Act (UStG) in the version in force on 31 December 2015 to all revenue generated after 31 December 2016 and before 1 January 2021. This declaration must be

70 cf. Heidner (n 62) 45 et seq.
71 cf. art 18 sec 4 StÄndG 2015.
72 Introduced by art 12 no 6 StÄndG 2015.

submitted by 31 December 2016 at the latest (cf. para 27 sec 22 sentence 5 Value Added Tax Act (UStG). The declaration may be revoked at a later date with effect from the start of a subsequent calendar year (cf. para 27 sec 22 sentence 6 Value Added Tax Act (UStG).[73]

If a legal entity of public law (l.e.p.l.) exercises this option, it will continue to be taxed in accordance with the existing legislation. This means that asset management activities and assistance services will remain taxexempt until 31 December 2020 at the latest. The exercise of this option is intended to allow legal entities of public law (l.e.p.l.) to extend the one-year transitional period provided by para 27 sec 22 sentence 1 Value Added Tax Act (UStG) for up to a further four years in order to enable an orderly transition to the new taxation system.[74] As there is currently considerable uncertainty with regard to the consequences of applying the new standard from 2017, not least as a result of the large number of indeterminate legal concepts contained in para 2b Value Added Tax Act (UStG), many legal entities of public law (l.e.p.l.) are expected to initially exercise the option in order to give themselves more time to intensively examine the individual steps that will be required to adapt to the new legal situation[75].

5 SUMMARY

The public sector in Germany is subject to both income tax and value-added tax when its activities go beyond the area of public administration to the extent that they enter into competition with other providers. The taxation of public-sector entities is intended primarily to prevent the distortion of competition. The delimitation of the spheres that are relevant for taxation purposes requires a complex system of statutory provisions. The German Tax Amendment Act 2015 seeks to establish a new statutory basis for the VAT treatment of the public sector that is compliant with EU law.

73 cf. German Federal Ministry of Finance (BMF), circular of 19 April 2016, III C 2 – S 7106/07/10012-06, BStBl. I 2016, 986 – on the application of the transitional arrangement provided by sec 27 (22) Value Added Tax Act (UStG).

74 cf. Bundestag printed paper 18/6094 of 23 September 2015 – Recommended resolution and report of the Finance Committee, 93.

75 For further information cf. Fritz Lang, 'The new VAT legislation for legal entities governed by public law in accordance with para 2b Value Added Tax Act (UStG) – to exercise the option or not to exercise?' (2016) 4 Sachsenlandkurier 186 et seq.

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TAXATION OF THE PUBLIC SECTOR IN POLAND

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A definitive explanation of "public sector" does not exist in the Polish law. However, there are some provisions which may suggest the legal meaning of this term. They are related first of all to European acts on public procurement – mostly Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC[1], but not only repeating their wordings.

Act of 29 January 2004 – Law on public procurement[2], according to art 3 sec 1, should be applied for contracting by (among others):

- public finance sector bodies,
- other state units without legal personality
- other legal persons established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character, if financed in more than 50% or managed by bodies mentioned above and if it does not act in the ordinary competitive market.

The most characteristic seems to be pointing to the public finance sector bodies as the main scope of relevant subjects. Therefore, "public sector" and "public finance sector" aren`t

1 OJ L 94 of 28 March 2014, 65.

2 Dziennik Ustaw – Official Journal of Laws of the Republic of Poland (hereinafter: Dz. U.) 2017, item 1986.

identical[3]. Following art 9 of the Act of 27 August 2009 on public finance[4], the public finance sector includes: public governance bodies, local government units, budgetary entities, selfgovernment budgetary establishments, budgetary institutions, state agencies and funds, some institutions ruled by special laws (public high schools, the Polish Academy of Sciences, cultural institutions etc.) – except enterprises, research institutes, banks and commercial companies. Though this list is relatively clear, some doubts on qualifying into the public finance sector still remain[5].

The, so declared public, sector taken as a whole is not a subject of any special rules on taxation in Poland. Acts of tax law even don`t use the term "public sector" and there is no system of taxation of the public sector. Therefore, its position in the sphere of taxation must be analyzed through detailed provisions of each tax separately.

The first evident example with reference to public sector can be found in the Act of 11 March 2004 on goods and services tax[6] (Polish version of VAT). Subject of the tax are individuals and organisational units, irrespective of their legal form – among others legal persons and organisational units without legal personality (art 151) of this Act). Such an expression, often used in different acts of tax law, means the widest scope of subjects to be taxed. However, in the same Act there are additional conditions, important for public sector bodies. First, taxpayers should perform their economic activity independently (art 15 sec 1 in fine). Second, public governance organs and their offices are not regarded as taxpayers in respect of activities in carrying out their statutory functions, excluding transactions of civil law (art 15 sec 6). All this is consistent with art 13 sec 1 and 2 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax[7].

Both of these conditions were analyzed by courts. The most characteristic were cases of the Municipality (City) of Wrocław.

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3 Cezary Kosikowski, Sektor finansów publicznych (Wolters Kluwer Polska, Dom Wydawniczy ABC 2006) 25.

4 Dz. U. 2017, item 2077 with later changes.

5 Kosikowski (n 3) 19.

6 Dz. U. 2017, item 1221 with changes.

7 OJ L 347 of 11 December 2006, 1.

Shortly after introducing the tax on goods and services (in middle 1990-ties) Wrocław did not tax numerous transactions of selling of the municipal property, considering them as public activity, executing independently, but not on their own account and for inhabitants` needs. The Administrative Court of the Voivodship in Wrocław, in the decision of 10 November 1999[8], decided that such deals are part of the common formula of taxation and there is no legal reason to apply any exemptions. At that time tax provisions were different, but similar to present, so the conclusion remains fully actual and nowadays even quite unquestionable.

In recent years, one important solution to this problem was passed by the Court of Justice of the European Union. The question – referring to the case of the Municipality of Wrocław – was if a budgetary entity could be a taxpayer of the tax on goods and services. According to art 11 of the Act on public finance, budgetary entities are state or municipal units without legal personality, fully dependent on the municipality in the organizational and financial spheres. Particularly they do not have their own revenues and do not have their own expenditures – they are both directly revenues and expenditures of relevant budget, so also of the state or the relevant municipality.

In the judgement of The Grand Chamber of the Court of 29 September 2015[9] answer was that because taxable activity should be independent, such entities must not be considered as subjects of this tax: "art 9 sec 1 of Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax must be interpreted as meaning that bodies governed by public law, such as the municipal budgetary entities at issue in the main proceedings, cannot be regarded as taxable persons for the purposes of value added tax in so far as they do not satisfy the criterion of independence set out in that provision". So it is the municipality itself who is the taxpayer in connection with transactions realized through budgetary entities.

The sentence was soon implemented into Polish law. The Act of 5 September 2016 on special principles of settlement of tax on goods and services and

8 I SA/Wr 1697/99, http://orzeczenia.nsa.gov.pl/doc/35FDF9BE0E (accessed 1 December 2016).

9 C 276/14, EU:C:2015:635, http://curia.europa.eu/juris/document/document.jsf;jsessionid=9ea7d0f130d66f85775f87c14b6d8206d0eb0835a797.e34KaxiLc3eQc40LaxqMbN4Pah8Me0?text=&docid=168801&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=58846 (accessed 10 September 2017).

reimbursement of public funds allocated for the implementation of projects financed with funds from the European Union budget, or from Member States of the European Free Trade Agreement, by local governments[10], fully confirmed the Court`s position. According to art 3 and 4 of this Act, self governments must undertake settlements of the tax on goods and services together with their organizational units at the very latest by 1 of January 2017.

Regarding this sentence the situation of "self-government budgetary establishments" (another form of public sector units, settled in arts 14-17 of the Act on public finance) is still unclear. There also do not have legal personality, but are more independent than budgetary entities. First of all they execute their activity (in the municipal public sphere only, such as public transport, maintaining of municipal apartments, roads, cemeteries and greenery and some other functions) covering the expenses by revenues gained for their services and allowed additional grants. That`s why they were usually treated as taxpayers. However, one decision of the Supreme Administrative Court of 26 October 2015[11] has accepted the municipality`s right of deduction of the tax paid in respect of the investment transferred for budgetary establishment, when such a possibility is usually characteristic for homogeneous taxpayers only. All these remarks were mentioned in the explanatory statement to the bill of The Act on special principles of settlement...[12]. Therefore this Act concerns all municipal organizational units listed in the art 2 point 1 of this Act – both budgetary entities and budgetary establishments, as well as offices of self governments.

Serious doubts still remain on taxation of state budgetary entities (staying out of the Act on special principles of settlement...). Their formal situation as units of the public finance sector is very similar to the municipal entities, but relations with superior subjects or even the state itself may be much more complicated because of expanded structure of state public bodies. On the one hand financial and organizational dependence of state budgetary entities fulfils all criteria of tax exclusion; on the other hand – lack of proper provisions may suggest their different position. The same question may apply to "budgetary institutions"; state legal persons with their financial status similar to self-government budgetary establishments (art 24-28 of the Act on public finance).

10 Dz. U. 2018, item 218 with later changes.

11 I FPS 4/15, http://orzeczenia.nsa.gov.pl/doc/22A56560C6 (accessed 10 September 2017).

12 Parliamentary paper of the Sejm of the VIII term, no 709, http://orka.sejm.gov.pl/Druki8ka.nsf/0/CA2F4A36CA6431ADC1257FEE0040CD59/%24File/709.pdf (accessed 10 September 2017).

So, finally, the public units are taxed not only according to the general construction of the goods and services tax – which creates important subjective exclusion. The Act on special principles of settlement... was declared[13] as specific, special provision, supplementary to the Act on goods and services.

In the Corporate Income Tax, taxpayers are legal persons and organizational units without legal personality (art 1 of the Act of 15 February 1992 on corporate income tax[14]). However, there are numerous exempted subjects, mostly from the public sector and from the public finance sector: among others the State Treasury, self-governments, state agencies and funds, the Polish National Bank, budgetary entities (art 6 of this Act).

Others (not listed as above) should be taxed normally. Some of them can stay out of taxation, if their activity regards to public utility. Article 17 of the same Act (named "Objective exemptions") introduces special settlement of the profit (income) accounts – free of tax is the amount of the profit or its part spent for statutory public purposes. The most important regulation (art 17 sec 1 point 4) concerns incomes of the organizational units of: science, education, culture, physical culture and sport, environmental protection, supporting social initiatives for the construction of roads and telecommunications network in rural areas and rural water supply, charity, health service, social assistance, professional and social rehabilitation of disabled, worship. Some of them (like public high schools, research institutes, museums, public health service units) are, once more, public and public finance bodies; others (like societies, foundations, sport clubs, private schools and high schools) usually use to be private subjects. The tax privilege from the art 17 depends on many additional details and conditions. The exclusion does not cover, with subjective exceptions, incomes from some kinds of commercial activity, such as selling tobacco, alcohol, electronic equipment (art 17 sec 1a). Not excluded at all are incomes of state or municipal enterprises, cooperatives and companies, as well as self-government budgetary establishments and other organizational units without legal personality if the object of their business is to satisfy the needs of the public indirectly related to environmental protection in the following areas: water supply and sewage, waste water treatment, landfills and municipal waste and transport (art 17 sec 1c).

13 ibid.

14 Dz. U. 2018, item 1036 with later changes.

The unit must produce and keep the tax rolls and declare the relevant statutory purpose of expenditures in proper tax returns. There is no time limit for spending the exempted income, but its assignment other than declared causes adding of such a quote to the present income and tax assessment[15] (art 17 sec 6). Therefore, irrespective on the individual situation, all these subjects are called taxpayers.

All these provisions are undoubtedly the most detailed tax regulation of the public sector`s tax status. According to them, typical public bodies are practically not taxed[16].

In real estate taxes (real property tax, land tax, forest tax) there are also listed subjects exempted from taxation. All these provisions: art 7 sec 2 of the Act of 12 January 1991 on local taxes and fees[17], art 12 sec 2 of the Act of 15 November 1984 on land tax[18], art 7 sec 2 of the Act of 30 October 2002 on forest tax[19] are identical. Free of these taxes are (among others) schools, high schools, research institutes.

First, it expresses a clear intention of the tax relief of some public bodies. (Though the exemption concerns also parallel private units – hereby different forms of property are treated equally -such private units are not representative for those spheres of activity). Second, this tax preference relates to only a small part of public sector bodies. The essential explanation is that all these taxes are revenues of the municipalities, when both the goods and services tax and the corporate income tax are revenues of the state budget. So the tax amounts are received from private subjects, but also from the State, voivodships, districts being owners of real estate placed in the area of the municipality. Only in the land tax is the State Treasury personally freed of tax (art 3a point 1of the Act on land tax). When state or self-government property is possessed by other subjects, they are taxpayers (immovable property in direct disposal of municipalities themselves are obviously free of tax).

15 For more details see Adam Mariański in Włodzimierz Nykiel, Adam Mariański (eds) Komentarz do ustawy o podatku dochodowym od osób prawnych 2015 (ODDK 2015) 846853.

16 Rafał Golat, Opodatkowanie działalności kulturalnej (Dom Wydawniczy ABC 2005) 69.

17 Dz. U. 2018, item 1445 with later changes.

18 Dz. U. 2017, item 1892 with later changes.

19 Dz. U. 2017, item 1821.

State Treasury and self-governments are exempted from two smaller tax burdens, also municipalities` receipts.

In the tax on civil law transactions both of these public subjects are pointed by simple and direct exemptions, as well as one only state agency (art 8 points 4, 5 and 8 of The Act of 9 September 2000 on the tax on civil law transactions[20]).

Self-governments and budgetary entities are also directly exempted of the most common fee – stamp duty, another municipality budgetary revenue (art 7 points 2 and 3 of the Act of 16 November 2006 on stamp duty[21]).

This short review of the main tax regulations relating to public sector bodies shows that, in different tax acts, different solutions may by binding at law. Actually they all attempt to introduce special tax exemptions, but with a substantial variety of legal constructions and –most importantly – of the subjective scope of exempted bodies. Perhaps it is possible to prove that there is some general trend not to tax public sector subjects. However, relevant provisions are fragmentary and incoherent. The most difficult situation seems to be in the tax on goods and services. Even clear regulation of some detailed questions may cause serious doubts as to the legal position of similar (but not settled so directly) spheres – like state budgetary entities as taxpayers of this tax. Other tax provisions usually do not provoke important disputes.

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20 Dz. U. 2017, item 1150.

21 Dz. U. 2018, item 1044 with later changes.

ENTREPRENEURS' OBLIGATIONS TO DISCLOSURE, RECORDING, BILLING, AND THE SAFE-KEEPING OF BILLS WITH REGARD TO VAT

1 INTRODUCTION

In connection with the new regulation of entrepreneurship of the public sector in para 2b of the German Value Added Tax Act (hereinafter: UStG)[1], the legislator granted legal entities of public law (hereinafter:

l.e.p.l.) the right to use the former regulation of para 2 sec 3 UStG, i.e. the previous regulation[2], until 31.12.2020 in para 27 sec 22 cl 3 UStG. According to this regulation, tasks which have a sales volume of less than 35.000 EUR, are part of the pure asset management sector, part of the agriculture or forestry sectors, or have been assigned to the public sector, can be excluded from taxation of turnover until 31.12.2020 if the l.e.p.l.

concerned declares the option effective to the competent fiscal authority[3].

1 Cf. Fritz Lang, 'Taxation of the public sector in Germany – an introduction', in this volume.

2 On former regulations and administrative interpretation cf. Pierre Frotscher, 'Umsatzbesteuerung der Kommunen –Rechtliche Rahmenbedingungen in der EU und im nationalen Recht sowie aktuelle Entwicklungen in der Rechtsprechung (2013) 4 Sachsenlandkurier 254 et seq.

3 This concession of the national legislation is not without problems as it defies the decisions of the CJEU and therefore European guidelines.

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On the other hand it may be of interest to relinquish such an option and to apply the new regulation immediately, especially to achieve a deduction of input tax in the case of planned investments. Tasks that so far have been classified as non-entrepreneurial would then expand the entrepreneurial tasks of the l.e.p.l or, if the l.e.p.l. has not been liable to pay VAT for other tasks so far, would constitute its entrepreneurial status.

The VAT-liable entrepreneurial status has a number of further obligations and duties, though, which not only lead to high efforts and expenditures, but which can incur sanctions and disadvantages if the obligations and duties are not fulfilled.

This text shall give an overview over the entrepreneurs' obligation to disclose, record, bill and safe-keep bills with regard to VAT.

To do so, the legal requirements will be discussed and summarized with a supplementary analysis of administrative orders and the relevant literature. This will offer the l.e.p.l. concerned by the regulations an overview over additional administrative obligations, and enable them to better estimate the effort necessary for the expected legal consequences.

2 THE OBLIGATION TO DISCLOSE WITH REGARD TO VAT

An entrepreneur in the sense of the VAT-act has a number of obligations to disclose, especially his obligation to a tax declaration.

In addition, there are further special obligations to disclose. They are less important for l.e.p.l., but are not completely unlikely and shall therefore be explained briefly.

2.1 THE OBLIGATION TO A TAX DECLARATION

According to para 149 sec 1 cl 1 of the German Fiscal Code (AO), the tax laws determines who has to file a tax report.

For the VAT, this is mainly regulated in para 18 UStG. As a basic principle, every entrepreneur is therefore obliged to declare advance sales tax returns as well as an annual sales tax return.

The duties to declare are independent of the existence of taxable and declarable turnovers[4]. Even small businesses in the sense of para 19 UStG, which are exempt from the VAT liability, are obliged to declare an annual sales tax return[5].

Legal entities – including l.e.p.l. – that are not entrepreneurs have to provide a tax declaration according to para 18 sec 4a UStG, if they owe VAT for the intra-community acquisition according to para 1 sec 1 no 5 in conjunction with para 1a UStG[6] or as recipient of benefits according to para 13b sec 5 UStG[7].

The sales tax returns have to not only include all facts relevant to levying the taxes, but the entrepreneur must calculate the VAT, according to para 18 sec 1 cl 1 and 3 UStG, himself. According to para 150 sec 1 cl 3 AO, these tax declarations are therefore tax self-assessments.

2.1.1 THE ADVANCE SALES TAX RETURNS

According to para 18 sec 1 cl 1 UStG every entrepreneur has to declare an advance no later than 10 days after the end of the advance declaration period.

A) PERIOD FOR THE ADVANCE DECLARATION

The period for the advance declaration according to para 18 sec 2 cl 1 UStG is, in principle, the calendar quarter. If the tax for the preceding calendar year has been higher than 7.500 EUR, the period for the advance declaration is the calendar month according to para 18 sec 2 sentence 2 UStG.

In the case of starting up, i.e., in cases where the entrepreneurial or professional occupation is taken up for the first time, there is an obligation to monthly

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4 Cf. Axel Leonard in Bunjes Umsatzsteuergesetz Kommentar (13th edn CH Beck 2014) para 18 m. n. 3.

5 Cf. German Federal Finance Court (BFH), decision of 24.7.2013, Ref.: XI R 14/11, BStBl. II 2014, 210; small-scale entrepreneurs do not have to provide advance VATdeclarations, c.f. A 18.7. sec 1 p., 4 Circular on the Application of the VAT (UStAE).

6 6 This would be the case if the non-entrepreneurial l.e.p.l. purchases goods – with the exception of new vehicles in the sense of para 1b sec 2 and 3 UStG or excisable goods in the sense of para 1a sec 5 p. 2 UStG - from other member states of the EU exceeding a netamount of 12.500 EUR or if the l.e.p.l. opted for sales taxation by indicating a German VAT-No.

7 A relocation of the tax liability towards the beneficiary of the good can be contemplated if other goods or services are purchased from foreign companies, cf. para 13b sec 1 and 2 no 1 in conjunction with sec 5 UStG. Especially if construction work is purchased from foreign companies, there is a general relocation of tax liability towards the beneficiary of the good, if the beneficiary is an entrepreneur or a legal entity.

advance declarations for VAT in the year of starting up and the following year according to para 18 sec 2 cl 4 UStG. In those cases where, in conjunction with para 2b UStG, there is an entrepreneurial status of the l.e.p.l. for the first time, this is, in my opinion, not a case of a start-up in the sense of para 18 sec 2 cl 4 UStG. What is new is only the legal classification of its tasks.

To realise a prompt reimbursement of the advance-tax, para 18 sec 2a UStG allows the entrepreneur a monthly advance declaration if the surplus in favour of the entrepreneur in the last calendar year exceeded 7.500 EUR. In this case, the entrepreneur has the right to choose, which he executes by handing in the advance declaration for the calendar month January no later than February 10th of the current year.

If the VAT to be paid in the last calendar year was less than 1.000 EUR, the fiscal authority can release the entrepreneur of his obligation to an advance declaration for the VAT according to para 18 sec 2 cl 3 UStG. If the l.e.p.l. is obliged to pay VAT for the first time due to the change of the regulations in para 2b UStG, I believe it would be helpful to focus on whether the VAT to be paid in the running calendar year is not more than 1.000 EUR. In this case, the l.e.p.l. should apply for a dispensation by explaining this case.

B) PERIODS OF DECLARATION

The advance declaration for VAT has to be handed in no later than the 10th day after the end of the time period of the declaration, i.e., at the 10th of the following calendar month or calendar quarter, at the latest. If the deadline is on a Saturday, Sunday or a holiday, the period of declaration is extended until the next working day according to para 108 sec 3 AO.

C) PERMANENT EXTENSIONS OF DECLARATION PERIODS

According to para 18 sec 6 UStG in conjunction with para 46 UStDV the fiscal authority can grant a so-called permanent extension of the period of declaration and prolong the period of declaration by one month.

In this case, according to para 48 sec 1 cl 2 UStDV the entrepreneur must apply for the prolongation with official mandatory data set[8] by electronic data

8 Cf. the model form (Vordruckmuster) USt 1 H published for 2016 by the federal ministry for finances (BMF) 2.10.2015, BStBl. I 2015, p. 773; cf. Leonard (n 4), para 18 m. n. 22;

...

transmission according to the regulation for the transmission of tax data (StDÜV) at his local fiscal authority. Since 01.01.2013, only an authenticated transmission, where the entrepreneur has to register in advance at the Elster-Online-Portal of the fiscal authorities, is allowed. On application, there is an option to avoid this electronic transmission if undue hardship must be avoided; in the case of l.e.p.l. it is highly unlikely that this can be justified, though.

If the entrepreneur has to provide a monthly advance declaration, granting the prolongation according to para 47 UStDV is only possible if the entrepreneur pays a special advance amounting to 1/11 of the sum of advance payments of the last calendar year. This special advance must be calculated, announced and paid by the entrepreneur. If the l.e.p.l. is obliged to pay VAT for the first time due to the change of the regulations in para 2b UStG, the focus should be on the expected VAT for the running calendar year according to para 47 sec 3 UStDV.

D) FORM AND CONTENT OF THE ADVANCE DECLARATION

According to para 18 sec 1 cl 1 UStG advance declarations for VAT have to be transmitted to the fiscal authority with the official mandatory data set[9] by electronic data transmission according to the regulation for the transmission of tax data (StDÜV) at his local fiscal authority.

Every entrepreneur has to provide only one advance declaration for every advance period, which has to include all required information[10]. This is also the case if the company consists of a number of firms or, in case of l.e.p.l. of a number of commercial enterprises. If applicable, integrated controlled companies must be included[11].

In reality, most entrepreneurs only have to fill in a few parts of the official mandatory data set, especially information about the company, taxable sales, deductible input tax and the resulting tax. The DATENSATZ contains a large

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Josef Heß in Rüdiger Weimann, Fritz Lang (eds), Umsatzsteuer - national und international (4th edn Schäffer-Poeschel Verlag 2015) para 18 m. n. 35 ff. for the process of application for the permanent extension of declaration periods.

9 Cf. the model forms (Vordruckmuster) USt 1 A and instruction USt 1 E published for 2016 by the Federal Ministry for Finances (BMF) on 2.10.2015, BStBl. I 2015, 773.

10 Otto-Gerd Lippross, Umsatzsteuer (23th edn Erich Fleischer Verlag 2012) 1224.

11 Cf. Pierre Frotscher, Heiko Schröder 'Die Organschaft im Körperschaft-, Gewerbe- und Umsatzsteuerrecht bei juristischen Personen des öffentlichen Rechts' (2014) 5 Sachsenlandkurier 239 for the requirements and legal consequences of the integrated company.

number of further items, which an entrepreneur can hardly understand and fill in without legal support[12].

E) EFFECT OF THE ADVANCE DECLARATION

The receipt of an advance declaration with a payment charge for the entrepreneur has the effect of a tax assessment with the reservation of reaudit para 164 sec 1 cl 2 in conjunction with para 168 sec 1 AO. Therefore, the tax calculated and paid by the entrepreneur is an advance payment that is due by the 10th day after the end of the period of the advance declaration, cf. para 18 sec 1 p. 1 and 4 UStG. If the deadline is on a Saturday, Sunday or a holiday, in this case as well, the period of declaration is extended until the next working day according to para 108 sec 3 AO[13]. If the tax is not paid in due time, there is a charge for delayed payment according to para 240 sec 1 point 1 AO[14]. If the tax is paid by transfer order, para 240 sec 3 cl 1 AO grants a three-day grace period.

If, according to the advance declaration for the VAT, there is a surplus in favour of the entrepreneur, the declaration of this tax refund only is on par with a tax assessment with the reservation of re-audit, if the fiscal authority agrees, para 168 cl 1 AO. Usually, this happens implicitly with the payment of the declared tax refund. If the fiscal authority has doubts, though, it can evaluate more thoroughly or even do an audit on-site.

If the tax assessment is under the reservation of re-audit, and the appointment period[15] is not expired yet, it can be adjusted according to para 164 sec 2 cl 1 AO.

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12 Explicitly in Martin Kemper, 'Erklärungspflichten des Umsatzsteuergesetzes' (2015) Umsatzsteuer- Rundschau 374.

13 Hans-Georg Janzen in Otto Gerd Lippross, Wolfgang Seibel (eds), Basiskommentar Steuerrecht (Verlag Dr. Otto Schmidt 2010) para 18 UStG m. n. 78.

14 The charge for delayed payment is roughly 1% of the overdue tax per commenced month delayed. If, for example, an advance VAT-payment of 14.133 EUR is due on 10.2. and is paid on 12.3., the charges for delayed payment are imposed for two months for the rounded down amount of 14.100 EUR, and therefore amount to 282 EUR.

15 The appointment period for the VAT is, in principle, 4 years according to para 169 sec 2 no 2 AO and generally starts with the end of the calendar year in which the tax was generated (para 170 para 1 cl 1 UStG. The elements of the statutory period regulated in para 170 sec 2 AO routinely delay the commencement of the term.

2.1.2 ANNUAL SALES TAX RETURN

In addition to the advance declaration of the VAT, the entrepreneur has to provide an annual sales tax return for the whole calendar year according to para 18 sec 3 UStG. The filing of the annual tax return is independent of, and parallel to, the advance declaration. Filing the annual tax return does not lead to a dispensation from the advance declarations[16].

A) TERM OF DECLARATION

The annual sales tax return has to be submitted by March 31st of the following year in principle, according to para 149 sec 2 cl 1 AO. If the tax return mentioned above is prepared by tax consultants, the time period is extended until 31.12. of the following year according to para 109 AO[17].

The law for the modernisation of the system of taxation[18] stipulates a general filing deadline of 7 months, starting from 2017. In case of tax consulting, the deadline is extended to 14 months until 28.2. of the second year after the year declared. In those cases, the financial authority can request an earlier declaration under certain circumstances, but must observe a grace period of 4 months when doing so.

B) FORM AND CONTENT OF THE ANNUAL SALES TAX RETURN

According to para 18 sec 3 cl 1 UStG, the annual sales tax return has to be transmitted to the fiscal authority with the official mandatory data set[19] by electronic data transmission according to the regulation for the transmission of tax data (StDÜV) at the competent fiscal authority.

C) EFFECT OF THE ANNUAL DECLARATION

If the tax to be paid according to the calculations of the annual sales tax return is different from the sum of the advance payments, a difference in favour of the

16 Leonard (n 4) para 18 m. n. 23.

17 Cf. identical decrees of the supreme fiscal authorities of the federal states, 4.1.2016 on periods for tax returns, BStBl. I 2016, p. 38.

18 Cf. BT-Drs. 18/7457, 3.2.2016 and BT-Drs. 18.8434, 11.5.2016 – cf. also Jörg Schwenker, 'Das Gesetz zur Modernisierung des Besteuerungsverfahrens – ein Meilenstein auf dem Weg der weiteren Digitalisierung im Steuerrecht' (2016) Der Betrieb 375 et seq.

19 Cf. the model form for the annual sales tax return 2015 published by the federal ministry for finances 1.10.2015, BStBl. I 2015, 758.

fiscal authority must be paid one month after submission of the annual sales tax return according to para 18 sec 4 cl 1 UStG.

If there is a surplus for the entrepreneur, because the sum of the advance payments, especially the sales tax prepayment according to para 47 UStDV, was higher than the actual annual tax, the refund is only due with the approval of the fiscal authority, para 168 cl 2 AO.

2.1.3 CONSEQUENCES IN THE CASE OF A DELAYED SUBMISSION OR NON-SUBMISSION

If an advance declaration for VAT or the annual sales tax return is not handed in, the fiscal authority can impose a charge for delayed payment according to para 152 sec 1 cl 1 AO. This charge can be up to 10% of the tax due. The law for the modernisation of the system of taxation will presumably lead to considerable changes with regard to the charge for delayed payment, starting in 2017. Especially in the case of a delayed submission, there is a mandatory charge for delayed submission of at least 25 EUR per month, or part thereof, delayed.

In addition, the fiscal authority can estimate the tax base according to para 162 AO in case of non-submission.

Negligence, in terms of non-submission contrary to duty or submission of incorrect or incomplete tax returns, can be considered as tax fraud, and therefore an offence according to para 370 AO, or a tax evasion, and therefore an administrative offence according to para 378 AO.

If an entrepreneur does not fulfil his fiscal duties, the fiscal authorities are, under certain circumstances, entitled to withdraw beneficial administrative acts, e.g., the permanent extension of the declaration period for the submission of the advance declarations for VAT according to para 47 UStDV.

2.2 FURTHER MANDATORY DECLARATIONS

In addition to the obligation to a sales tax return, in some cases there may be other mandatory declarations[20].

20 Cf. also Kemper (n 12) 375 et seq.

2.2.1 THE SUMMARY STATEMENT OF TURNOVER ACCORDING TO PARA 18A USTG

The summary statement of turnover (SST) is used by the fiscal authorities to secure the tax revenue of the European Single Market and to trace cross-border deliveries and services within the territory of the community. Accordingly, an entrepreneur exporting a good or service to another member state of the EU must state these sales in a SST.

The SST is a legal obligation in the taxation system and the entrepreneur must declare those turnovers monthly in case of exports within the EU according to para 18a sec 1 UStG, or quarterly in case of special exports[21] according to para 18a sec 2 UStG. The SST has to be submitted to the Federal Central Tax Office '(BZSt) until the 25th day after expiration of the relevant notification period.

The content of the SST to be submitted with the official mandatory data set by electronic data transmission according to the regulation for the transmission of tax data (StDÜV) is regulated in para 18a sec 7 UStG and includes, e.g., the VAT identification number (USt-IdNr.) of the customers and the assessment basis for the goods or services delivered.

For l.e.p.l., the submission of a SST is usually of little importance. But if, e.g., there is an advertisement of a Czech company in a community newspaper in Germany, this would be a case for a SST, because the municipality acts as an entrepreneur in this case[22] and is no small-scale entrepreneur within the meaning of para 19 UStG[23].

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21 This only includes goods and services with turnover in regions in the further regions of the community according to para 3a sec 2 UStG where the receiving entrepreneur is obliged to pay the tax.

22 Under the regulations of the previous para 2 sec 3 UStG, the entrepreneurial status is precluded for those with an annual revenue of less than 35.000 EUR; under the new regulations of para 2b UStG, a structure under public law and an estimated annual revenue of less than 17.500 EUR for those activities are necessary to preclude the entrepreneurial status.

23 The SST, according to para 18a sec 4 UStG, does not have to be submitted by smallscale enterprises according to para 19 UStG. The regulation for small-scale enterprises according to para 19 UStG assumes that the gross turnover of the previous year was less than 17.500 EUR and does not exceed 50.000 EUR in the current calendar year.

If there is an obligation to submit a SST, the submission of an incorrect or delayed SST or the non-submission are an administrative offence according to para 26a sec 1 no 5 UStG.

2.2.2 SPECIAL DECLARATION OF INTRA-COMMUNITY EXPORTS AND SPECIAL OTHER SERVICES AND GOODS ACCORDING TO PARA 18B USTG

In addition to para 18a UStG, para 18b UStG states that the entrepreneur must declare intra-community exports as well as certain exports within the further regions of the community[24] to the fiscal authorities.

Para 18a UStG is expected to ensure that data transmitted for the SST to the Federal Central Tax Office concurs with data submitted to the fiscal authorities and can be compared.

The official forms for the advance declaration for VAT and the annual sales tax return are complemented by corresponding spaces, so that declarations can be made together with the regular advance declaration or annual sales tax return.

2.2.3 THE OBLIGATION TO REGISTER THE DELIVERY OF NEW VEHICLES ACCORDING TO PARA 18C USTG

If new vehicles are delivered to a buyer from another member state within the community, and this buyer does not use a VAT identification number[25], the obligation to register according to para 18c UStG in conjunction with the regulation for obligatory registration of delivery of vehicles (Fahrzeuglieferungs-Meldepflichtverordnung = FzgLiefgMeldV) must be observed.

It is important to note, for example, that a vehicle is considered new according to para 1b sec 3 UStG, if it has not been driven for more than 6.000 km or if has been brought into service less than six months ago.

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24 The regulation also includes the declaration of deliveries according to para 25b sec 2 UStG. para 25b UStG regulates the intra-community triangular trade. It assumes that three entrepreneurs from different member states carry out turnover transactions and the goods are directly delivered from the first entrepreneur to the final buyer. This is likely not relevant for l.e.p.l.

25 If the entrepreneur uses a VAT identification number, the transaction is considered a regular intra-community transaction that has to be declared according to para 18a and para 18b UStG.

In addition, if new vehicles are sold, even non-entrepreneurial suppliers are treated as entrepreneurs according to para 2a UStG and have to observe the registration requirements.

If, e.g., a municipality sells a car that has been driven for less than 6.000 km to a Polish private individual, then it has to observe the registration requirements according to para 18c UStG in conjunction with the FzgLiefgMeldV, irrespective of the former use for public administration or for entrepreneurial purposes.

In case of obligatory registration, a large amount of information has to be transmitted to the BZSt by the 10th day after the end of the calendar quarter of the delivery[26].

Entrepreneurs have to submit their registration by the official mandatory data set by electronic data transmission according to the StDÜV. Non-entrepreneurial suppliers are allowed to submit their registration on paper, using the official mandatory form[27].

The incorrect, omitted or delayed registration is considered an administrative offense according to para 26a cl 1 no 6 UStG.

3 MANDATORY RECORD-KEEPING FOR ENTITIES SUBJECT TO VAT

In addition to mandatory declarations for entities subject to VAT, the entrepreneur has to observe a number of obligations for record-keeping.

According to para 22 sec 1 cl 1 UStG, the entrepreneur has to provide records for the determination of the tax and the basis for its calculation[28]. Generally, the entrepreneur fulfils his mandatory recordkeeping with regard to VAT by standard accounting. According to para 22 sec 2 no 1 UStG the records must include the payments for services and goods provided by the entrepreneur, observing the differentiation between taxable turnover (separated by tax rate) and tax-exempt

26 The content of the registration is specified in para 2 FzgLiefgMeldV and A 18c.1 sec 4 UStAE.

27 Cf. A 18c.1 sec 2 and 3 UStAE and the information on www.elster.de and www.bzst.de.

28 Cf. general UStAE on para 22 UStG; Lippross (n 10) 1268 et seq; Hans-Hermann Heidner in Bunjes Umsatzsteuergesetz Kommentar (13th edn CH Beck 2014) para 22 m. n. 1 et seq.

turnover. For the deduction of input tax, the remuneration for taxable goods and services paid to the entrepreneur for the company have to be recorded according to para 22 sec 2 no 5 UStG.

According to para 63 sec 1 UStDV, the records must be provided in a form that enables an expert third party to get an overview of the turnover of the entrepreneur and the deductible input tax within a reasonable period. The sales receipts indispensable elements of the records.

According to para 146 sec 2 cl 1 AO, the records have to be made basically in the German territory.

In case of missing or incomplete records, the fiscal authority is entitled to estimate the tax base according to para 162 AO, and uncertainties connected with the estimation are at the expense of the entrepreneur[29]. Culpable violations of the record requirements constitute an administrative offense according to para 379 AO.

In addition to the mandatory record-keeping according to para 22 UStG, there are special obligations to provide evidence for the entitlement to certain tax exemptions. Non-taxable export-deliveries or nontaxable intra-community deliveries, for example, must be proved by accounting and the provision of receipts. If the proof is missing, the tax exemption is not granted.

4 OBLIGATION TO ISSUE AND STORE INVOICES

According to para 14 UStG, the entrepreneur is obliged to issue a qualified invoice to the recipients of goods and services in a large number of cases.

In addition, he is obliged to keep a duplicate of all invoices issued and received according to para 14b UStG.

29 Lippross (n 10) 1269.

4.1 OBLIGATION TO ISSUE AN INVOICE

An entrepreneur is obliged to issue an invoice for certain propertyrelated services, especially construction services, but also property development, gardening and cleaning services[30] according to para 14 sec 2 no 1 UStG.

In addition to this specific obligation to issue invoices, para 14 sec 2 no 2 UStG regulates a general obligation to issue invoices if the entrepreneur provides services or goods to another entrepreneur for his company or to a non-entrepreneurial legal entity, and the turnover is not taxexempt according to para 4 nos 8 to 29 UStG.

In all other cases, i.e. non-property-related services to nonentrepreneurs, the entrepreneur is not obliged to issue an invoice with regard to VAT. Voluntarily or based on contractual agreements, an invoice can be issued in these cases as well.

4.2 FORM OF THE INVOICE

According to para 14 sec 1 cl 1 UStG, an invoice is every document used to charge for a service or good. It can be issued in paper form or, since 1.7.2011, electronically.

The authenticity of the origin, i.e. the identity of the issuer of the invoice, the integrity of the content and the legibility of the invoice must be ensured[31]. How this is realised is for the entrepreneur to decide.

4.3 CONTENT OF A QUALIFIED INVOICE

The requirements for the contents of an invoice are stated in para 14 sec 4 nos 1 to 10 UStG. The entrepreneur has to state in particular:

- The complete name and address of entrepreneur and the recipient of goods or services (no 1).
- His tax identification number or VAT identification number

30 Lippross (n 10) 883; Fritz Lang in Rüdiger Weimann, Fritz Lang (eds), Umsatzsteuer - national und international (4th edn Schäffer-Poeschel Verlag 2015) para 14 m. n. 37 et seq.

31 Lippross (n 10) 880 et seq; Ronny Langer, Robert Hammerl, 'Rechnungen im Umsatzsteuerrecht' (2013) Neue WirtschaftsBriefe für Steuer- und Wirtschaftsrecht 1280 et seq.

- (no 2).
- The date of issue (no 3).
- An invoice number (no 4).
- A description of the good or service (no 5).
- The date of the delivery or the date of receipt of the remuneration (no 6).
- The net remuneration (no 7).
- The tax rate and the amount of tax or a reference to the tax exemption (no 8).
- Reference to record retention, if applicable (no 9).
- Specification "credit", if applicable (no 10)[32].

Further mandatory contents are found in para 14a UStG. Especially in cases of reverse charging of tax, the invoice must include the specification "tax liability of the recipient of services".

For invoices for small amounts of less than 150 EUR (from 2017, expected to be less than 200 EUR) and tickets, the special regulations of paras 33, 34 UStDV apply.

4.4 MANDATORY RETENTION AND FILING

According to para 14b sec 1 cl 1 UStG, every entrepreneur is obliged to retain all invoices issued or received by him.

The period of retention begins with the end of the calendar year where the invoice was issued and lasts 10 years. The period is prolonged in cases where the invoices are still relevant for taxes where the appointment period has not yet run out. If the period is not over yet, the authenticity of the origin, the integrity of the content and the legibility of the invoice must be ensured. Invoices issued on thermal paper may have to be copied to ensure legibility.

Invoices on paper may be scanned and digitally archived under certain circumstances[33].

32 A credit exists in cases where the recipient of the service instead of the providing entrepreneur bills the service, cf. para 14 sec 2 cl 2 and 3 UStG.

33 Cf. Langer, Hammerl (n 31) 1292.

The repository is generally the German territory. Electronically stored invoices can be deposited in Community territory, if an immediate on-line access of the authorities is guaranteed.

4.5 CONSEQUENCES IN CASE OF BREACH OF THE REGULATIONS

If an invoice is not issued or not issued in time due to a culpable breach of the entrepreneur, this is considered an administrative offence due to para 26a sec 1 no 1 UStG.

If the VAT stated on the invoice is too high, the issuer of the invoice owes the excess amount according to para 14c sec 1 UStG.

If the supplying entrepreneur does not issue the invoice properly or not on time, this may justify claims for compensation by the recipient of the goods or services, because the deduction of his input tax depends on the invoices.

Culpable breaches of the mandatory retention of invoices are considered an administrative offence according to para 26a sec 1 no 2 UStG.

If the entrepreneur cannot provide proper purchase invoices, the fiscal authorities will not grant him the deduction of input tax according to para 15 sec 1 cl 1 no 1 UStG.

5 CONCLUSION

An entrepreneur's obligations for declaration and record-keeping as well as mandatory issuing, retention and filing of invoices connected with the VAT alone are manifold and comprehensive. Without expert advice, the entrepreneur will unlikely be able to fulfil all of the obligations. The efforts and expenses of compliance must not be underestimated.

The taxation of turnover according to previous law that exempted comparably large fields of activity of l.e.p.l. from taxation, and thereby from compliance with further additional obligations in conjunction with taxation, is generally less complex and therefore more beneficial for many l.e.p.l. Taking this into consideration, it will be advantageous for many l.e.p.l. to exercise their option right and opt for the regulation of para 2 sec 3 UStG by declaring to their fiscal authority that they want to observe the previous regulations.

The transitional period until 31.12.2020 granted by the legislator should be used to examine activities according to the new regulations and to prepare for the new legislation according to the new para 2b UStG.

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INFORMATION ASYMMETRIES IN THE COMMUNICATION BETWEEN BUREAUCRACY AND CITIZENS

1 INTRODUCTION

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The public sector is one of the most important employers worldwide. Within many OECD countries, public sector employment amounts to more than 20% (e.g., Sweden, Poland, Great Britain) or even 30% (Norway, Denmark) of the total labour force. The OECD average is over 19%; only in Japan and Korea public sector employment is responsible for less than 10% of total employment.[1] In Germany, more than 5.8 million persons, i.e., roughly 13% of the total labour force, is employed in the public sector[2]. The annual budget of the German public sector in 2016 is estimated at 316 billion EUR[3], and it is virtually impossible to not be in contact with any public authorities as a German citizen – the same goes, possibly to a higher or lesser extent, for many other countries. At the same time, surveys among citizens aimed at analyzing their satisfaction with the public sector in general, and civil servants in particular, show a continuing or, in some cases, even an increasing, dissatisfaction with the contact between the public and the administration. Data for Germany showing that in 2016, 74% of the citizens answering a questionnaire agreed

1 OECD, Government at a Glance 2015 (OECD Publishing 2015) 85.

2 Statistisches Bundesamt, 'Finanzen und Steuern. Personal des Öffentlichen Dienstes 2015' 2016, data of the German Bureau of Statistics; this includes civil servants in the core administration on the federal, state and communal level, employees in public foundations etc., as well as employees in public enterprises.

3 Bundesregierung, 'Bundeshaushalt' 2016 <www.bundeshaushalt.de> (German Federal Budget) accessed 9 Dec 2016.

that civil servants are conscientious (2009: 79%) and 65% consider them to be competent or rather competent (2009: 64%), implies that 26% resp. 35% of the citizens do not share the positive impression. In addition, civil servants are often considered corrupt, arrogant, and even superfluous. The specific assessment varies among the occupational groups among the civil servants, though. While firemen and medical personnel as well as (to a slightly smaller degree) teachers and professors are highly estimated (75-90% of those surveyed stated a high regard for those professions), civil servants of the fiscal authorities, e.g., are only regarded highly by 29%[4].

As the contact between citizens and the administration is highly relevant for a utilisation of public offers by citizens, the effectiveness of measures depends to no small amount on this contact. In addition, for many citizens, the administration is equivalent to the government. Citizens tend to attribute the (perceived) failures of public services to politicians[5] – making a good image and effective functioning of the administration important with regards to democracy and transparency[6].

To explain communication between citizens and bureaucracy, and to improve their interaction and thereby the efficiency and effectiveness of their interaction, economic theory offers various insights. In cases where governments take action to reduce information asymmetries or to correct problems occurring due to information asymmetries, economic theory is still somewhat restricted in explaining the utility of such interventions. Public choice theory discusses interactions between the public sector and stakeholders with the assumption of rational agents and does not focus on information asymmetries. Institutional Economics, on the other hand, may prove helpful in analyzing the necessity and possible success of such actions; another field of applicable research is likely the study of cultural and behavioural economics.[7] E.g., the principal-agent model and the corresponding aspects of information asymmetries may be useful in

4 forsa, Bürgerbefragung Öffentlicher Dienst: Einschätzungen, Erfahrungen und Erwartungen (dbb verlag 2016) 7-11.

5 Oliver James, Sebastian R Jilke, Carolyn Petersen, Steven Van de Walle, 'Citizens' Blame of Politicians for Public Service Failure: Experimental Evidence about Blame Reduction through Delegation and Contracting' (2015) 76(1) Public Administration Review 83.

6 Hans-Ulrich Derlien, Doris Böhme, Markus Heindl, Bürokratietheorie: Einführung in eine Theorie der Verwaltung (VS Verlag für Sozialwissenschaften 2011) 190.

7 Stefan Mann, Henry Wüstemann, 'Public Governance of Information Asymmetries—The Gap Between Reality and Economic Theory' (2010) 39 The Journal of Socio-Economics 278.

explaining friction between the stakeholders and lead to a better understanding of possible solutions to the problem.

In the following text, bureaucracy and (public) administration shall be used synonymously, i.e., civil servants and employees of the public administration in general are synonymously described as bureaucrats.

2 BUREAUCRACY

Stemming from the words *bureau* (for desk, i.e., the working place of the administration) and *kratein* (Greek for ruling, controlling), the first use of the word is attributed to the French economist Vincent de Gournay who coined it in the middle of the 18th century.[8] Since then, a large number of scientists, mostly sociologists, but also economists and political scientists, have analysed the public sector and its employees, and developed extensive theories. While some of their findings still influence today's management of the administration and have an effect on the image of the civil servants in the eyes of the public, newer theories need to deal with a changing reality, more complex regional and global requirements, changed demands of the citizens and, last but not least, the demographic development[9].

The classical image of a bureaucrat is strongly influenced by Max Weber's theory of bureaucracy. He describes the characteristics necessary in a bureaucrat as follows: they must be impartial, base their actions solely on rules, be objective, assessable, and be able to separate the incumbent and the resources. In short, Weber considered bureaucracy as an impartial agent to the legislative.[10]

Ludwig von Mises expanded the theory by stating that as bureaus supply services where the value cannot be calculated in monetary unit prices, and economic calculation cannot be used as a guiding principle, bureaus must therefore be centrally managed by regulation and monitoring.[11] His widely acknowledged work stressed that the perception of bureaucracy is negative and goes on to analyse the shortcomings of the bureaucratic system.

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8 Nathalie Behnke, 'Bürokratie und Verwaltung', in Steffen Mau, Nadine M. Schöneck (eds), Handwörterbuch zur Gesellschaft Deutschlands (Springer Fachmedien 2013) 130.

9 On the impact of the demographic change on the administration in the Freestate of Saxony cf., e.g., Frank Nolden in this volume.

10 Max Weber, Grundriß der Sozialökonomik: III. Abteilung Wirtschaft und Gesellschaft (J C B Mohr Paul Siebeck 1922) 650 et seq.

11 Ludwig von Mises, Bureaucracy (Yale University Press) 1944.

A few decades later, William A. Niskanen was the first to discuss bureaucracy based on the theory of the firm and analysed the characteristics of bureaus, the relation between bureaus and their environment and the aspects that bureaucrats aim to maximise. He defines bureaus as non-profit organisations which are at least partly financed not by selling output at a unit price, but rather by a budget.[12] He defines the variables the bureaucrat aims to maximise as the follows: "salary, perquisites of the office, public reputation, power, patronage, ease of managing the bureau, and ease of making changes"[13], i.e., in general, they are maximising their budget.

3 THE PRINCIPAL-AGENT-MODEL

With his theory, Niskanen contradicts Weber's theory, as in his analysis, the bureaucrat has his own subjective interests, causing frictional losses in the process of the administration. Thus, the bureaucrat is no longer a mere servant following the rules, but rather an agent with own interests. The field of New Institutional Economics addresses such interactions with the help of the so-called principal-agent model. The model is used to describe interactions of a principal who employs an agent to act in his interest. Due to information asymmetries, i.e., one party possessing information the other does not, the principal cannot monitor or judge the quality of the agent's actions, and the agent acts under the aspect of maximising his own utility[14]. Typical examples for information asymmetries are hidden characteristics (often leading to adverse selection[15]), hidden action, hidden information, both often connected with moral hazard, and hidden intentions[16].

The German basic law states in art 20 sec 1 cl 2 that "all state authority is derived from the people. It shall be exercised by the people through elections and other votes and through specific legislative, executive and judicial bodies"[17]. This,

12 William A Niskanen, Ein Ökonomisches Modell der Bürokratie. Aus dem Englischen übersetzt und leicht gekürzt von Charles B Blankart, in Werner W. Pommerehne, Bruno S Frey (eds), Ökonomische Theorie der Politik (Springer 1979).

13 William A Niskanen, 'The Peculiar Economics of Bureaucracy' (1968) 58(2) The American Economic Review 293.

14 The origins of the principal-agent models are mainly attributed to Michael C. Jensen, William H. Meckling, (1976).

15 George Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1976) 89 Quarterly Journal of Economics 488.

16 Cf. the work of Agnieszka Chrisidu-Budnik and Justyna Przedańska in this volume.

17 Basic law for the FRG, translated by Christian Tomuschat and Donald P Kommers, cf. https://www.gesetze-im-internet.de/englisch_gg/englisch_gg.html#p0111

in the democratic reality, leads to a multilayered chain of democratic delegation. Considering the typical connections between citizens, the government and the administration, one finds a multistep process. Citizens will elect their members of parliaments (or, on other levels of government, local representatives, etc.) according to their preferences, thereby acting as principals authorising the agents to act in their interest. The members of parliament in turn elect the head of government who then has the right to appoint ministers, which again act as agents to the head of government as the agent. The legislature, consisting of the parliaments and the head of government with the ministers, passes bills and regulations which are then passed on to the administration (as the agent to the legislature principal) to realise their implementation. In the administration itself, there are various hierarchical levels, again leading to various steps of principal-agent relationships. The citizen is not able to monitor the process of political decisions and implementation completely, but only sees the outcome. In this multi-layered principal-agent model, there are all kinds of information asymmetries, divergences of interests and monitoring problems, and the citizen does not know whether the outcome is in spite or because of the efforts of the elected agents. Considering that there are information asymmetries on every step of the model, the whole process becomes a highly complex structure where the outcome can only partly be influenced on every level. Therefore, the citizen sees an outcome in which he tends to contribute to the civil servants actions, but which may well be determined by the many decision levels above. At the same time, the civil servant with his own interests such as those defined by Niskanen or an interest in minimising his workload and therefore, e.g., offering only limited advice, can influence the final outcome of a measure.

4 THE INTERACTION BETWEEN CITIZEN AND BUREAUCRACY

As mentioned above, the citizen's direct contact with the political and administrative system is mainly through interaction with the administration.

The expectations regarding the services provided by the public administration are shaped not only by prior experiences, but also in comparison to the private sector.[18] The high quality of services, the promptitude and the importance placed

18 Robert Knappe, Die Eignung von New Public Management zur Steuerung Öffentlicher Kulturbetriebe (Gabler Verlag 2010).

on the customer and his wishes in commercial transactions lead to corresponding demands in the public sector.

Surveys on the satisfaction of citizens with public services show the following results: on a scale from +2 (very satisfied) to -2 (very dissatisfied), German citizens rate their overall satisfaction with the public administration at 1.06, which is a rather positive result. It has to be stated though, that the satisfaction clearly varies between the services used. The highest satisfaction rate can be seen regarding marriage-related services (satisfaction: 1.46), whereas the satisfaction with services and consultations concerning unemployment and financial problems is considerably lower, if still positive, at a satisfaction average of 0.37.[19]

The most important aspects for citizens as customers of the public administration are trust, non-discrimination, incorruptible civil servants and expertise in the field of consultation. The least satisfaction was indicated with the understandability of the laws and regulations as well as the comprehensibility of the forms and applications. In this case as well, there are considerable differences in the various fields of service; e.g., when applying for drivers licences, the satisfaction with the comprehensibility of regulations and forms is 1.22, whereas the satisfaction regarding situations where citizens face financial problems is at only -0.08.[20]

Another survey showed that the points that were mostly criticised on the communal level were suboptimal opening hours, to long timeframes for the processing of applications, a lack of clarity regarding the appropriate contact person, and services that are not customer-, i.e., citizen-oriented.[21] The last aspect must be discussed with the background that the equal treatment and the strict following of rules is also intended to protect the citizens by providing services without regard to the person, with legal certainty and predictability of outcomes, though.[22]

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19 Statistisches Bundesamt, Bürger sind mit ihrer Öffentlichen Verwaltung Überwiegend Zufrieden: PM 298/15 (2015) 1.

20 ibid.

21 Claus Stickler, Veränderungsprozesse in der Kommunalverwaltung: Ziele, Inhalte und Methoden (Deutscher Universitätsverlag 2000) 17-18.

22 Derlien, Böhme, Heindl (n 6) 199.

At the same time, the civil servants have to deal with a heterogeneous clientele with heterogeneous demands, while observing the precept of non-discrimination. An analysis of citizens classifies them into the following groups: the "helpless subject", the "competent pragmatic", the "identified technocrat", the blind bureaucrat, the insecure frustrated citizen, the estranged citizen, and the competent critic of the system.[23] While this classification may be clichéd and simplified, it contains a number of characteristics that civil servants have to observe. The level of information of the citizens before a consultation varies highly, as do the understanding of administrative processes, the self-confidence and the demands on the administration. In all cases, the administrative staff has to consult to the best of their knowledge[24] while observing the non-discrimination precept.

5 CHALLENGES FOR THE ADMINISTRATION

The citizen's wishes regarding personalized consultations, problem- and service-oriented civil servants, direct communication and simplified forms are in stark contrast with the bureaucrat's preferences for impersonal counselling that is governed by an obedience of rules to avoid mistakes and ensure equal treatment.

In addition to those differences in preferences, the public administration faces three important challenges: the financial gap, an acceptance gap and a modernisation gap[25].

The *financial gap* describes the situation especially on the community level, where the budgets are insufficient to cover the current spending. Therefore, many communes are indebted, which in turn leads to an even more restricted scope of action and a possible limitation especially of the optional task, but also to a limited quality of the provision of the mandatory tasks. The reasons for the discrepancy between budget and spending are mainly high investments and deficits in the budgets for the administration itself. These deficits are caused by additional tasks such as the increased demands on quality and quantity of childcare.

23 Pippig Gerhard, Die Verwaltung und ihr Publikum: Psycho-Strukturelle Bedingungen und Klientenorientierung der Öffentlichen Verwaltung (Beiträge zur sozialwissenschaftlichen Forschung 107, VS Verlag für Sozialwissenschaften 1988) 157.

24 On the citizen's rights to consultation cf. Matthias Thum in this volume.

25 Stickler (n 21) 7 et seq.

Generally, the consequences of the financial gap are either a growing debt, decreased spending or efforts to modernise the administration[26].

The *acceptance gap* consists mainly of an attractiveness gap, i.e., a low satisfaction of the citizens with the administration as well as a low satisfaction of companies with the bureaucracy and the decreasing interest of potential applicants for the civil service; and a legitimisation gap, i.e. the perceived suboptimal quality, efficiency and effectiveness of public services. The latter aspect is usually addressed by increasing transparency of the decision processes, the scope of services and the evaluation of measures[27].

The *modernisation gap* addresses the underlying structural problems of the public administration. These structural deficits are especially noticeable in comparison with structures in the private sector. The structure of the bureaucracy has not changed in parallel to the increasing complexity and dynamic. A transformation and modernisation is complicated by the size of the administration and the established structures. The typical approaches to lessen this gap were the outsourcing of tasks as well as the consolidation of households, i.e., increasing revenues and decreasing expenses[28].

6 POSSIBLE SOLUTIONS

Institutional economics offers a number of solutions for the various information asymmetries. The standard solutions are signalling[29] (i.e., the agent makes efforts to increase the information of the principal) and screening (i.e., the principal makes efforts to decrease the information asymmetries).

Administrative theory has developed several new concepts in the last decades which address the challenges mentioned above.

The *New Public Management* is based on an economisation of the administration and focuses on performance orientation, innovation, pragmatic solutions, quality orientation and concentration on the outcome. This may contradict the equal

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26 ibid. 14-15.

27 ibid. 18-20.

28 ibid. 28-30.

29 On Signalling, cf., e.g., Michael Spence, 'Job Market Signaling' (1973) 87(3) Quarterly Journal of Economics 355, who explained the theory using the example of the labour market.

treatment stipulation, though[30]. This theory is criticised because public services cannot always be provided with private business methods, for example because, as mentioned in section 2, the public sector often offers services whose value cannot be measured in monetary unit prices, e.g., because they are public goods or merit goods. In addition, the realisation of some of the aspects led to unclear responsibilities , higher risks of failure on the side of the bureaucrats due to increased scopes of discretion, and possibly a higher susceptibility to corruption[31].

Public Governance, another approach to a modernisation of the public administration, states the importance of a stronger active participation of citizens and expects the public sector to initiate and moderate the commitment of the citizens[32].

Ethical management is based on an OECD recommendation and contains hard measures such as regulations, laws and sanctioning, as well as soft instruments such as education, raising awareness, sensitisation to the risk of corruption and conflicts of interests.[33]

There is also the general approach of increasing transparency. This would not only include explaining public decisions, but also the reduction of bureaucratese ("Amtsdeutsch"), the simplification of forms and applications, educating civil servants not only on technical aspects, but also in soft skills. The introduction of e-Government aspects can reduce time for processing requests and waiting times. There are also ombudsmen on several levels that can offer citizens a comparably unbureaucratic possibility to control the administration[34].

Most of the reforms proposed are only implemented selectively, though. Transformations such as the introduction of e-Government or a reorganisation of the administration hierarchy is costly, which increases the financial gap. In addition, the acceptance of transformations both with the citizens as well as the bureaucrats is not necessarily high. In addition, a number of studies find that public management reform was often conducted suboptimally, with politicians

30 Knappe (n 18) 53-55.
31 Kurt Kippels, Demokratie und Exekutive in Edwin Czerwick, Wolfgang H Lorig Erhard Treutner (eds), Die öffentliche Verwaltung in der Demokratie der Bundesrepublik Deutschland (VS Verlag für Sozialwissenschaften 2009) 17-19.
32 Knappe (n 18) 92-93.
33 OECD, 'Managing Ethics: An OECD Recommendation' (1998) Public Management Gazette.
34 Derlien, Böhme, Heindl (n 6) 34.

and top-level civil servants choosing their preferred reform areas and measures while neglecting others[35].

7 CONCLUSION

The satisfaction of citizens with the public administration needs to be improved. Institutional economics and especially the theory of information asymmetries can be used to explain several aspects of the legitimacy gap and, in parts, the modernisation gap. Considering the financial situation on the communal level as well as the demands of the citizens, but also the expected demographic changes, a modernisation and transformation of the administration is inevitable. Such a change must also include civil servants who do not only fulfil Max Weber's requirements for bureaucrats, but are also educated to react flexibly to changes and individual situations of the citizens and who possess the skills to communicate and consult in a way that decreases the gap between citizens and the bureaucracy. The increased demands on bureaucrats' skills are a special challenge taking into consideration the demographic situation in Germany.

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THE AGENCY THEORY APPROACH TO THE PUBLIC PROCUREMENT SYSTEM

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1 ASSUMPTIONS TO THE AGENCY THEORY

The literature on the subject states that the agency relationship is "one of the oldest and commonest codified modes of social interaction"[1]. At the foundation of the agency theory is the assumption that there is an asymmetry of information between the two parties to a relationship in a given decision-making situation when one of the parties, referred to as the agent, acts on behalf of or represents the other party, referred to as the principal. The analysis of the agency theory helps identify the relativity and mutability of the subject matter of the cognition. The entity participating in the principal–agent relationship can be an individual person, entire groups of people, the state administration or an enterprise. Each party may have different (more precise, fuller) information on the subject of the relationship.

The agency theory has opened up new research perspectives, illustrating the relativity and mutability of the subject matter of the cognition. The subjects of the cognition are the relationships that typically assume the form of formalized contracts in various areas of the economy, such as on the insurance market, in the process of corporate governance, in the human resources management process in the organization, in the process of creating strategic alliances, in public-private

1 Stephen Ross, 'The economic theory of agency: the principal's problem' (1973) 62 (2) American Economic Review 134.

partnerships, as well as in contracting for public services and tasks. The agency relationship appears whenever one of the parties must rely on the acts of the other. The agency relationship is a contract, under which the principal engages another person (the agent) to perform specific projects on its behalf, delegating decisionmaking rights[2]. Three further assumptions are made in the agency theory:

(a) the efficiency of the principal's operations depends on the agent's acts and decisions; (b) decisions are made by the parties to the relationship under conditions of uncertainty and risk[3]; (c) the principal and the agent have conflicting objectives to some extent[4]. The pluralism of the assumptions constituting the central part of the agency theory leads to the focusing of attention on issues of monitoring the activities of one of the parties to the relationship. It is assumed in the classic mainstream of the agency theory that the agent operating on behalf of the principal has the information advantage. The information advantage and the assumption of the existence of a conflict of interests between the principal and the agent can generate opportunistic behaviour on the part of the agent. The term "opportunism" has exactly the same meaning as Olivier E. Williamson assigned to it. He understood opportunism as the desire to implement one's personal interests. Williamson claimed that even the more blatant forms, such as lying, stealing and cheating are included in this. Opportunism is typically based on more subtle forms, involving action, as well as inaction taken up *ex ante* – even before the conclusion of the contract, *in tractu* – during the performance of the provisions of the contract, as well as *ex post*– after the end of the contract[5].

From the economic point of view, the agency relationship is a strictly optimizing issue, involving the appropriate selection of legal and organizational solutions that reduce the asymmetry of information and/or encourage the agent's activities to be consistent with the principal's expectations. The problem of optimization in the literature on the subject is viewed in the context of the assumption that this asymmetry of information exists, as does a conflict of interests between the principal and the agent – to some extent, each party

2 Michael C Jensen, William H Meckling, 'Theory of the firm: managerial behavior, agency cost and ownership structure' (1976) 3 (4) Journal of Financial Economics 305–360.

3 Kathleen M Eisenhardt, 'Agency theory: an assessment and review' (1989) 14 (1) Academy of Management Review 57–74.

4 Hounaida Daly, 'Conflicts of interest in agency theory: a theoretical overview' (2015) 15 (1) Global Journal of Human-Social Science: E Economics 17–22.

5 Olivier E Williamson, The economic institution of capitalism (The Free Press 1985) 47.

pursues its own individual objective[6]. This is because, if the agent has a different function, but does not have an information advantage, the principal could create a complete contract – encompassing claims in unpredictable conditions. A complete contract is a utopian structure, which falls into the category of the first-best outcome, namely a result of the collaboration of the principal and the agent, such as which would only be achievable in an unreal world of full and/or symmetrical information. The objective of optimization is to form the agency relationship in such a way as to achieve the second-best outcome, which is a result that is as close as possible to the first-best outcome[7]. The problem of optimization also focuses on looking for ways to minimize agency costs, which are higher as the principal's and agent's interests, objectives and values are more divergent. Three categories of agency costs are distinguished:

1. The costs borne by the principal in order to control the agent.

2. The costs borne by the agent in order to build his own credibility and incite the principal's confidence.

3. Opportunity costs, meaning a loss of efficiency by the principal because of the divergence of the objectives of the parties and the difficulty in controlling the agent's activities.

The acceptance of the above view of the phenomenon of opportunism justifies focusing on three aspects of asymmetry of information. The first, adverse selection, appears before the contract is concluded and refers to actions taken by the agent, the objective of which is to encourage the principal to enter into a contract with him. Adverse selection encompasses the phenomenon of hidden information – the agent has knowledge of environmental variables which are not available to the principal. The variables describing the environment can therefore be random, regardless of the agent's actions (e.g., rate of return on an investment project). The agent has an information advantage and can also claim that he has the know-how and resources needed for performing the contract, while the principal does not have the instruments to verify the agent's

6 Jean-Jacques Laffont, David Martimort, The theory of incentives. The Principal-Agent Model (Princeton University Press 2002) 20.

7 John W Pratt, Richard J Zeckhauser, Principal and agents: the structure of Business (Harvard Business School Press 1985) 3; Patrick W Schmitz, 'On the interplay of hidden action and hidden information in simple bilateral trading problems' (2002) 1103 (2) Journal of Economic Theory 444–460.

reliability[8]. The phenomenon of hidden information creates a situation in which the principal can observe the activities, but is unable to identify and verify the external factors affecting the agent's choice of actions[9].

The second, moral hazard, appears during the performance of the contract and applies to actions taken by the agent, which are difficult for the principal to monitor[10]. Moral hazard involves the phenomenon of hidden action – the agent takes action which cannot be observed by the principal (e.g., the level of effort in implementing an investment project) due to the costs of obtaining the information. Therefore, the principal is unable to identify the relationship between the agent's effort and the result he achieves. The phenomenon of hidden activity creates a situation in which the principal cannot see the agent's actions, only their outcome[11].

The third, non-verifiability, can take place at the stage of entering into and performing the transaction, or after its completion. It arises when the principal has information about the agent's inappropriate activities, but is unable to validate them and, in this sense, prove them. It is therefore useless, or, in other words, not available to the stakeholders, courts or the public[12].

2 CONTRACTING OUT. RESTRICTIONS OF THE AGENCY THEORY

A trend is noticed in the functioning of the public sector regarding the increasing importance of contracts as forms of operation of this sector. This kind of form of fulfilment of public tasks and services has intensified in Europe and the United States under the influence of institutional reforms initiated by U.S. President Ronald Reagan and British Prime Minister Margaret Thatcher. These reforms led to the development of discipline, as well as a set of practices, which are

8 Caroline Nyman, Fredrik Nilsson, Birger Rapp, 'Accountability in local government: a principal-agent perspective' (2005) 9 (2) Journal of Human Resource Costing and Accounting 123–137.

9 Jacek Miroński, 'Relacja agencji w teorii przedsiębiorstwa' (2005) 164 (4) Gospodarka Narodowa 3; Andrzej Paliński, 'Kosztowna weryfikacja jako element relacji bank–kredytobiorca' (2009) 40 (3) Bank i Kredyt 94.

10 Trevor L Brown, Matthew Potoski, David M Slyke, 'Managing public service contracts: aligning values, institutions, and markets' (2006) 66 (3) Public Administration Review 323–332.

11 Miroński, Paliński (n 9).

12 Jean-Jacques Laffont, David Martimort, The theory of incentives. The Principal-Agent Model (Princeton University Press 2002) 3.

considered a paradigm of New Public Management (NPM), namely, a certain unity of the starting assumptions and methods of discipline, a unity determining its claims and hypotheses. The NPM paradigm is a special and impressive phenomenon. The rate of development of research taken up within different, individual academic disciplines (economics, law, the science of administration, management science, politics and sociology), which identify the advantages and limitations of NPM as a public sector practices, is especially noteworthy[13]. Regardless of the discussions taking place between the representatives of the various academic disciplines, the common denominator of all older and newer theoretical propositions is the focus of attention on the issue of contracting out public tasks and services. The process for contracting out tasks between the public awarding entity and the private entity, which is a contractor, currently assumes the form of a transaction which can be analysed from the point of view of the agency theory.

The analysis of the institution of public contracts from the point of view of the agency theory implies the need to note its limitations. The most comprehensive critical assessment was made by Nilakanta and Rao[14]. Certain limitations of the application attributes of the agency theory arise from the specifics of the public procurement system as one of the forms of contracting out. There is no doubt that there is asymmetry of information on the public procurement market, which can lead to:

1. An increase in agency costs.

2. Problems with the fulfilment of the subject matter of the contract.

3. The cancellation of the public procurement proceedings.

A characteristic element of the public procurement system is the double-sided asymmetry of information. Both the principal (the awarding entity) and the agent (the contractor) can be affected by asymmetry of information. The awarding entity knows which services it needs, but does not always know how to obtain the service on the market to make the contract effective. This especially

13 Van R Johnston, Paul Seidenstat, 'Contracting out government services: privatization at the millennium' (2007) 30 (3) International Journal of Public Administration 231–247; Graeme A Hodge, 'Competitive tendering and contracting out: rhetoric or reality?' (1999).

14 Venkataraman Nilakant, Hayagreeva Rao, 'Agency theory and uncertainty in organization. An evaluation' (1994) 15 (5) Organization Studies 649–672.

applies to the lack of knowledge on how to articulate expectations and needs in the terms of reference. Regardless of how the asymmetry of information is distributed among the parties to the transaction, the adverse consequences of the asymmetry of information will affect the awarding entity to a greater extent. Therefore, the awarding entity should be motivated to gain knowledge to enable it to effectively prepare a description of the subject matter of the procurement.

Public procurement is not only a legal, but also an economic instrument. The decisions made by the awarding entity determine the conduct of the contractors and the effects of fulfilling the contract as early as at the start of the process of awarding the public contract. The analysis of the mechanisms on which the relationships between entities in the public procurement system are based enables a certain, particular feature to be captured. The classic mainstream agency theory assumes that the principal has to rely on the actions of the contractor. From the point of view of effectiveness of public procurement, it is of particular importance that the contractor (agent) first has to rely on the actions of the awarding entity (principal), namely its substantive qualifications. When introducing legal regulations on the method of preparing the description of the subject matter of the contract and the organizational/legal solutions intended to eliminate the asymmetry of information, the lawmakers noted the significance of quality and transparency of the actions taken by the awarding entity at the stage of preparation of the procurement. And it is here where the strict optimizing function of the law mentioned above appears, involving a reduction in the asymmetry of information between the awarding entity and the contractor. The optimizing function of the law at the stage of preparation of the procurement should be considered on two levels.

First, optimization can be considered at the level of the awarding entity's activities, where it is important to formulate its expectations holistically, transparently and objectively for each of the potential contractors. If the awarding entity arrives at the conclusion that its knowledge is insufficient, it may benefit from the services of experts or, for example, take advantage of the institution of the technical dialogue, recognizing that the contractor has an information advantage regarding the subject matter of the procurement.

Second, optimization can be considered at the level of action taken by the contractor if it concludes that it does not have sufficient knowledge regarding the terms of reference. Contractors who have experience and are therefore familiar with the public procurement market, who can anticipate potential

problems arising from the vague provisions in the tender documents, for example, the deadline for fulfilling the contract, primarily take advantage of this opportunity. If the contractor arrives at the conclusion that the information contained in the tender documents is insufficient, using its substantive skills and assuming that the awarding entity has an information advantage with regard to its expectations and needs, it can take advantage of the optimization instrument of asking questions. Given that the contractor's substantive skills can determine the success of performing the public contract, the importance and the need for the awarding entity to take account of the comments and reservations raised by the contractors is noticeable in practice.

It should be added that these two levels of analysis regarding the optimization of the functions of the law constitute a part of the mainstream of research, in which the agency theory is perceived from the point of view of the theory of authority in any organizational structure[15]. Authority – in relational terms – is interpreted as the ability to exert an influence. Taking into account the so-called authority of the contractor's expert, which enables him to exert an influence on the awarding entity's acts and, simultaneously, benefit from the institution of the awarding entity asking questions, shows that the contractor can modify the awarding entity's behaviour. Similarly, the theory of authority enables the analysis of the agency relationship in public procurement from the point of view of dynamic reciprocity, where the actions taken by the awarding entity and the contractor can be mutually modified under the influence of the impulses coming from each of the parties to the transaction. The launch of this dynamic reciprocity simultaneously enables the reduction of the three types of agency costs mentioned above. At the same time, it should be pointed out that the analysis of the functioning of the Polish public procurement system in practice leads to the conclusion that the awarding entity and the contractor often deliberately do not take advantage of these optional legal instruments, which enable the asymmetry of information between them to be eliminated. There are cases where contractors, being aware of the low level of precision of the provisions of the tender documentation, deliberately do not exercise the right to ask so as to interpret their doubts to their own advantage. This means that some contractors are willing to take the risk, when they estimate that the potential gains can outweigh the potential losses. The awarding entity, which is required to accurately describe the subject matter of the contract, may deliberately not

15 John W Pratt, Richard J. Zeckhauser, Principal and agents: The structure of business (Harvard Business School Press 1985).

make any efforts to satisfy the obligation of applying the diligence understood in this way, thereby providing potential contractors with the opportunity to reinforce the adverse selection and take advantage of the moral hazard; the latter can be analysed in the context of "possessing" or "not possessing" the appropriate knowledge for the performance of the subject matter of the contract.

The ability to substitute clarity and precision through the multiplicity of interpretations in an area optimizing the function of the law clearly reduces and frequently eliminates the effectiveness of the implementation of the public procurement process at the tendering stage, as well as and the stage of fulfilling the contract. The perspective assumed by the awarding entity and the contractor with regard to the asymmetry of information in the public procurement process could give rise to two types of effects. Firstly, positive, when both parties are aware of the possibility of asymmetry of information arising and are willing to take steps to eliminate it. Information asymmetry is treated as the ambiguity of information, which creates the possibility of the same message being interpreted differently. The instrument used to eliminate such situations is, for instance, the said asking of questions. This means the submission of an application to clarify the terms of reference resulting in the awarding entity's obligation to respond within specified deadlines. Both the questions and the answers that are published by the awarding entity create equal access to information on the part of entities applying for the contract, reducing the asymmetry between the contractors themselves and between the contractor and the awarding entity. Secondly, negative, when the awarding entity and the contractor, despite being aware of the presence of asymmetry of information do not take any steps to eliminate it. They treat the ambiguity of the message as the opportunity to maximize the utility of their own objectives. The principle of buying as cheaply as possible becomes consolidated instead of making the principle of achieving the optimum price in specific conditions of the provision of the service comes about. Therefore, they are not aiming to make use of the instruments of the law, such as competitive dialogue, the procedure of announcement and negotiation, which would enable the asymmetry of information to be reduced.

3 HIDDEN INFORMATION. HIDDEN ACTION

Taking into account the specificities of the public procurement system justifies drawing attention to its subjective aspect. Most of the literature on the subject focuses on "one-to-one" interactions (one principal, one agent). In practice, the "one-to-one" public procurement situation is relatively rare (e.g. in the case of

natural monopolies); in the majority of cases, there are developed relationships, namely one principal, namely the awarding entity, and many potential agents, or contractors. Several contractors take part in the tendering process, trying to influence the decisions made by the awarding entity. From the point of view of the effectiveness of the public procurement system, of key importance is that the multiplicity of contractors can intensify the phenomenon of the asymmetry of information and weaken the incentives which should affect the awarding entity's decisions. This has the objective of, *inter alia*, countering the principle of fair competition, which is one of the fundamental rules in force in Polish public procurement law. In accordance with its wording, the awarding entity must prepare and conduct the public procurement proceedings in a manner which assures fair competition and equal treatment of contractors. Therefore, the awarding entity is responsible for compliance with this principle. The protection of competition has the objective of achieving the said optimization of the transaction between the awarding entity and the contractor, as well as the optimization of the allocation of resources, to ensure the effectiveness of the contract and the protection of the awarding entity's interests. The literature on the subject notes that the assurance of the appropriate level of competitiveness and transparency of the public procurement system leads to: (a) a reduction in the agency costs and (b) an increase in the probability of choosing the agent with the greatest potential. However, the public procurement system has a clearly focused nature; both the knowledge gathered by other academic disciplines and some of their interpretations are initially eliminated. This particularly applies to the phenomenon of ties, informal attitudes, which are out of the control of the contracting authority and which generate the effect of hidden information.

The intensity of the phenomenon of negative selection in the Polish public procurement system up to 2014 was compounded by the so-called price criteria for the selection of the proposal. The contractors offering the most competitive prices and, therefore, the contractors who are most inclined to bear a high risk won the tenders. Furthermore, the lowest price offered by the contractor does not mean that he is able to guarantee a high quality of fulfilment of the subject matter of the contract within the set deadline. Contractors, who were careful in their exposure to risk, namely those wishing to ensure that the task is completed within the deadline and at a satisfactory level of workmanship, offered higher prices and lost tenders. Recognizing this problem, the lawmakers strengthened the non-price criteria in the assessment of bids. When awarding a public

contract, the awarding entity was required to pay more attention to the quality of the goods, services or works.

An example has been presented below of the phenomenon of hidden information and hidden action in a specific public procurement procedure. A public sector unit organized a tender for the purchase of furniture for a monumental building that it manages. Open tendering was applied five times. In each tender, in accordance with the amendment to the public procurement law, alongside the price criterion for the selection of the bid, a criterion was applied in the form of a guarantee provided by the contractor on the furniture, whereas, in the last tender, one more criterion was applied, namely the timing of the fulfilment of the contract. The course of the whole of the public procurement process is presented in the following table.

Tab. 1 Process of fulfilling the public contract

OPEN TENDER NO 1					
Contractor	Price	Guarantee	Timing of completion	Evaluation criterion	Total score
T	10018.35	24 months (6.67)	–	Price (C) – 90% Guarantee (G) – 10% Price=(C lowest /C analysed) * 90 Guarantee = (G analysed /G longest) * 10 Total l. points = C + G	63.46
M	6322.20	36 months (10)	–		100.00
OPEN TENDER NO 2					
Contractor	Price	Guarantee	Timing of completion	Evaluation criterion	Total score
T	24600.00	48 months (8)	–	as above	93.50
M	23370.00	60 months (20)	–		100.00
OPEN TENDER NO 3					
Contractor	Price	Guarantee	Timing of completion	Evaluation criterion	Total score
T	23141.22	48 months (10)	–	as above	100.00

OPEN TENDER NO 4					
Contractor	Price	Guarantee	Timing of completion	Evaluation criterion	Total score
T	46236.68	24 months (8)	–	Price (C) – 80% Guarantee (G) – 20% Price=(C lowest /C analysed) * 80 Guarantee = (G analysed /G longest) * 20 Total l. points = C + G	54.18
M	52484.10	60 months (20)	–		60.68
A	26691.00	60 months (20)	–		100.00
OPEN TENDER NO 5					
Contractor	Price	Guarantee Weight: 0–24 months 10–25–36 months 20–37–48 months	Timing of completion Weight: 0 – to 16/12 10 – to 09/12 20 – to 30/11	Evaluation criterion	Total score
T	21979.49	37 months (20)	30/11 (20)	Price (C) – 60% Guarantee (G) – 20% Timing of completion (T) – 20% Price=(C lowest /C analysed) * 60 Guarantee = 0 or 10 or 20 Timing of completion = 0 or 10 or 20 Total l. points = C + G + T	94.45
M	22841.10	48 months (20)	30/11 (20)		92.40
B	19948.14	48 months (20)	09/12 (10)		90.00

Source: own study.

In spite of the mechanisms used, such as a tender deposit, the requirement for contractors to submit appropriate statements/certificates and non-price criteria for assessing bids, which should eliminate the problem of asymmetry of information, the awarding entity was unable to identify any hidden information or hidden actions of contractors. The question of whether the contractors had entered into any price collusion in this case has become justified. In analysing the bids that were submitted, the awarding entity was only able to notice that contractors T and M conduct the same business which is registered in two different towns in Poland. In each tender in which contractor M took part, it was accompanied by contractor T. The bids were submitted separately, whereby, in every case, the bids submitted by contractor M were received later than contractor T's bid. Contractor T was selected as the best bidder in tender

numbers 3 and 5. However, it did not sign the contract, which resulted in its forfeiture of the tender deposit. The contract was awarded to bidder M in tender 5, whereas the awarding entity was forced to open another tender as a result of tender 3. Contractor M was selected in tender 4, in which contractor A failed to provide explanations on the abnormally low prices within the prescribed period. In tenders 1 and 2, contractor T was "respectively" worse than contractor M. It seems that contractor T was a "figurehead" which agrees to lose the tender deposit, as long as M is chosen as the contractor in the procurement.

The simulation of the contract that was awarded in the open tender procedure justifies the assertion that, despite observing the principles of fair competition and using mechanisms to increase transparency and objectivity of the choice of a specific contractor, the awarding entity was unable to reduce the said agency costs, primarily the opportunity costs. As a result of tender 5, the public contract is being fulfilled by contractor M, who offered the highest price. This outcome of the tender procedure was affected by contractor T's conduct, who withdrew from signing the contract, thereby forcing the awarding entity to prepare and conduct the next tender. From this point of view, the lack of verifiability, as an element of the asymmetry of information in the public procurement system is compounded by the particular situation where several potential contractors are trying to win the contract, between whom there are informal relations, which may distort the results of the tender procedure and affect the quality of performance of the contract.

4 CONCLUSION

The agency theory is an attractive cognitive research tool. Only selected aspects of asymmetry of information in the public procurement system have been mentioned in this article. The acceptance of the specificities of the institutional environment, as well as the new mechanisms introduced into the public procurement system, justify the assumption that it will develop faster. The Polish Government passed an Act in 2016 adjusting the public procurement system to the requirements of the EU directives. The amendment to the Public Procurement Law that was introduced has the purpose of directly contributing to the elimination of many negative aspects of the public procurement system in Poland and, indirectly, makes it possible to eliminate the asymmetry of information between the awarding entity and the contractor. The promoters of the bill primarily indicate the decided reduction in the excessive use of price as the sole criterion for evaluating bids, as well as the solution to the problem of a lack of legal grounds for selecting a bid using cost accounting on the basis of the

criterion of the most economically advantageous bid using life-cycle cost accounts (encompassing the costs related to acquisition, use, withdrawal from operation and the environmental cost related to the life cycle of the product, service or work). In addition, the need to apply rigid premises for applying negotiating procedures preceded by the contract notice, namely the competitive procedure with negotiations and the competitive dialogue will change to ensure the ability to select solutions that better match their expectations, which are more economic, more innovative, tailored to the needs of the awarding entity and the users of the subject matter of the contract. In the light of the proposed provisions, a very interesting field of research in this area arises from the awarding of rights to the awarding entities to audit the entities declaring that they will be benefiting from the potential of third parties in the fulfilment of the contract (the awarding entity will be able to demand of the contractor that the entity providing the potential takes part to the maximum possible extent in the fulfilment of the contract).

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