

By PwC Deutschland | 29 September 2016

Tax administration stresses the need for an effective Tax Compliance System

For the first time the German tax administration publicly raised the issue of an internal control system for tax purposes to ensure tax compliance. However, the corresponding Implementation Decree published on May 23, 2016 leaves many questions open and neglects to point out what the companies should be prepared for in the future.

The tax environment has significantly changed for companies in last few years due to the tightening of regulations and administrative practices, as well as the position taken by the courts. The documentation and reporting requirements and tax compliance in the area of wage tax, VAT and transfer pricing have increased. This has been fueled by recent developments and discussions on *BEPS* (Base Erosion and Profit Shifting), dealing with tax-driven profit transfers, and the publicised tax evasion cases, followed by improved systems of information exchange and of detection and, of course, the subsequent tightening of the rules on tax evaders. The current handling of doubtful cases and errors (mistakes) will obviously no longer be tolerated by the tax administration. Up to now it was more or less “common practice” that any such shortcomings could be corrected in the course of a tax audit or by submitting amended tax returns at leisure. That is no longer acceptable to the tax authorities. It is to be expected that, due to internal instructions, that the tax auditors will forward their findings to the competent tax investigation team even in the case of small inconsistencies. Even the submission of a “simple” (straightforward) amendment of tax returns could be viewed as fraud or a voluntary self-disclosure of tax evasion.

The tax authorities are already asking for an adequate organizational structure for compliance. This issue has now been taken up in an official administrative implementation decree issued on May 23, 2016 on Sec. 153 for the Fiscal Code (*Abgabenordnung – AO*). Section 153 Fiscal Code deals with the correction of returns and the duties of taxpayers. The actual wording of the provision:

Sub-sec. 1: “Where a taxpayer subsequently realises before the period for assessment has elapsed that a return submitted by him or for him is incorrect or incomplete and that this can lead or has already led to a reduction of tax (...) or that a tax was incorrectly paid he is obliged to indicate this omission without undue delay, and to make the necessary corrections. This obligation shall also apply to the taxpayer’s universal successor and the persons acting for the universal successor or the taxpayer pursuant to sections 34 and 35”.

Sub-sec. 2: “The duty of notification shall also apply where the conditions for a tax exemption, tax reduction or other tax privileges subsequently cease to exist, whether in full or in part.”

Sub-sec. 3: “Whoever wishes to use goods for which a tax privilege has been granted subject to a condition and in a manner which does not correspond to this condition must inform the tax authority accordingly and in advance.”

In the administrative Implementation Directive of May 23, 2016 the differences between a correction of a tax return and a voluntary disclosure of tax evasion are explained. For the administration the implementation of an internal control system would initially be taken as evidence against any intentional or negligent tax evasion – but always under the proviso that each case be viewed and checked separately. With its decree the tax administration - for the first time – publicly addresses the need for an internal control system. However, no further explanations of what exactly is meant are to be found in the decree.

For that matter the Institute of Chartered Accountants (*IDW*) was asked by the tax administration for further

assistance and the institute drafted some practical – but rather technical – initial clues as to the implementation of a Tax Compliance System (TCS) and which was then published in its *IDW Practice Pronouncement No. 1/2016* from June 22, 2016. The IDW comments on TCS are currently discussed among the professional associations. The IDW regards the internal control system as an integral part of an overall Compliance Management System (CMS). However, clear standards for a TCS are neither given by the Finance Ministry nor the IDW, both apparently taking into account the complexity and different corporate structures as the companies themselves are asked to set up a viable TCS specifically tailored to their business.

On the other hand, the tax administration emphasizes that there would be no disadvantages if a TCS has not been set up. Rather the companies would only benefit from its implementation as it will then avert the first impression of any intentional act. It should however be borne in mind that presently the implementation of a TCS is neither a legal requirement nor is it required under a statutory provision in the German tax law. The future reaction by the tax officials to all this remains to be seen. Time will tell.

Keywords

Fiscal Code, Internal control systems, Tax Compliance System, Tax Reporting