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By PwC Deutschland | 16 April 2024

External tax audit to include review of tax withholding for limited taxpayers

The competence of the Federal Central Tax Office is for both full assessment of German income tax of limited taxpayers as well as monitoring and carrying out the withholding tax procedure in accordance with Section 50a (1) Income Tax Act. In a most recently published case, though, the Supreme Tax Court held that it is not permissible for the Central Tax Office to conduct general external tax audits. This is solely the responsibly of the local tax offices.

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Background

The Federal Central Tax Office is a higher federal authority under the authority and jurisdiction of the Federal Ministry of Finance. One of its many responsibilities is to safeguard the procedure for tax withholding on income paid to foreign taxpayers with limited tax liability for their domestic services.

The plaintiff, a limited partnership which operates a concert management company in Germany, organizes the annual music festival and hires foreign artists, artist groups and production companies which are subject to limited tax liability as regards their income received for their local performances by way of tax deduction at source (Section 50a Income Tax Act - ITA). In 2028 and 2019 the plaintiff duly withheld the tax and submitted the corresponding reports and documentation to the Federal Central Tax Office.

In February 2020, the local tax office announced a tax audit with view to an external wage tax audit; the audit was also to include the "tax deduction pursuant to Section 50a (1) no. 1 and 2 ITA with respect to the artistic and similar performances in Germany.". The Federal Central Tax Office had previously suggested sending control material and requested that the tax deduction pursuant to Section 50a (1) ITA be included in the wage tax audit as part of the external audit. The Federal Central Tax Office had also explained that it was not necessary to issue a specific audit assignment notice, as the material responsibility for external audits remained with authorities of the federal states. The plaintiff objected and expressed doubts that a local tax office would still be in charge for the tax deduction procedure following the transfer of responsibilities to the Federal Central Tax Office. The Supreme Tax Court, however, disagreed.

Decision

The local tax office was also responsible for issuing the tax audit notification with respect to the review of the tax deduction pursuant to Section 50a (1) ITA.

The Federal Central Tax Office is responsible for issuing notices of liability and assessments for additional claims and their enforcement. Its role is furthermore limited to the *participation* in external audits which are to be conducted by the competent local tax office. Only the local state tax offices themselves (the Land revenue authorities referred to in the Fiscal Administration Act) are responsible for carrying out the tax audit.

In the course of the tax assessment and during external audits of the debtor of the remuneration (here: the plaintiff), it must also be checked whether the taxes were properly withheld and duly paid. Such are the rules laid down in Section 73 (2) of the Income Tax Implementing Regulation. This clearly allows the state tax authority (here: the tax office responsible for the regular tax audit) to extend their inspection to the review of the fulfillment of the debtor’s (the plaintiff’s) withholding obligation. Particularly in the case of dispute, since the plaintiff, as a business operator, is in any way routinely earmarked for external audits. This implicitly retains the audit competence for the tax deduction at source on behalf of limited (foreign) taxpayers with the local competent tax office.

According to the relevant provisions of the Fiscal Code, the competent local tax office was fully and unconditionally authorized to order an external audit of the plaintiff as a commercial trader. Since the plaintiff

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was also subject to tax withholding obligations, the tax office correctly referred to Section 193 (2) no. 1 Fiscal Code. The wording of this statutory provision is beyond any doubt for the Supreme Tax Court as it states that „*with respect to taxpayers other than those described in subsection (1) above, an external audit shall be permissible to the extent that it concerns the obligation of these taxpayers on behalf of another to pay taxes or to withhold or remit to revenue authorities taxes which are due (…)*“.

Reference:

Supreme Tax Court, judgment of 20 December 2023 (I R 21/21), published on 11 April 2024.

Keywords

tax at source, tax audit